

MEMORANDUM

TO: ETIC
FROM: PSC
DATE: September 10, 2003
RE: Discussion draft of Options for Default Supply of Electricity. This is presented as an aid to the committee's preliminary deliberations, and does not state binding conclusions on the part of the Commission.

1. Higher rate of return for better default supply service
 - a. procurement "rewards"
 - b. higher rate of return for transmission and distribution utility based on risk associated with default supply service.

These options are already available under current PSC statutory authority. The current absence of expressed standard was at the request of MPC. Incentives can also be developed and implemented under the Default Guidelines. NorthWestern Energy's Advisory Committee has also flagged this issue. The PSC's default supply planning and procurement guidelines specifically recognize the possibility of rewards for superior performance in procuring default supply resources and managing the default supply portfolio. A traditional transmission and distribution utility rate proceeding is the proper place to evaluate the rate of return on utility assets. The PSC can assess the risk profile of the utility given its default supply obligations and ensure the Company is reasonably compensated given its risk profile. NorthWestern Energy has not filed a transmission and distribution utility rate case since purchasing the utility from Touch America.

2. Revise provisions of 69-8-201 that affect default supply load.

HB 509, from the 2003 legislative session, already did this. The amount of load that may leave in any one year is capped. The return of industrial customers is precluded. The PSC is authorized to ensure that those exercising customer choice, whether leaving default service or returning to it, pay the associated costs so neither default supply customers nor the default supplier are adversely affected by those choices. What additional revisions are contemplated? Do we have enough history with the recent changes to know whether further modifications are necessary?

3. Authorize/require PSC to order the default supplier to sell its utility assets if the financial condition of the default supplier is such that rates and customers are adversely affected.

First of all the Legislative Counsel or some other qualified entity will have to address the difficult issue of whether this action would be constitutional. Assuming it is constitutional to order the default supplier to sell its assets, the primary question is likely to be what is just compensation for the assets and, given that the PSC has ordered the sale, are ratepayers responsible for the entire cost if just compensation exceeds book value. Ultimately it might be a court of law that determines just compensation.

The situation now facing NorthWestern Energy and Montana policy makers involves a financially healthy utility, but financially troubled affiliates potentially threaten the cost and quality of utility service. Therefore, strong PSC authority to establish affiliate transaction rules or “ring fencing” requirements may be more appropriate than authority to order sales of utility property.

4. Provide greater assurance for recovery of costs of procurement of electricity.

Additional rules and guidance are being developed by the PSC, with input from the Montana Consumer Counsel, NorthWestern Energy and other stakeholders as the PSC implements SB 247 regarding advanced approval of power supply contracts. The utility is statutorily assured that it will recover all prudently incurred costs of procuring electricity and providing utility service. PSC rules are designed to achieve this result by providing default supply utilities policy guidance related to prudent default supply resource planning and procurement. The court system serves to ensure that PSC decisions regarding cost recovery are well reasoned and based on factual information.

5. Create or authorize formation of a cooperative to assume some or all default supply functions of NWE

For a utility like NorthWestern Energy, which serves close to 300,000 customers spread over almost 108,000 square miles, the idea of shifting from a privately owned, regulated structure to a cooperative model requires a lot of thought, because such a cooperative would be unlike any Montana has ever known. Establishing workable governing procedures alone could be difficult and time consuming – how many board members are needed, how many customers should each represent, how are they elected, how will board decisions be made, what is the opportunity for member input prior to decisions, given the expansive geographic area of the cooperative where are board meeting to be held and how often. Because of the size of the cooperative, will customers of various types decide to organize in order to present their views to the board more effectively, for example residential customers, large customers, city customers, rural customers? Will the Consumer Counsel and PSC have any role? Would this cooperative be required to implement retail choice?

The idea of transforming NWE into a cooperative is a whole new restructuring discussion that should engage all stakeholders and consider all costs and benefits compared to the current structure. The Montana Electric Cooperatives Association should be consulted on governance issues.

6. Establish a Montana Power Authority with default supply procurement responsibilities.

Again, how is the Montana Power Authority structured, to whom is it accountable, what are its goals and objectives, how does it make decisions, and what are the costs and benefits of creating this new default supply entity compared to the current structure?

7. Make the PSC responsible for procurement of electricity.

The PSC developed draft default supply rules in 1999 that achieved the essence of this option. Numerous parties objected to the draft rules asserting that supply procurement is not a proper role for the PSC. In order to fulfill such a role given normal staff levels and expertise, the PSC's draft rules were designed to use frequent Requests for Proposals to serve discrete blocks of default supply needs. The PSC's selection criteria would have focused on obtaining the lowest cost. However, other things being equal, this structure may not produce the lowest possible cost default service. The PSC is not a utility and therefore is not set up to perform standard utility business functions such as load following, scheduling and balancing. Bidders would likely add premiums to their offers if they are required to perform these functions. Additionally, a knowledgeable utility might be able to negotiate more creative contracts that lower costs to customers. Maine has adopted a similar approach and an analysis of the experience there could be useful.

8. Create a public/private partnership to purchase the poles and wires

What is the objective, how are decisions made, to whom is it accountable, what are the costs and benefits compared to the current structure? What problem is this option designed to solve?

9. No change in ownership or default supplier

The PSC, NWE and several key stakeholders have worked hard over the last year to implement recent legislation and inject some needed stability into the process of procuring and managing a portfolio of electricity supply resources in a retail-restructured environment. These parties continue to work on further developing a rational, workable framework for providing reliable, efficient service at reasonable rates for customers who will likely require a long-term default supply option. This work has been difficult, but progress is being made. While uncertainty and risk surround bankruptcy, it is important to keep in mind that a reorganized, financially healthy utility could very well emerge at the end of bankruptcy and may be in the best position to build on that progress.

10. NWE sells utility assets to another utility

Any sale of utility property raises the issue of PSC authority. Clear, broad and flexible PSC authority over utility sales, along with strong affiliate transaction review/authority, could help ensure the next utility, if there is one, does not find itself in the same situation.