



Energy and Telecommunications Interim Committee

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58th Montana Legislature

SENATE MEMBERS
ROYAL JOHNSON
DON RYAN
EMILY STONINGTON
FRED THOMAS

HOUSE MEMBERS
DANIEL FUCHS
DAVE GALLIK
GARY MATTHEWS
ALAN OLSON

COMMITTEE STAFF
MARY VANDENBOSCH, Research Analyst
TODD EVERTS, Staff Attorney
REBECCA SATTLER, Secretary

MINUTES

January 29, 2004

Montana Electric Cooperatives' Association Office
501 Bay Drive
Great Falls, Montana

Please Note: These are summary minutes. Testimony and discussion are paraphrased and condensed. Committee tapes are on file in the offices of the Legislative Services Division.

Exhibits for this meeting are available upon request. Legislative Council policy requires a charge of 15 cents a page for copies of the document.

COMMITTEE MEMBERS PRESENT

SEN. ROYAL JOHNSON
SEN. DON RYAN
SEN. EMILY STONINGTON

REP. DAVE GALLIK
REP. GARY MATTHEWS
REP. ALAN OLSON

COMMITTEE MEMBERS EXCUSED

REP. DANIEL FUCHS
SEN. FRED THOMAS

STAFF PRESENT

MARY VANDENBOSCH, Research Analyst
TODD EVERTS, Staff Attorney
DAWN FIELD, Secretary

Visitors & Agenda

Visitors' list, Attachment #1
Agenda, Attachment #2

COMMITTEE ACTION

Adopted Committee minutes as written from the November 20, 2004, meeting.

CALL TO ORDER AND ROLL CALL

The meeting was called to order at 8:30 a.m. by CHAIRMAN OLSON. Roll call was taken, Sen. Thomas and Rep. Fuchs were excused (ATTACHMENT #3).

The November 29, 2004, minutes were approved as written by a unanimous voice vote.

Mary Vandebosch, ETIC Research Analyst, discussed the status of the Committee budget (EXHIBIT #1).

UPDATES

John Bushnell, Governor's Energy Consumer Protection Task Force, provided an update detailing the activities of the Task Force. Mr. Bushnell discussed:

- # ways to meet the remaining funding needs for low-income households. The Committee has already identified funds to meet \$4.2 million of the \$7.8 million need;
- # the November 2003 meeting, which addressed topics such as:
 - ▼ the building code update in which the adoption process was discussed;
 - ▼ the formation of a Subcommittee to work on the adoption of energy efficiency building codes;
 - ▼ adoption of a recommendation containing several components that is to go to the Governor, the Department of Labor and Industry (DLI), and this Committee:
 - there is no legal barrier to the adoption of updated residential energy codes;
 - will request the Governor and the DLI to begin the adoption process; and
 - will request that ETIC designate the Governor's Task Force as the appropriate entity to oversee this endeavor.
 - ▼ whether or not the 2003 International Energy Conservation Code makes sense for homes heated with natural gas;
 - ▼ the Task Force white paper study, which will be passed on to the Committee as soon as it is completed;
 - ▼ a NorthWestern Energy (NWE), presentation on the status of the default supply resource plan;
- # the January 9, 2004, meeting, which covered topics such as:
 - ▼ a panel discussion of the NWE bankruptcy;
 - ▼ the formation of a Montana Memorandum of Understanding (MOU) group between the Governor's Office, the Attorney General's Office, the Public Service Commission (PSC), and the Montana Consumer Council (MCC);
 - ▼ goal setting to provide consumer protection through the NWE bankruptcy proceedings:
 - to work for long-term financial viability and stability,
 - to have NWE focus on being a utility,
 - to protect the rate payer, and

- to make a significant investment in the NWE infrastructure to provide for future power needs.
- ▼ Jan Deeter, Michigan State University, Institute of Public Utilities, (her primary responsibility is research of regulatory structures and education for regulators) led a discussion which included the following topics:
 - appointed versus elected commissioners and commission structure and
 - the regulation balancing act required between consumer/public need and providing incentives to utilities.

COMMITTEE QUESTIONS & DISCUSSION

SEN. RYAN said many homeowners in his district own older homes and they may be faced with the very expensive task of asbestos removal when updating their homes to become more energy efficient. SEN. RYAN asked Mr. Bushnell if it was possible to use Universal System Benefits (USB) to assist these homeowners with asbestos removal. Mr. Bushnell said he was not sure if asbestos removal would qualify for the low-income assistance programs.

Matt Brainard, Public Service Commission (PSC), in reference to International Energy Codes on Energy, asked if there had been any discussion on if the venting of natural gas appliances would be a requirement. Mr. Bushnell said the Governor's Task Force had not specifically discussed this issue.

Environmental Quality Council Energy Policy Subcommittee, Todd Everts, Legislative Environmental Policy Analyst (LEPO),

Mr. Everts presented a summary of the January 13, 2004, meeting of the Subcommittee. He reported the Subcommittee:

- # heard presentations on alternative fuels (biodiesel, hydrogen, ethanol, and distributed wind energy);
- # will further investigate alternative fuels and identify obstacles to development of these fuels;
- # will research and examine other states' legislation regarding alternative fuels;
- # will look at the existing incentive package for ethanol production in Montana;
- # will look at the potential use of Coal Tax Trust and Security funds for developing alternative energy resources in Montana; and
- # scheduled its next meeting for March 9, 2004.

REP. GALLIK asked Mr. Everts to provide specific details on the proposal to use the Coal Tax Trust funds for alternative energy resource development. Mr. Everts said an expert panel on state finance was being assembled to present information at the March meeting to help the Subcommittee develop the specific details.

Mary Vandenbosch, ETIC Research Analyst, discussed:

- # features of the Energy and Telecommunications Interim Committee website and the information posted on the website (EXHIBIT #2);
- # Interim Committee Rules and Procedure changes adopted on January 16, 2004, by the Legislative Council (EXHIBIT #3); and

a National Conference of State Legislatures (NCSL) report titled, *FUNDING ENERGY EFFICIENCY* (EXHIBIT #4).

DISCUSSION: OWNERSHIP AND RATE-BASING OF GENERATION ASSETS FOR DEFAULT SUPPLY OF ELECTRICITY

David Hoffman, Manager of External Relations, and Joel Cook, Director of Marketing, PPL Montana, discussed a Power Point presentation (EXHIBIT #5).

SEN. STONINGTON asked Mr. Cook how an RTO would benefit Montana ratepayers. Mr. Cook said the high transmission rates in Montana would likely decrease as the power resource "pool" increased.

John Alke, Montana Dakota Utilities (MDU), said all new generation discussion must focus on what result the proposed plan may have on the rate payer and said he was qualified to discuss the principles of rate making as they apply to generation. Mr. Alke listed his reasons for supporting his position:

- # The key is to understand cost of service rate making: what is the difference between the price of power to the consumer with cost of service rate making and the price of power in the free market?
 - ▼ The free market: if it is assumed that there is an equilibrium in price for power in the free market, through time, the price of that power shouldn't increase more than the rate of inflation. That is not the case under cost of service rate making. A huge portion of an electric utility's cost of providing electricity is the physical generation plant. In cost of service rate making, a generation station hits the rate base at original cost or cost of building the plant. Through time, it is depreciated. Cost of service rate making under original cost depreciation has been criticized as understating true cost of power through time. The theory is that the real cost of power is replacement cost through time. Cost of service rate making develops a price without regard to the market.
 - ▼ There is no right answer: it depends of the condition of the market and whether there are transmission constraints.
 - ▼ As policy makers, you should at least give the default supplier the option of owning its own generation. Simply having the option of owning the generation facility impacts the negotiations and the price that will be achieved by those negotiations. This option may never need to be exercised.
- # If the generation plant is owned, there is a symmetric set of risks and rewards from the market: there is the risk of having the price of power at a higher cost, but also the opportunity to sell excess power at a higher cost.

Mr. Alke also distributed a graph depicting MDU's power pool supply costs for 2003 (EXHIBIT #6). Mr. Alke reminded the Committee members that MDU is not in the same power pool as NorthWestern and the nature and characteristics of the two power pools are significantly different.

Greg Jergeson, Public Service Commission (PSC), started his discussion by stating that the views he would present today are his own, not necessarily those of the PSC. He said the PSC has not developed an official position on rate based generation. Commissioner Jergeson said

he agreed with many of Mr. Alke's points regarding rate based generation, and encouraged the Committee to seriously consider the advantages and impacts of rate based generation (EXHIBIT #7). Commissioner Jergeson discussed the following points:

- # The 1997 restructuring law: Montana Dakota Utilities (MDU) would continue to operate as an integrated utility that owned its own sources of electrical supply and the default supplier would get rid of its generation resources. A great deal of the stability demonstrated by MDU is due to the fact that they own their own generation resources and those resources are rate based. It has been 16 years since MDU has requested a rate case.
- # Bargaining strength is greater when the option of building and owning the resource exists. Economists would say that a fair price is achieved when there is a willing seller and a willing buyer. The circumstance that we have with the default supplier in Montana is that the default supplier is an obligated buyer: they have no choice in the matter and must secure the supply to deliver to the customer. This puts them at an extreme disadvantage when negotiating for a power supply. The biggest danger in combining smaller markets like Montana with larger markets, such as California, is that the market will level at a rate between the lower market (Montana) and the higher market (California), resulting in a rate that is higher than the rate Montana was previously paying.
- # The Montana rate payer must be protected: rate based generation assets being held by the default supplier, identifying the bargaining position of the default supplier, and looking at the market from a broad perspective must all be considerations.

Pat Corcoran, Vice President of Regulatory Affairs, NorthWestern Energy (NWE), said as policymakers, the Committee has an obligation to consider the concept of allowing NWE/default supplier to own its own generation. Mr. Corcoran went to say:

- # the standard that exists in law today is more of a market based standard. There have been modifications to that standard in past legislative sessions that have continued to refine and modify the law in an effort to provide more rate stability to small consumers.
- # The purely regulated model from the past was a fully integrated utility. All of the customers were captured and there was a long term defined obligation to serve. The standard was more of a "used and useful" premise and so long as the asset was used and useful in the market, those costs were recovered.
- # Technically, current Montana law doesn't preclude default suppliers from owning generation (MCA section 69-8-210). There is a functional separation requirement in the state law and there are similar federal standards. The distribution service provider, is supposed to be functionally separated yet under current law has the responsibility to provide default supply service. There is a conflict, because the energy supply is supposed to be a separate function from the distribution service. This may be a technicality but it is a meaningful one.
- # The definition of electricity supply costs continues to focus on more the market base reference point and should be addressed.
- # The default supplier is obligated to follow the law. Montana law has established rules, including some recent PSC rules, regarding how to go about procurement of power on behalf of the default supplier. NWE will continue to commit to certain contracts for power and resources for customers into the future. NWE is going to focus on those longer term contracts in order to provide long term, low cost, and stable rates for consumers.
- # Many factors that must be considered in the decision making process:

- ▼ elements of the portfolio, such as base load, intermediate, and peak load. There are a number of different kinds of resources that are appropriate to serve those loads so then the question becomes what is the appropriate type of generation that the default supplier should focus it's interest on.
 - ▼ The small consumers are most in need of protection at this time and measures have been taken to ensure this. If NWE is successful, it is fully expected that there will be long term, low cost power available to customers well into the future.
- # NWE's ability to raise capital is an issue that must be dealt with. An alternative to consider would be the concept of "virtual rate basing". NWE would not own the generation but, through a competitive bid process, pursue contracts that produce costs similar to the regulatory structure. Actual costs, stranded costs, and deciding who should pay for what are also factors that would have be considered, as well as whether it should be a market based structure, a fully integrated utility service structure, or something in between. NWE's goal is to find a way to provide long term reliable service and rate stability through low price energy.

Bob Nelson, Montana Consumer Council (MCC), stated he agreed with the previous speakers' points and said he wanted to address four questions for the Committee:

- # What is rate basing: Many refer to rate basing as any new expense or item that is included in rates. From a regulatory perspective that is not completely accurate. For example, expenses are not normally considered part of the rate base. "Rate base" refers to capital investment and when an item is rate based, the company that made that investment gets a return on the investment and a return of the investment through depreciation. Both of those are then included in the rates. Also associated with rate based items are expenses that come along with those items, such as the cost of running the plant and fuel. When the PSC makes a decision to add an item to the rate base, then there are these other responsibilities that come with that decision. Also included are benefits such as revenues that are generated from surplus/off-system sales. These sales can have significant benefits for Montana consumers. Rate based generation has traditionally had to pass the "use and useful" test in Montana for inclusion in the rates. Once it is included, rate payers have a broad responsibility for that decision. That responsibility has led to the "stranded costs" concept. Once the item is included in the rate base, there are benefits and burdens that go to rate payers.
- # Why should Montana consider default supplier owned rate based generation? It is clear that the default supplier (NWE in Montana) is going to have a long term obligation for the vast majority of small customers. At the same time, NWE has virtually no generation of its own, as a result of previous decisions. Against that backdrop, MCC has concerns about the wholesale market in Montana and in this region. There are some misuse issues problems with the workability of that market and it is going to take a while to sort those things out. A potential long term fix could be an RTO but it shouldn't be relied on to be a solution at this point in time. The MCC is not suggesting that NWE should abandon the wholesale market. It thinks it is important that NWE has the option to compare ownership against what might become available in the wholesale market. Risk shifting and the use of competitive purchases to avoid risk shifting to customers are concerns that must be considered. It is important to understand that even in long term contracts, there are risks involved and unless power is purchased on strictly short term contracts, those risks will exist.

- # Is statutory change necessary to allow NWE keep basing of generation? Statutory change probably is not necessary. House Bill 509 removed the provision that required taking generation out of rate base and likely would not preclude NWE from pursuing rate base generation. The functional separation requirement could become an issue but the MCC thinks it can work around that requirement. A potential problem and a concern to the MCC is the provision that requires that the utility not charge noncompetitive prices for its power.
- # Should rate based generation be eligible for preapproval or advanced approval? The MCC is trying to balance three general goals in this area:
- ▼ to create a level and fair playing field for all involved;
 - ▼ to minimize risk shifting to rate payers; and
 - ▼ to maximize resource options for the utility.
- These goals may conflict at times, making it difficult to achieve a balance. Historically, preapproval hasn't been available because of the risk shifting concerns and because of the conclusion that those risks are more easily managed by the utility. It is best to leave the incentive to manage those risks with the utility. SB 247, in balancing those goals, did make some changes in respect to third party purchases for the default supplier.
- # Should SB 247 provisions for encouragement of preapproval apply to rate based additions as well? Our conclusion at this point is that there is no reason to take that approach. Long term, the MCC sees NWE as a temporary problem. Preapproval is not necessary at this time and the reasons for not engaging in preapproval in the past are still valid.

COMMITTEE QUESTIONS AND DISCUSSION

SEN. STONINGTON asked Mr. Nelson to clarify the preapproval process and its application to rate based generation. Mr. Nelson said the biggest concern regarding preapproval is risk shifting to consumers from utilities. Those financial considerations should remain with the utility.

SEN. JOHNSON asked Mr. Alke to confirm that MDU is interested in purchasing the assets of NWE if they become available for sale. Mr. Alke confirmed this. SEN. JOHNSON asked Mr. Alke to discuss what would change if NWE assets were purchased by MDU. Mr. Alke said in his judgment it would make no difference because MDU is physically separated from the NWE system and the two utilities are on two entirely different power grids. MDU couldn't use its existing resources to meet load on a NWE system. The major difference would be that MDU is financially strong. If MDU had the authority to build generation, it would have the ability to fund the construction of the generation. Mr. Alke restated his prediction that PPL Montana would oppose MDU's acquisition of NWE because the purchase would weaken PPL's position in the market. SEN. JOHNSON asked Mr. Alke to comment on where MDU would sell the power generated from the proposed 100 megawatt plant to be built at Hardin. Mr. Alke said that by necessity, the power generated from that plant would be sold in the western grid.

REP. GALLIK referred to Mr. Alke's previous testimony that he believed it was important that the default supplier have the option for having rate based generation in its ownership. REP. GALLIK said it appears that the default supplier already has that option, based on other testimony regarding SB 509. He said he would like Mr. Alke to comment if he saw an impediment to this happening. He asked Mr. Alke to suggest legislation that he believed would take care of it. Mr. Alke said while he agreed with most of Mr. Corcoran's statements, he said it was not MDU's

view is there was no need for statutory changes. He said MDU's position is that there are probably 3 to 6 statutes that should be amended.

REP. GALLIK asked Commissioner Jergeson if he agreed with Mr. Alke that there will be a necessity for statutory changes. Commissioner Jergeson said he wasn't sure if the changes already made would be sufficient and would have a greater comfort level if more statutory changes were made to explicitly clarify this part of the law.

REP. GALLIK asked if any panel members believed there was a reason not to allow the option and not to make it specifically clear in statute that the option is available to the default supplier to have rate based generation. Mr. Hoffman said he did not believe there should be any prohibition against the default supplier having rate based generation and said he did not mean to indicate otherwise. He said the point he was trying to make was that in the event the default supplier pursues construction of new generation and attempts to rate base it, the analysis must focus on lowest cost to the consumer. It must not saddle the consumer with the prices of rate based generation that would exceed competitors market price generation. He said PPL Montana does not oppose a modification of the statutes but does think the default supplier already has the authority under the existing law.

REP. GALLIK asked Mr. Hoffman if he disagreed with Mr. Alke's statement that PPL Montana would oppose any entity with rate base generation attempts to become the default supplier by purchasing NWE's poles and wires. Mr. Hoffman said it was a mischaracterization to say that PPL Montana would oppose it. He said PPL Montana would invite discussion to examine this as a critical component in providing the lowest cost to the consumer.

REP. GALLIK referred to Mr. Nelson's earlier testimony with regard to financing of generation assets and asked Mr. Corcoran to comment. Mr. Corcoran said that in today's market, power suppliers are unwilling to go forward with their contracts until they have certainty that those costs are going to be recovered in rates and discussed an example involving Basin Creek Power Services.

SEN. RYAN asked Commissioner Jergeson how the PSC would determine the short term and long term impacts on power costs of building new generation facilities and how far into the future the PSC would look in making this determination. Commissioner Jergeson said it was difficult to answer that question because he had not been through a rate case that dealt with that specific kind of question.

SEN. RYAN asked Mr. Nelson if new construction is built now, temporarily drives up the price but down the line - 25 years from now for example - in terms of what was paid for that plant, how would that cost out. Mr. Nelson said life cycle costs would have to be analyzed and factors such as owning generation and utilizing third party contracts or short term markets would have to be considered also.

SEN. RYAN asked Mr. Corcoran, regarding new construction, to discuss if Montana would have an advantage in accessing transmission, considering the existing infrastructure. Mr. Corcoran said this has been a widely discussed and debated question and made the following points:

- # Currently Montana is a net exporter of power.
- # There are generally surpluses going to the west, except during peak periods of usage.

- # There seldom is a surplus of power available to go east.
- # The question is this: there are a number of parties with interest in building generation projects in Montana but they need to find a home for that power.
- # The "home" is one of two places: a contract with NWE for its default supply service or possibly with a co-op.
- # If a home doesn't exist for the power or the load doesn't increase substantially to use more power, another market will have to be found for that power .
- # That entails more transmission access to other markets west, which at that point, starts turning more into the question of what type of additional transmission facilities are needed, which in turn requires the building of those transmission structures and the recovery of those costs.
- # Pancaking of rates will also be a factor: if a builder has to pay the transmission costs to get power from Montana to California through Idaho, Washington, Oregon, etc., the builder will likely decide to build the new generation in California, since that is where the end market is.
- # Its not to suggest that there aren't opportunities in Montana for economic growth but there are other things that have to be done before those opportunities will exist in a wider scale, because the most important factor is a market to purchase the power.

SEN. RYAN said he wanted a status report on the PPL Montana protested tax situation because of the negative impact it has had on his constituents. Mr. Hoffman said a hearing for the 2000 and 2001 protested taxes has been scheduled for April 2004. A hearing for the 2002 and 2003 protested taxes has been scheduled for May 2004. SEN. RYAN asked Mr. Hoffman if PPL Montana was planning to accept the Appeal Board's decision or to appeal. Mr. Hoffman said he could not comment since the hearings have not yet been held.

REP. GALLIK asked Commissioner Jergeson to clarify his testimony that indicated that if Montana rids itself of its transmission constraints, energy costs would likely will go up to California levels. REP. GALLIK said that was of great concern to him and asked why would anyone build new generation and transmission if it would only result in higher power rates. Commissioner Jergeson said that was a question that must be considered. He said that at the RTO/MISO workshop he recently attended, he learned of a situation in western Pennsylvania and New Jersey in which consumers living on opposite sides of a river had a 50% difference in power costs. If the constraints between Pennsylvania (the smaller market) and New Jersey (the larger market) were eliminated, the cost would rise up to the higher level. The producer will go where they can maximize their return. Commissioner Jergeson said this same scenario would occur if Montana and California markets were combined. Montana, as a small market, would lose out and pay the California rates.

REP. GALLIK asked Commissioner Jergeson how much higher on average the California market is than the Montana market. Commissioner Jergeson said he would have to guess from recent calculations of commodity prices in California but estimated that on average, the California price would be more than twice as high as Montana's.

REP. GALLIK asked the other members of the panel if they agreed or disagreed with Commissioner Jergeson's assessment and if they disagreed, to state their reasons. Mr. Corcoran said he didn't think it was quite as simple as that and that forces from the competitive market would have an influence on the cost of power.

Mr. Nelson said this has been a big issue for a long time and that past studies of RTO West have shown there will be negative impacts on Montana. It is vital that a valid cost benefit analysis is done to determine any possible detrimental effects before a final approval is given to this kind of transmission organization (RTO).

SEN. JOHNSON asked Mr. Corcoran if the new schedule of rates PPL Montana was working on would raise the cost to consumers. Mr. Corcoran said he could not definitively answer the question but the goal was to not increase rates.

**BRIEFING ON SIGNIFICANT ISSUES IN ENERGY AND TELECOMMUNICATIONS --
GREG JERGESON, PUBLIC SERVICE COMMISSION (PSC)**

Commissioner Jergeson discussed several issues with the Committee, included as:

- # EXHIBIT # 8 - Utility Consumer Complaints Annual Report, 2003. Commissioner Jergeson reported that consumer complaints decreased in 2003 and referred the Committee to page 5 of the report which displays the number of complaints filed, district by district.
- # EXHIBIT #9 - Residential Electric Rates/Usage. Commissioner Jergeson discussed this comparison of MDU and NWE electric and utility rates and NWE's residential electric bills and portfolio costs specifically.
- # EXHIBIT #10 - Natural gas rates & comparisons from November 1, 2003 through January 1, 2004, for MDU, NWE, and E. W. M.
- # EXHIBIT #11 - statistics on natural gas production in the southwest from the Western Energy Infrastructure Conference.

Commissioner Jergeson also discussed several telecommunication issues:

- # Qwest applications for an increase in long distance rates - the Commission expects to have a decision in early February.
- # Extended Area Service (EAS) and related issues - business and residential consumers are asking for expanded EAS areas and the Commission must carefully balance the demands of the public with the profitability of the telecommunication company.
- # "Eligible Telecommunications Carrier" designations as it relates to distribution of universal service funds. Applications are coming from rural areas and the PSC must make the decision of whether or not to designate additional carriers.
- # House Bill 642 (2003 Legislature) provided for an annual tracker of property tax changes and Commissioner Jergeson said to date, only one utility has filed for a property tax change under this new statute. He had asked the standing committee to amend HB 642 to allow the utility to get compensation for the increase in property tax because property tax is deductible on federal income tax and that reduction in federal income tax had to be taken as an offset against the increase. The amendment was not passed and the PSC will follow the statute as written.

SEN. RYAN asked if increased cell phone usage for long distance was responsible for the increased demand for EAS calling areas. Commissioner Jergeson said he didn't think the increased demand was related to cell phone usage.

REP. GALLIK referred back to the 2003 Consumer Complaint Annual Report (Exhibit #8) and said he noticed there were no resolutions listed. He asked if there was a way to track if the

complaints had been resolved. Commissioner Jergeson said there was not an actual document showing results but that most of the complaints were resolved easily just by PSC facilitation of communication between the customer and the service provider. He added that he would follow up on that question and provide additional information.

Steve Vick, PSC, said the full report does contain the results of the complaint filed and that he would make the full document available to the Committee members if they wished to receive a copy.

PROCUREMENT OF DEFAULT SUPPLY OF ELECTRICITY

Pat Corcoran, NWE, provided a brief history of default supply procurement in Montana and supply:

- # In 2002, Montana Power Company filed the first default supply case before the PSC which resulted in a ruling (June 2002) and marked the beginning of default supply service in Montana (effective July 1, 2002).
- # The PSC issued guidelines for default supply service: pursuit of portfolio resources, consider demand side management, public involvement in the process, etc..
- # NWE was still required to work with the existing portfolio and had to make decisions on how to fill in the additional needs.
- # The PSC developed a complete and precise set of rules in late 2002 to provide default suppliers guidance on power supply procurement activities.
- # NWE didn't feel it could wait for these rules and moved forward on its own by issuing RFP's for dispatchable resources, wind energy, and demand side management. Work continues today on those three items.
- # The 2003 Legislature made changes to the law which required additional changes to these rules which were implemented in mid-2003.
- # During this time, the corporation filed for bankruptcy.

Mr. Corcoran also reported that:

- # The rules require a default supply service plan. In mid-2003, NWE began work to analyze and identify all of the elements of a default supply portfolio. The plan was filed on Friday, January 23, 2004 (EXHIBIT #12 - NORTHWESTERN ENERGY'S ELECTRIC SUPPLY RESOURCE PROCUREMENT PLAN).
- # The plan is largely a generic plan with some specifics, until recommendations and suggestions can be obtained from the PSC.
- # In parallel to this plan, NWE will file a separate plan with the PSC for each specific resource.

Mr. Corcoran also discussed components of the plan (pages 12 -21 in EXHIBIT #12) which covered the topics of:

- # a resource needs assessment;
- # resources available;
- # base, intermediate, and peak load resources;
- # demand side resources;
- # modeling;
- # a default supply resource evaluation matrix;
- # data sources used;

- # results of the analysis;
- # portfolio performance: cost/risk standard; and
- # observations and conclusions.

Mr. Corcoran also discussed the steps that need to be taken to get the plan approved by the PSC. The NorthWestern Technical Advisory Committee has been and remains an important part of the process and will be meeting on February 11, 2004 to provide feed back on the plan. The advisory committee did not review the plan before it was submitted.

Gerald Mueller, NorthWestern Energy Technical Advisory Committee, gave a presentation (EXHIBIT #13) containing:

- # the PSC directive;
- # information about the Committee;
- # Committee advice regarding default supply;
- # Committee general observations; and
- # future Committee activities.

Mr. Corcoran said minutes from the NWE Technical Advisory Committee meetings are available.

REP. GALLIK said he predicted his constituents would question how NWE could be the default supplier with such a generic plan. Mr. Corcoran said a good portion of the existing portfolio is included in the generic plan and that NWE was working hard to do the right thing. NWE is aggressively addressing the problem areas of the plan and will be proactive in planning for the future.

REP. GALLIK asked if PPL Montana contracts, which will expire in 2007, will be rebid or if NWE would pursue other suppliers. Mr. Corcoran said it is a competitive bid process and bids from PPL Montana would welcome.

SEN. RYAN asked Mr. Corcoran to explain if there was a 5% decrease in demand how that would be made up in the transmission and distribution. Mr. Corcoran said that issue was examined in the demand side management section of the plan and that a lost revenue adjustment was addressed.

SEN. STONINGTON said as she understands it, this is the first try at the preapproval process:

- # NWE is entering into negotiations with the PSC;
- # is gathering input from stakeholders on the proposed portfolios; and
- # the goal is to go out for RFPs later this year

SEN. STONINGTON asked Mr. Corcoran how much approval he expected to have from the PSC by then and how does he conceive this pre approval process to work in practice. Mr. Corcoran said pre approval is actually the second step in the process, that the first step is an informal hearing with the PSC where input and guidance will be given to help refine the plan.

SEN. STONINGTON asked if NWE's plan was that by going through this planning process the prudency review will be facilitated. Mr. Corcoran said PSC feedback will given only if NWE has

a complete and proper planning exercise to provide guidance to move forward. The plan will be continually updated and changed.

SEN. STONINGTON asked when NWE hoped to have its medium and long term contracts in place. Mr Corcoran said he did not have an exact answer but that NWE is focusing on demand side management, dispatchable resources, and wind energy as its first priorities. SEN. STONINGTON asked if any of the wind projects could proceed prior to the removal of the federal tax credit. Mr. Corcoran said this issue is of concern and NWE is monitoring it closely.

SEN. STONINGTON asked if the qualifying facility contracts will be renegotiated during the bankruptcy proceedings and if those contracts were renegotiated, should the savings flow to the ratepayer or to the company. Mr. Corcoran said it is being reviewed as a part of the bankruptcy proceedings, that there are many factors involved in this issue, and that he was not in able to answer that definitively at this time.

Mary Vandebosch reminded the Committee members that she e-mailed information on the Farm Renewable Energy Seminars.

PUBLIC COMMENT

Ron Perry, President, Commercial Energy Montana, commented on the NWE plan/portfolio:

- # Modeling is a good tool but it is important to not get lost in the details - step back and examine the broad implications carefully. Macro and micro issues must both be considered.
- # Gas transmission costs, gas price volatility, and hedging are issues.
- # Risk factors can be misleading - analyze the risk factors from a broad perspective.
- # Character is a question: the owners of NWE are unknown so proceed slowly and with caution.

REP. GALLIK asked Mr. Perry if he anticipated that the NWE investors are looking at their investment in NWE as a long term or short term investment. Mr. Perry said he couldn't comment on the investors' intentions and recommended looking at their investment history to get an idea of how they conduct business.

RECESS - JANUARY 30, 2004

The Energy and Telecommunications Interim Committee recessed until 8:30 a.m., January 30, 2004.

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