



# ENVIRONMENTAL QUALITY COUNCIL

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**ENVIRONMENTAL QUALITY COUNCIL  
Energy Policy Subcommittee  
May 8, 2002  
FINAL MINUTES**

**COUNCIL MEMBERS PRESENT**

**SEN. WALTER McNUTT, Vice chair  
REP. DOUG MOOD  
REP. PAUL CLARK  
SEN. KEN TOOLE  
REP. DON HEDGES**

**MS. ELLEN PORTER**

**COUNCIL MEMBERS EXCUSED**

**REP. MONICA LINDEEN, Chair**

**STAFF MEMBERS PRESENT**

**MR. TODD EVERTS**

**AGENDA**

**[Attachment 1](#)**

**VISITOR REGISTRATION**

**Attachment 2**

**I CALL TO ORDER**

The minutes from the February meeting were accepted by consensus.

## **II HYDRO POWER GENERATION FACILITY ACQUISITION PROPOSED INITIATIVE DISCUSSION**

### **• *SENATOR KEN TOOLE, initiative sponsor***

**SEN. TOOLE** said that one of the basic assumptions of the initiative is that electric deregulation is not working and competition isn't developing. There is a problem with the current path. Deregulation severed the tie between Montana-based generation and the Montana customer base. From his perspective, the solutions to the problem will be focused on trying to reconnect the connection of Montana generation and Montana customers.

There was a debate amongst the proponents of the initiative concerning the option of buying all generation versus just buying the hydro electric facilities. There are other public values related to the rivers and the management of the rivers that essentially distinguishes them from factory producing power. The act sets up a 5 member elected Public Power Commission that is elected out of the existing Public Service Commission (PSC) districts. Once elected, that commission has to first examine hydro electric facilities in the state of Montana that are over 5 megawatts to determine if it is in the public interest to purchase those facilities. The criteria that would be used includes the condition of the facilities, estimated cost, estimated cost of maintenance and repair, operation, debt burden, revenue expected to be derived, etc. The commission will essentially do a due diligence work and a feasibility study of whether or not it makes sense to acquire these facilities. If it is determined that it is, the commission would then move forward in an effort to acquire those facilities.

His personal opinion is that the commission will conclude that inspection and decide that the hydro facilities are a good deal for the people of Montana.

There are two ways to purchase these facilities. One is to negotiate with the current owners. The other option is to use the power of eminent domain. This is one of the more controversial aspects of the initiative. He feels that sales of these facilities will become more common as deregulation proceeds at the national level. The purchase would be done through revenue bonds that would be paid for by the sale of electricity.

The act also sets up a descending priority of customers, including only small customers, those under 1 megawatt.

There have been a lot of questions about management of the facilities. Those working on the initiative envision a system where the state is contracting for operation of the facilities through some existing energy services company, a utility company, or the rural electric cooperatives. The act also makes an effort to protect the benefits and wages of the workers who are currently working within the facility. There is a constitutionality issue with this, so a severance clause is included in the initiative. There was also an attempt to address the loss of tax revenue to local governments. There is a provision providing for payments in lieu of taxes to local governments.

The timing of this would be the election in November 2002. If it is adopted, the elections would occur in the next cycle to actually establish the commission. This would be in 2003. It would be January 2004 before the actual commission is even seated. Then the commission will have to invest time in organization and determining who will do the due diligence work. The assumption

is that the work will be contracted out. The actual acquisition would take place in 2006 or 2007. This fits very well with what is happening right now.

**REP. CLARK** asked at what point in time would the payment in lieu of taxes be looked at.

**SEN. TOOLE** said that would take place when the actual transfer would occur. **REP. CLARK** asked if the reimbursement scheme would be the responsibility of the state Legislature and how that would play out. **SEN. TOOLE** said that the goal is to make sure that those payments are not something that may act to the detriment of local governments. The actual formula has occurred on the federal level for some time.

**REP. HEDGES** asked if the payments would be similar to school trust lands, in which case the state reimburses property taxes on 85% of value. **SEN. TOOLE** said that the goal is to reimburse local governments so that there is no loss of revenue because of the change in ownership. The mechanisms for doing that have been left to the Legislature to determine.

**MS. PORTER** asked if a group has given any consideration as to how the current owners would be able to meet their obligations if the facilities are taken through eminent domain.

**SEN. TOOLE** said that regardless of whether it is through eminent domain or a negotiated process, the current owners will get fair market value to be determined by the courts.

**SEN. TOOLE** said that the payment in lieu of taxes will be left up to the Legislature, but tax classifications are also left up to the Legislature. Within this there is nothing new. The revenue stream for local governments will always be affected by legislative decisions.

**MS. PORTER** said that the current owners have most of the power contracted out.

**SEN. TOOLE** said he would assume that is correct. One of the facilities is a part of the default supply.

**REP. MOOD** said that if the state government will reimburse the local governments, it is costing the state government twice as much to pay the same amount of money to the local entities.

**SEN. TOOLE** said that those taxes that are paid now are included in the cost of operation and the rates that are paid for the power from those facilities. If it was owned by state government, as the rate for the consumer is determined those values would be built in. Those are legitimate expenses of the operation of those facilities. **REP. MOOD** asked if **SEN. TOOLE** would anticipate that the rates would go down but the taxes would go up. **SEN. TOOLE** said that the electric rates would go down and the taxes will remain the same.

**SEN. McNUTT** asked where the revenue will come from to support the commission and the work they are supposed to do. **SEN. TOOLE** said that it is not addressed in the initiative and would have to be addressed by the Legislature. There are a number of potential sources within the public power community. Another idea is charging fees for the use of the water.

**SEN. McNUTT** asked, since the value is limited in the initiative to \$500 million, if the facility is taken through eminent domain using a fair market value and the value is greater than \$500 million, where will the extra funds come from. **SEN. TOOLE** said that if the fair market value is above the amount that the commission can spend, it will not go forward. There is no requirement that they buy the whole system.

• ***Jim Driscol, Energy Producers Against Property Confiscation***

**Jim Driscol, Energy Producers Against Property Confiscation**, said that there is nothing secure about this act. It goes far beyond buying back the dams. This initiative will have an adverse and lasting effect on the entire state of Montana. This is a direct assault on private property rights as it contemplates confiscation of private property. It does this by using eminent domain. Proponents have stated that eminent domain should be used in instances where the common good outweighs the rights of the private property owner. The initiative is designed for the state to condemn and confiscate a private industry, keep it intact, and operate it itself. If this is successful, every business in Montana will have to evaluate whether it will be the next target. Will it end with the hydro generation? He doesn't think so. This is opening the door where we may not want to go.

Dams are a critical energy source. To keep them functioning efficiently and effectively requires a tremendous amount of knowledge, expertise, and capital. The state of Montana doesn't have these things.

I-145 creates an all-powerful commission. The commission is comprised to study whether the dams should be bought. The commission can spend unlimited time and countless resources on this study. The budget office has estimated that the commission may need up to \$12 million to determine whether to buy the dams, after which no action is required. The commission must determine the conditions of the dams, estimate the value of the dams, estimate the costs of maintenance, operation and repair of each dam, determine debt service, estimate the revenue to be realized, and determine the value of avoided risks in a volatile power market. This is a huge responsibility for 5 elected individuals who are only required to be a registered voter. Once elected, the commissioners will receive all the benefits of an upper level civil servant. There are no term limits for the commission. Staff and facilities will be provided. The commission will be subject to the interests of competing groups. Economics could take a backseat to powerful lobbyists. The commission doesn't report to the Legislature or the Governor. No public hearings are required. The commission can exist indefinitely.

The initiative allows the commissioners to authorize up to \$500 million in revenue bonds. All the privately owned dams in Montana could be near \$2 billion in value. The Attorney General has noted that the costs of acquiring the dams are undeterminable. The revenue bonds don't have the full backing of the state. The bonds are based solely on the profit derived from the dams. With this initiative there is no guarantee that if the state decides to get into the hydro electric generating business that there will be cheaper rates for Montana ratepayers.

Shifting property from the private sector to the governmental sector will also have a major impact on the collection of taxes in Montana. Over \$10 million in property taxes are paid annually by the hydro electric facilities. That doesn't include income taxes or other fees. The revenue bond proceeds can not be used to replace taxes.

The initiative will create instability, uncertainty, and chaos for the state. It is ironic that the state has undertaken a major economic effort to attract private development to Montana, yet this initiative will send a chilling message to both instate and out-of-state businesses. The hydro facilities are committed to Montana. They have an established record of balancing power generation and water use. The owners of the dams are not going to turn over the keys and walk away. There will be lawsuits to follow.

**REP. HEDGES** asked if the PSC reports to anyone. **Mr. Driscol** said that the PSC reports to the voters of Montana as they are elected. **REP. HEDGES** asked if the power companies have been involved in the downstream flow lawsuit in terms of the water flow out of the Fort Peck and Garrison dams. **Mr. Driscol** was not aware of any lawsuits.

**Mr. Driscol** said that if the Legislature could get 2/3 of the body to vote one way or another on this issue, the Legislature has a great deal of power. **MR. EVERTS** said that a majority vote to change the initiative was all that is needed. **SEN. TOOLE** asked if there was a source of revenue that would not be controlled by the appropriation process of the Legislature. **Mr. Driscol** said that there is nothing in the initiative that talks about appropriation of money. **SEN. TOOLE** asked if that would be expected. **Mr. Driscol** said that the initiative only speaks to the spending authority. **SEN. TOOLE** asked who Mr. Driscol represented. **Mr. Driscol** said that he is employed with the campaign that is looking at this initiative. **SEN. TOOLE** said that he would offer the opportunity to debate this measure publicly during the last two months of the campaign. **Mr. Driscol** would look at that. **SEN. TOOLE** asked what confiscation meant. **Mr. Driscol** said that the eminent domain book refers to it. **SEN. TOOLE** asked if Mr. Driscol was aware that it would pay fair market value. **Mr. Driscol** said the fair market value has changed substantially since 1997.

• ***Jeff Martin, Tax Impacts of the Proposed Initiative***

**Jeff Martin, Legislative Analyst**, referred to **EXHIBIT 1**. The report shows a breakdown for each county, including the property tax from the dams in each county. It is for the current fiscal year. There is a table that shows the dams in Montana that could be purchased by the Public Power Commission, which is set up in the initiative. The purchase price for all the facilities is \$757 million, which is about \$157 million above book value. Because the sales price was high, there was an allocation method developed to assign value to each of the generating facilities. In some cases the value of the dams went up and in some cases the value went down.

Under the original restructuring legislation, the revenue oversight committee was assigned the task of looking at the taxation of previously regulated generation facilities in the state. As a result of the study, the committee determined to reduce the tax rate on generation facilities because they were moving to a more competitive market and the tax rate needed to be more in line with other commercial property.

Lake County has the Kerr Dam. The taxes from this dam for the county is about \$1.2 million. Lewis and Clark County has the Hauser and Holter Dams. Cascade County receives taxes from Black Eagle, Cochrane, Morony, Rainbow, and Ryan Dams. Madison county receives a small amount from the Madison Dam. Sanders County houses the Noxon Rapids and the Thompson Falls Dams. Stillwater County houses the Mystic Lake Dam.

Page 10 of the Exhibit presents tax implications of the dams going public. If the dams disappear from the tax base the counties would be able to adjust mill levies to get the same amount of revenue that they had previously from the generation facilities. A local government would not be required to lower mill levies for an increased reimbursement that may be associated with the dams. Removing the dams from the tax base would impede somewhat the local governments' ability to issue general obligation bonds. Page 11 talks about changes in the property tax base since 1999. This shows how the market and taxable value changed based on the allocation

method of value to the assets after PPL bought Montana Power Company (MPC) generation assets.

The reimbursement amount would be dependant on which dams are acquired by the state, the best market values of the dams at the time of acquisition, the tax rate applied to the dams, and the mill levies in effect at the time. If competition were to develop in the state the argument could be made that why should generation facilities be dealt with any differently than any other type of commercial and industrial property as far as the tax rate.

**REP. HEDGES** asked if the dams were taken off the tax roles and the tax burden would then be shifted to the remaining property to keep the revenue stream equal, would any payment in lieu of taxes be a bonus. **Mr. Martin** said that a local government would be entitled to raise the same amount of property tax revenue that they had in the previous year. If they get an increased reimbursement from the state, they would not be obligated to lower mill levies to compensate for that increased reimbursement.

**REP. CLARK** asked, assuming that the cost of electricity to the ratepayer includes the amount that the generating facility is paying in taxes, without those taxes being assessed by the state, is it likely that the generating facility will be able to generate and distribute that electricity at a cheaper rate. **Mr. Martin** said that under a competitive market scheme you would have to figure out what the tax shift would be. The actual tax burden may be paid by the consumer in the form of higher taxes, labor in the form of lower wages, or by the stock holder with a lower rate of return. If the price of electricity for generation that goes out of state into a competitive market includes the price of taxes in the price, it may be less competitive than generation from elsewhere. **REP. CLARK** asked if there is an increase in the property taxes, will there be a decrease seen in the cost of electricity because the taxes are no longer in the rate that is being charged to the consumer. **Mr. Martin** said that it depends on the method that is used to replace the revenue. One way would be to include replacement revenue in the rates. Those revenues could also be replaced through the general fund or using a different type of tax. Each one of those methods has a different implication on the shifting of the tax burden.

**REP. MOOD** asked who provides electricity to Sanders County. **REP. CLARK** said that there is the Northern Lights Cooperative and MPC. **REP. MOOD** asked if the cooperative gets its electricity from the Bonneville Power Administration (BPA). **REP. CLARK** said that it did. **Mr. Martin** said that Avista also has a few customers in Sanders County. **REP. MOOD** asked if we have a potential situation where, if we buy the dams and reduce the cost of electricity by the tax revenue, forcing the county to make up that revenue by increasing taxes, are we shifting the burden from the ratepayers to the property owners in the county. **Mr. Martin** said that the initiative requires that the local governments be reimbursed. The tax shift under that scenario is going to be more widespread. There will be a shift out of the county to other taxpayers or ratepayers in the state. **REP. MOOD** asked if the idea that we would save money by buying the dams is a myth. There is a certain amount of money that will have to be generated either by taxing an entity, which then passes that on to its customers, or by increasing the rates to reimburse the counties. **Mr. Martin** said that with the dams being public, there isn't a rate of return built into the price of power. **REP. MOOD** asked if the tax revenue generated by the dams is considered a natural resource. **Mr. Martin** said that it is a property tax revenue. Generation property is taxed as a class 13 property along with telecommunication property. The reason that it is in a separate class is the result of the study done by the Revenue Oversight Committee in 1997 and 1998.

**SEN. TOOLE** said that the initiative doesn't talk about removing revenue from local governments. It specifically tries to hold that harmless. He is concerned that the whole discussion is pulling these properties out of local government tax assessment. The initiative directs the Public Power Commission to reimburse local tax revenues.

**SEN. TOOLE** asked if the bonding capacity is directly related to the value of the asset that is being taxed or is it directly related to a revenue stream. **Mr. Martin** said that it is directly related to the assessed valuation for tax purposes. **SEN. TOOLE** asked, if the Legislature puts back in to local governments the amount of money that was coming from property taxes, would the bonding value of the community still drop because that asset was gone. **Mr. Martin** said that it would. **SEN. TOOLE** asked if that is under the purview of the Legislature to determine whether or not the formulas for determining bonding capacity can change or is it a function of the bonding markets. **Mr. Martin** said that it was a function of both. The Legislature has the ability to change how bonding capacity is determined, but when the bond counsel looks at the tax base it will be taken into consideration when determining the risk and interest rates that may be appropriate. **SEN. TOOLE** asked if there is a large amount of payment in lieu of taxes, is that looked at in any way by bonding entities as part of the debt service capability. **Mr. Martin** said that it is not. Under the reimbursement scheme, there would be a mechanism to provide reimbursement on the value of the generator, but it may change over time depending on the relative changes in the market value of the different classes of property. **SEN. TOOLE** asked if any of the counties are at caps regarding mill levies. **Mr. Martin** said that if the assets come out of the tax base, are these school districts that are at caps going to drop below caps and be able to raise their mill levies to make up the revenues? The response was given that the aggregate total will go down. If they maintained enough revenue income to replenish that, it would remain neutral. **Mr. Martin** added that the Legislature would still need to revisit the issue of not reducing mill levies to account for an increased reimbursement. There are some potential windfalls.

**REP. MOOD** said that Table 16 indicates that the market value increased between 1999 and 2001 by 125%. That increase was the consequence of the negotiated sale price of the dams to PPL. **Mr. Martin** said that it is a function of the sales price and the allocation method that was used to assign value to the various generation assets. **REP. MOOD** said that there is an assumption being made that \$350 million is a reasonable buying price. The price that someone will pay is not driven by the state market value, rather it is the other way around. **Mr. Martin** said that when you look at the market value for tax purposes, it is the assessed value. **REP. MOOD** asked if the amount of income that the dams are capable of generating is a changeable number. **Mr. Martin** would agree with that, especially in a non-regulated environment.

**Jerome Anderson, PPL Montana**, said that one of the first things that comes to his mind is that everybody is approaching this as if it was a regulated function, but it is not. Pricing is dictated by the market. There is no provision in the initiative as to how the power is to be sold by the state. There is no regulation of that price, so that price will be market based and will vary with the market. The way in which the state of Montana will try to price the electricity will include, among other things, the tax reimbursement figure, the cost of the generation, and the cost of paying off the bonds. There have been estimates of what that cost will be. It is expected that the interest rate of the bonds will be higher because they don't have the full backing of the state and it is a risky business. There is no guarantee that this initiative will result in lower pricing. There is

always the risk that generation won't meet the load and the state will have to bear the cost of buying power on the open market.

**SEN. TOOLE** said that the state revenue figures put the market value at about \$350 million for PPL's hydro facilities. **Mr. Anderson** said that was correct. **SEN. TOOLE** asked if PPL is appealing that. **Mr. Anderson** said that they are. **SEN. TOOLE** asked if PPL feels that it is too high or too low. **Mr. Anderson** said that they feel the valuation for tax purposes is too high. This has no relationship to the valuation that would constitute the purchase price of a willing buyer and a willing seller or the price that would be put on the property in an eminent domain proceeding. The measures of pricing under those circumstances are remarkably different than the measure of market value as established by the method followed by the Department of Revenue. **SEN. TOOLE** asked if the goal of Montana's appraisal system to determine market value is to determine market value. The response was given that there are contested cases all the time. One of the biggest problems is that we are not selling hydro electric dams every day of the week. **SEN. TOOLE** asked if PPL Montana sells anything other than electricity in Montana.

**Mr. Anderson** said that the only thing they sell out of Montana is electricity. **SEN. TOOLE** asked, in the last 2 years, has there been more than \$150 million in profit taken out of Montana. **Mr. Anderson** said that there was a profit spike during the California crisis. On either side of that spike, PPL has had very limited profits and in some quarters they have had losses.

**REP. CLARK** asked, with the changes in the markets and the taxable values, why are some values showing an increase while others are showing a decrease. **Mr. Martin** said that the reason that Noxon Dam is decreasing is that it was not involved in the sale and continues to be valued according to the methods that the Department of Revenue (DOR) has been using. That value is unaffected by the sale of the assets to PPL.

**Ken Morrison, PPL Montana**, said that the DOR doesn't do a market value of the dams. Annually, the DOR looks at all of the assets that PPL Montana owns and say, based on information that was provided to them by the company, they believe that is what a certain amount of the property is worth under statutory requirements. This is a statutory assessment, not a market assessment. They apply the taxable value rate to the valuation of the assets to get the taxable value for the assets. Then the DOR distributes a portion of the value back to all districts where property is located. That is how the value gets back to the dam.

**REP. CLARK** asked if Avista felt left out of the re-evaluation. **Tom Ebzery, Avista Corporation**, said that Avista has interests in Colstrip 3 and 4, as well as the Noxon Rapids Dam. Every year there is an assessment made and Avista goes through the process. If they find the assessment to be fair, they enter into negotiations. If it is not found fair, the assessment can be appealed. The assessment is probably as friendly as possible. **REP. CLARK** said that it strikes him as peculiar that these evaluations can be so precipitous, where one will greatly increase while another greatly decreases. **Mr. Ebzery** said that the definition of centrally assessed and how the process is done has not changed. There is criteria that is fairly subjective. **Mr. Martin** said that Avista owns generation assets in a number of states that are still under a regulatory scheme. Their assets are still valued as an interstate integrated property. The whole system is valued as a single entity and portions of that are valued back to Montana. PPL is a little different because the valuation of their generation assets in Montana are just based on the value of the generation assets in Montana because they are not an integrated utility.



**REP. CLARK** asked if the decrease in valuation is a reflection of some total of Avista properties in multiple states. **Mr. Martin** said that was correct. Other than to the extent that the Noxon Dam is part of the unitary assessment of Avista, the Noxon Dam has little to do with the value. You are also looking at the change in taxable value as well. There is also a history that regulated utilities throughout the country generally are used as pass-through entities for collecting taxes.

### **III REVIEW DRAFT OF THE STATE OF THE STATE EQC ENERGY PUBLICATION**

**Paul Cartwright, Department of Environmental Quality (DEQ)**, referred to **EXHIBITS 2 and 3** (not available). The guide is four area papers dealing with electricity. The big issue is what is happening on the portfolio case, since that case hasn't been concluded, new generation is not included. There is a section on transmission in the region and the formation of the regional transmission organization (RTO). Natural gas and coal are discussed.

**MR. EVERTS** said that this isn't the last chance for the subcommittee to comment on these. The documents go out for public comment in June for 30 days. In July there will be a chance to modify the documents based on those comments, as well as subcommittee member comments.

**REP. MOOD** said that he is not prepared to give any recommendations today.

**SEN. TOOLE** said that it would be interesting to have more discussion on conservation, what the potential might be, and an explanation of conservation as a resource. The concept that might be easy to include is how the available conservation changes with the price of the avoided generation. **Mr. Cartwright** said that the value also changes with the perceived risk of not improving your efficiency. The problem with this is that there is virtually no data. He can summarize MPC's last study that used 1994 data and give some guesses. He can discuss the contextual aspect. **SEN. TOOLE** said that the best way may be to look at the MPC study as an example.

**SEN. TOOLE** said that another idea is to mention the new emerging technologies, such as fuel cells. He also thinks that discussion on realtime metering would be interesting. He also noted that on page 3 it discusses that as electricity prices go up, growth and consumption should slow, might be a place to get into the conservation. He would also like to be clear on what the assumptions are on cost and effect and what the thresholds are for when behavior starts to change. On page 4 there is a bullet that says, "the transmission system is managed differently than the way it operates physically." The following bullets should be subsets of that. This area needs to be better organized.

**REP. HEDGES** said that he would be cautious about putting too much into the document that is speculation in terms of conservation. He would like to see specific goals and activities that the state has plotted out in terms of conservation, such as the Universal Systems Benefits Programs. He would like to see the summary give the related page number in the document where more information on that subject could be found.

**MS. PORTER** said that it might be helpful to have a graph that she had seen from John Hines that showed generation and where the current contracts are sending that power. **Mr. Cartwright** said that Table 3 in the back of the electricity section includes that information. **MS. PORTER** said that the graph was easier to read. It referred to the companies. She also had some concern about the electricity portion that it offered the conclusion that it is clear that Montana's instate

market will require relatively little new generation over the next decade. Is it premature to make that conclusion at this point? **Mr. Cartwright** said that the ranges of possible growth are in the low hundreds to negative to meet domestic load. The point is that if one is proposing power plants, they are going to be primarily for the export market. That can be clarified.

**MS. PORTER** asked for explanation about the statement "Note: the declining 2000 commercial sales may be a data problem." **Mr. Cartwright** said that with deregulation a lot of the reporting requirements went away. As a general problem with deregulation, the data is horrible.

**MS. PORTER** said that on page 6 it states, "These figures date before the price spikes in 2000/2001, for some companies to cut back consumption." Have those large industrials increased their consumption? **Mr. Cartwright** said that they had this because they were trying to make a point during the session. It is not something that is reported regularly. The idea was to show the big chunks that make up the Montana load. **MS. PORTER** asked about the statement, "As for growth in commercial sales, one can expect that to slow as the economy slows." Are we expecting that the economy will slow? **Mr. Cartwright** said that if you look over the decade, economic growth was much higher in the first part. It is not picking up a whole lot of steam. Whether it will slow from where it is now or just remain slow compared to the early 1990's is unknown.

**MS. PORTER** asked if it would be possible to have a conclusion in the transmission portion similar to that found in the electricity portion. **Mr. Cartwright** said he thought that could be done.

**REP. MOOD** said that if the conservation discussion gets very involved, there are some astounding numbers indicating how much electricity consumption has gone down in the northwest as a result of conservation. He has never seen any explanation about how much of that conservation may be the result of shutting down the aluminum plants. That needs to be included in any discussion. **Mr. Cartwright** said that at least half of the conservation was shutting down those plants. Perceived risk influences investment in conservation and efficiency as much as cost.

**SEN. TOOLE** said that there is a qualitative difference between conservation as a result of an economic hemorrhage versus the programmatic conservation that MPC was doing throughout the 1990's. The best thing may be to look at historic investment and to track conservation investments through MPC. **Mr. Cartwright** said that the MPC study was based on their current load without the industrials. They were looking at a 10 to 15% reduction, which is the general rule of thumb what can be conserved on any system. One of the reasons conservation isn't in the document is that the efficiency section should be largely done by November.

**REP. HEDGES** asked if under the transmission area there is a section on what authority, responsibility, or control the state of Montana may or may not have. **Mr. Cartwright** said that is not discussed. That wasn't in the charge they were given. **MR. EVERTS** said that is covered in the law handbook that will be discussed later.

**Mr. Cartwright** said that if the subcommittee wants a supplemental guide that would come out in December, the topics that have been identified are an update on the forecast of regional adequacy for the winter, the status of new generation facilities in Montana, the status of the

regional transmission grid and the RTO development, the conservation and energy efficiency section, and any better statistics that may be available.

**SEN. McNUTT** said that what they want is a handbook for the next session. It would be prudent to have the final version mailed out before the session to have the subcommittee members look at it. **Mr. Cartwright** said that he can send it out mid November.

**SEN. McNUTT** asked if there was a consensus that the five issues Mr. Cartwright listed were a good idea. It was decided that there was a consensus.

#### **IV REVIEW THE DRAFT EQC ELECTRICITY LAW HANDBOOK**

**MR. EVERTS** referred to **EXHIBIT 4** (not available). The DEQ publication is a factoid style publication. This handbook is a basic primer on energy law for the general public. This handbook is patterned after similar law handbooks. He found that the development of this handbook was more challenging than other handbooks because of the convoluted nature of electricity law.

Chapter 1 is a critical chapter. This first chapter is a basic primer for those people who have no clue of what electricity means. This is a contextual chapter to set up Montana citizens so that they understand why the laws were enacted the way they were. Chapter 2 describes what defines a Montana consumer and describes the laws that apply to those Montana consumers based on who their electricity services provider is. Chapter 3 talks about the primary fuels that we have in the state that are used to generate electricity. There is a lot of law on regulating these types of fuel sources. This chapter describes those laws based on the energy source. Chapter 7 discusses pricing of electricity transmission and distribution. Chapter 8 includes a description of what the electric restructuring laws are and what their status is today.

This handbook is simplified and in doing that some information is lost. However, it makes it understandable. There is a traditional disclaimer in these handbooks saying that it is not a legal reference, but rather it is an educational tool. That is the balance that he tried to create in this handbook.

**REP. MOOD** asked if the Transition Advisory Committee (TAC) is involved in this handbook at all. **MR. EVERTS** said that it is not. He has informed the TAC of the 2 documents that this subcommittee is producing. Sending a draft copy to the TAC is a great idea.

**SEN. McNUTT** said that this handbook will be very helpful and will be of great value.

#### **V LEGAL OPINION ON THE IMPACT OF THE REFERENDUM (IR-117) TO REJECT HOUSE BILL 474**

**MR. EVERTS** referred to **EXHIBIT 5**. He said that the TAC requested this opinion. This opinion was presented to the TAC recently. They spent 2 hours going through the opinion and making some policy decisions on the direction that they wanted to go with certain elements of HB 474. Two themes that come out of potential rejection of HB 474 and the legal impacts are that if voters do reject it, it provides the Public Service Commission (PSC) with more discretionary authority than they have now, and it creates a legal uncertainty.

Page 2 of EXHIBIT 5 talks about low interest loans from the Montana Board of Investments for generation facilities. Rejection would eliminate that incentive. Currently there is one entity that is applied and subject to PSC approval to receive a low interest loan under this incentive. Voter rejection will not impact the transition date because Senate Bill (SB) 19 also extended the transition period. There are a number of issues with the default supply. HB 474 specifically designated the default supplier and required that there only be 1 default supplier. Previous to that the PSC had designated the default supplier, but had the opportunity to designate additional default suppliers. If HB 474 is rejected, the default supplier will be the same entity, which is the distribution services provider, NorthWestern Energy. The PSC's authority to reinstate additional default suppliers would come back into play. One of the issues that HB 474 clarified was that the default supplier has an ongoing obligation to default supply customers beyond the end of the transition period. If that is removed it creates a legal issue of whether that obligation still exists. His conclusion is that an argument could be made that the default supply situation would last beyond the end of the transition period, but there is a legal question. Potential rejection also raises the issue of whether large customers who had previously elected an alternative energy supplier would be able to come back to the default supply. Before HB 474, the PSC had precluded large customers who had gone to choice from coming back to the default supply. HB 474 allowed those large customers to come back.

Rejection of HB 474 eliminates provisions clarifying that the PSC will set up a process to determine how those customers who are with the default supplier transition to choice over the transition period. His analysis concludes that the PSC has broad rule-making authority and would still be required to do this anyway. The argument could be made that full customer choice has already occurred under a PSC order in 1998 where the PSC approved for all MPC customers that they had the opportunity to choose. This issue here is the market for the small customers, which hasn't developed sufficiently to allow for that transition to take place.

**SEN. TOOLE** asked if that was when the PSC did the pilot projects. **MR. EVERTS** could find that information.

**MR. EVERTS** said that the big issue is what is the difference between HB 474 cost recovery and pre HB 474 cost recovery. This discussion starts on page 6 of EXHIBIT 5. He concluded that depending on the different legal scenarios and the PSC's discretion, it could be credibly argued that the cost recovery could be the same or vastly different. Under HB 474 and the restructuring act, a cost recovery mechanism was set up as opposed to traditional utility rate-making mechanisms, which are still in law and unmodified. Those laws allowed the utility to recover their costs, but also make a reasonable rate of return. When you shift to a market based cost recovery, like HB 474, you are allowing the utility to recover their costs, but not get a rate of return. If HB 474 is rejected, pre HB 474 there isn't a lot of detail on cost recovery. The PSC potentially has the discretion to go back to traditional rate-basing ways. If HB 474 is rejected, there is an equally credible argument that the cost recovery would mirror HB 474. The critical issue is the PSC and their discretion to go either way.

**SEN. TOOLE** asked about rate of return. In traditional rate making there was a rate of return on capital investments. Under HB 474, that issue is resolved because the default supplier doesn't own generation. There was no inconsistency in moving from the rate-making rate of return assumptions to the HB 474 cost recovery. **MR. EVERTS** said that was correct.

**REP. CLARK** asked about the difference between prudent and just and reasonable.

**MR. EVERTS** said that page 8 analyzes the prudence standard and the just and reasonable standard. Credible arguments could be made that they are very similar, but the PSC has the ability and discretion with rejection of HB 474 to say that the 2 standards are different.

**MR. EVERTS** said that he has raised the issue of the PSC's assertion of jurisdiction out there. PPL has the potential to appeal that or intervene in the state court proceedings. The PSC will be having a working session to discuss those issues as they relate to portfolio decisions.

The procurement process is addressed. There is a default supplier that doesn't have generation assets. There needs to be a procurement process. He concludes that overall the process will still look the same.

USB programs were extended in HB 474 by 2 ½ years. If HB 474 is rejected, those programs will terminate in July 2003. This is fairly significant. In 2001 \$13, 426,000 was expended across the state on USB programs. The argument for the extension was to create legal certainty for the programs in terms of investments. Montana Power Authority (MPA) would be repealed. MPA to date has not done anything because of the initiative and the legal uncertainty surrounding it.

**SEN. TOOLE** said that the initiative to buy back the dams also eliminates the MPA because of the potential repeal of HB 474.

**MR. EVERTS** said that HB 474 created a consumer electric support program that was to be funded by the excess revenue tax, which didn't pass during the session. This is now a program that is not funded and would be eliminated with the repeal of HB 474. There is the Montana Electric Buying Cooperative that was affected by HB 474 because of its default supplier status. It would be given its default supplier status back and have the ability to get licensed as a default supplier by the PSC.

**REP. CLARK** asked about the application for funding through the Montana Board of Investments. **MR. EVERTS** said that they are waiting for the PSC to determine whether they are going to approve the contract. The loan is contingent on contract approval by the PSC.

**REP. CLARK** asked what will happen if the contract is approved and HB 474 is eliminated. **MR. EVERTS** said that if the PSC wanted to go back and review contracts that it had previously approved and apply different cost recovery criteria, they would run into contract impairment issues, but it is an outstanding issue. Contract impairment is a legal concept that says that the Legislature or people through referendum can't retroactively go back through law and impair the rights, duties, and obligations of contracting parties.

**REP. MOOD** asked if HB 474 is rejected and the default supplier has contracts for electrical supply, essentially the default supplier goes to the PSC under the old rules and the PSC will decide if it meets the criteria of the laws that existed prior to HB 474. **MR. EVERTS** said that if the PSC approves the portfolio as it is now and HB 474 is rejected, there would have to be some action on the part of the PSC or some outside party to go back and do that review. His conclusion is that the PSC has the ability to call it good.

**SEN. TOOLE** asked what were the things that the TAC decided to do in addition to extending the USB program. **SEN. McNUTT** said that one issue was that HB 474 allocated 6% of USB funds for irrigation. It was agreed to revisit that issue and try to put some flexibility into that portion of the USB. **MR. EVERTS** said that the USB subcommittee unanimously recommended

that the USB funding level remain and be extended regardless of HB 474. The full TAC adopted that. There was also a piece of legislation adopted that said that any leftover USB funds that went into the state accounts be directed back into the service territory from which they came. **SEN. McNUTT** said that was a prerequisite for the vote to be unanimous.

**REP. HEDGES** asked if HB 474 is repealed, doesn't the USB go away. **MR. EVERTS** said that it is still in effect until July 1, 2003. The Legislature can extend that in the next session if they choose to. **REP. HEDGES** asked how the referendum is written. **MR. EVERTS** said that he could get a copy of it to **REP. HEDGES**.

## **VI     ADJOURN**

There being no further business the meeting was adjourned.