

DRAFT

TRANSITION ADVISORY COMMITTEE

June 23, 2000

Room 102, State Capitol Building
Original Minutes with Attachments

COMMITTEE MEMBERS PRESENT

Sen. Fred Thomas, Chair	Bob Anderson
Rep. Joe Quilici, Vice Chair	Neil Colwell
Rep. Tom Dell	Art Compton
Rep. Royal Johnson	Stan Dupree
Sen. J. D. Lynch	Paul Farr
Rep. Ray Peck	Gene Leuwer
Sen. Mike Sprague	Bob Nelson
	Dave Wheelihan

COMMITTEE MEMBERS EXCUSED

Sen. Bill Wilson
Rep. Ernest Bergsagel
Sen. Steve Doherty
Rep. Stanley Fisher
Sen. Walter McNutt
Ed Bartlett
Stephen Bradley
Kathy Hadley
Don Quander
Roma Taylor

STAFF MEMBERS PRESENT

Stephen Maly
Judy Keintz, Secretary

VISITORS' LIST

Attachment #1

COMMITTEE ACTION

- < Approved the minutes of the April 20, 2000 meeting.
- < Agreed to hold a public hearing prior to the next TAC meeting regarding the report by the State of

Oregon proposing ways to consider the future of the Columbia River system.

- < Changed the next meeting date from September 8th to October 6th, or at the call of the Chairman to address issues dealing with MPC's stock sale.

I OPENING REMARKS

CHAIRMAN THOMAS called the meeting to order at 9:00 a.m. Roll call was noted; SEN. BILL WILSON, REP. ERNEST BERGSAGEL, SEN. STEVE DOHERTY, REP. STANLEY FISHER, SEN. WALTER MCNUTT, ED BARTLETT, STEPHEN BRADLEY, KATHY HADLEY, DON QUANDER, ROMA TAYLOR were excused, **Attachment 2**.

- < *Adoption of Minutes*

Motion/Vote: REP. JOHNSON MOVED THAT THE MINUTES OF THE APRIL 20, 2000, TAC MEETING BE APPROVED AS WRITTEN. THE MOTION CARRIED UNANIMOUSLY.

II STRANDED COSTS: AN OVERVIEW OF "COMPETITIVE TRANSITION CHARGES" FOR CUSTOMERS IN MPC'S SERVICE TERRITORY

Pat Corcoran, MPC, provided copies of stranded cost documents related to MPC's Amended Tier II and Generation Sale Filing, **Exhibit 1**. The Public Service Commission (PSC) issued an order denying the use of a tracking mechanism to recover costs over time. The MPC pursued this matter in district court and won a preliminary ruling. The issue is still unresolved and will more than likely be taken up in the Supreme Court. The MPC's Amended Tier II and Generation Sale Filing was made with the PSC on June 2, 2000.

The three primary stranded cost items in SB 390 were hydro and thermal generating assets, regulatory assets, and qualifying facilities. The MPC sold all of its generating assets and contracts except the Milltown Dam and the qualifying facility contracts. The sales price was \$740 million. Including additions and deductions, the cash at closing amounted to \$758 million. Transaction costs were approximately \$11 million which left a net cash amount of \$747 million. The cost basis of the sale amounted to \$497 million and this left a gain on the sale before tax amount of \$249 million. Deferred taxes were \$131 million which left an amount of \$118 as the gain on sale after tax. Other transition costs amounted to \$22 million. This would include \$5 million of the book value associated with the Milltown Dam. It would not include the other costs associated with the Milltown Dam. The MPC's capital costs were restructured. The cost of retiring the debt was \$9.3 million. The net gain before other transition costs amounts to \$95 million. Regulatory assets exist on the MPC's books due to prior regulatory treatment. The largest amount would be deferred taxes. Energy conservation would also be included. The regulatory assets were \$65 million. The net proceeds

before items requiring trackers amounted to \$30 million.

The Milltown Dam activity is waiting for a record of decision from the Environmental Protection Agency (EPA). The operating costs of the Milltown Dam for the next 4-5 years will amount to \$822,285. . The environmental liability of the Milltown Dam is estimated at approximately \$20 million.

The MPC holds SO2 credits associated with thermal plants. They are attempting to sell those credits at an estimated price of approximately \$3.5 million

The single largest item in regard to stranded costs is the qualifying facility costs. The estimated out-of-market costs for those contracts is \$423 million. The MPC has been working to buy out as many contracts as possible. There are letters of agreements to buy out some of the small contracts and one of the larger contracts. In many cases, these contracts run up to thirty years. The net stranded costs in the QF category amount to \$397 million. The retail portion of stranded costs are approximately \$374 million while the FERC-administered wholesale portion of the stranded costs amount to approximately \$23 million.

In their proposed filing, MPC is recommending the implementation of a CTC charge for the out-of-market costs of operating Milltown Dam and qualifying facility contracts by using an annual tracking mechanism. The remainder of the items requiring tracking would be handled by a PSC accounting order. As the costs occur, they would be recognized and allowed for recovery.

Relative to the MPC's existing energy divestiture process, the new owner of electrical utility following the stock sale will assume responsibility for all the above-mentioned activities. This filing may still be pending upon completion of the sale.

COMMISSIONER ANDERSON remarked that the MPC's filing was made several weeks ago. A notice was issued affording the parties in the case an opportunity to comment on the adequacy of the filing. The procedural schedule calls for discovery and filing of testimony, **Exhibit 2**. A hearing will be held in October.

SEN. SPRAGUE questioned whether, in the impending sale, the stock would remain with the new owner or whether there would be a transfer of stock for stock. **Mr. Corcoran** explained that the public stockholders that exist today will become stockholders of Touch America as a part of the divestiture process.

SEN. SPRAGUE stated that it was his understanding that during the transition of the power facilities,

certain miscellaneous land was given to the Department of Fish, Wildlife and Parks. He requested further information on this matter. **Mr. Corcoran** agreed to provide this information to the Committee.

SEN. SPRAGUE questioned whether the Milltown Dam would have earnings to offset its costs. **Mr. Corcoran** explained that the \$822,285 amount is the estimate of the total cost of operating the dam over the next 4-5 years. This is net of the power generated and would be a negative cash flow. Due to its age and the environmental concerns, it is more than likely that the dam will not continue to operate.

SEN. LYNCH remarked that it was his understanding that the stock sale will involve various packages. **Mr. Corcoran** explained that the stock sale includes five possible variations. A buyer could bid on the entire package but this would include oil and gas as a separate entity, coal as a separate entity, and the independent power group.

REP. DELL questioned whether the MPC was continuing its efforts to buy out qualifying facility contracts. **Mr. Corcoran** affirmed that they continue to work toward this end. The buyouts need to make economic sense. The contracts are very tight and there are minimum opportunities to buy out the contracts unless the contract owners are willing to negotiate.

REP. QUILICI questioned the average costs of qualifying facility contracts. **Mr. Corcoran** explained that the average qualifying facilities contracts were approximately 50 mills. These contracts will continue to exist for 25 to 30 years. The other side of the qualifying facilities issue is whether it would be better to simply track the contracts.

REP. QUILICI questioned whether the costs attributed to the qualifying facilities contracts were rate-based. **Mr. Corcoran** explained that they are expense related items that occur on an annual basis.

MR. WHEELIHAN stated that as the market price approaches some of the qualifying facilities prices this would diminish the stranded costs. **Mr. Corcoran** stated that this may be the present case but the contracts are long-term contracts and need to be viewed from that perspective.

CHAIRMAN THOMAS questioned why the ratepayers would be expected to carry the \$20 million environmental liability associated with the Milltown Dam. The ratepayers were not responsible for the pollution. **Mr. Corcoran** stated that this is a unique situation. The MPC has been working with a variety of entities on this problem and has been trying to be a part of the solution. The costs would be directly related to the MPC ownership of the dam. The \$20 million is an estimate of the costs associated with the

treatment of the Milltown Dam situation. It includes changes needed to be made to the facility so it would no longer be an operating facility but would be a dam that continued to be an non-operating, stable reservoir.

III REGIONAL TRANSMISSION ORGANIZATION (RTO)

Alan Davis, DEQ, used a series of slides to explain the evolution and current status of the western RTO. Davis reported that the electrical grid in the United States is broken into three interconnections. The only way to cross interconnections is to convert alternating current to direct current and then back to alternating current under the different synchronizations. Montana is split and falls into two separate interconnections. At the wholesale level, the power markets defy utility system boundaries and political boundaries. Also, at the wholesale level, the utilities choose the suppliers. At the retail level, customers choose their suppliers.

Open access, non-discrimination, and proper pricing are important elements of an RTO. Currently, within state boundaries, utilities use "postage stamp" rates on the transmission system; i.e., the same price within jurisdictions, irrespective of location. Pancaking of rates involves stacking rates and paying the collective price. Certain places on the system face more traffic than other parts of the system, and crowding slows delivery. There needs to be a way of allocating the congestion.

The Federal Energy Regulatory Commission (FERC) Order 888 opened independent operation of the system. FERC proposed that all the filing utilities form regional transmission organizations (RTOs). The four characteristics of an RTO include the following: 1) independent of market participants, 2) sufficient geographic scope, 3) operational responsibility for transmission facilities, and 4) exclusive authority to maintain short term liability. RTOs must perform 8 functions: 1) administer own transmission tariff, 2) use market mechanism to control congestion, 3) address parallel loop flow, 4) serve as a supplier of last resort for ancillary services, 5) determine available transmission capacity and allow for use in a non-discriminatory basis, 6) provide for market monitoring, 7) be responsible for planning and expansion, and 8) integrate the reliability practices and market interface practices.

By October 15, 2000, utilities must file a proposal for an RTO meeting FERC's functions and characteristics and be operational by December 15, 2000. If this cannot be accomplished, the utilities must file a document explaining why not.

SEN. SPRAGUE noted that for businesses to develop in Montana, predictability was important. **Mr. Davis** remarked that there are two components to reliability which include the safe and secure operation of the bulk electrical grid system and making sure that there is enough power on the system to be able to serve

loads. States need to act collectively in the interest of the region.

Within the western part of the United States, four to five RTOs will be formed. The filing utilities in RTO West include Avista, the Bonneville Power Administration (BPA), Idaho Power, MPC, Nevada Power Company, PacifiCorp, Portland General Electric, Puget Sound Energy, and Sierra Pacific Power. The BPA is a federal government enterprise while all other utilities are privately owned companies. All investor owned utilities (IOUs) are subject to FERC jurisdiction, while the BPA is not. The BPA owns 80% of the bulk transmission in the Pacific Northwest. A series of work groups have been formed to address pending issues.

CHAIRMAN THOMAS questioned whether the RTO would threaten Montana's low cost power. **Mr. Davis** noted that if transmission costs were too high, the amount left for the producer is smaller. Dependent on the set up of pricing on the system, Montana's generation could be advantaged, be made economically neutral, or be threatened. There is a risk of loading costs on the transmission system.

IV STATUS REPORTS/UPDATES

< *Legislative Council on River Governance*

MR. MALY stated that the organization is becoming more formal. Four members of the Montana Legislature have a vote in any official pronouncements from the group. There is an expectation that the BPA system will be changing. The State of Oregon has developed a proposal for ways to consider the future of the Columbia River System. Each state has been requested to analyze the proposal. SEN. DOHERTY has raised a concern that the report does not address Montana's interests. He would like to have a hearing on this issue in conjunction with the next TAC meeting. The hearing could take place prior to the TAC meeting.

SEN. LYNCH questioned the impact of the TVA on the eastern part of the United States. MR. MALY noted that the federal proposed legislation aimed at reorienting the BPA is also aimed at the TVA. The attempt is to make adjustments for a market price environment rather than sustaining cost-based regional preference programs that are perceived as subsidies.

MR. MALY reported that the BPA has invited delegations from each of the four states to tour their Portland operating facilities. Four Montana legislators will be attending this function on July 12th and 13th.

CHAIRMAN THOMAS stated that the above-mentioned hearing will be planned in conjunction with the

next TAC meeting.

< ***Universal Systems Benefits Programs***

Deb Young, MPC, reported that the MPC filed its report with the Department of Revenue (DOR) on March 1, 2000. There were no challenges to the report or the activities of the MPC. In the year 2000, their activities are ongoing along the same mix of programs.

REP. JOHNSON questioned the increase in rates. **Ms. Young** explained that before the USBP charges went into effect, the MPC made investments in conservation that were capitalized over a number of years. These investments are now being expensed on an annual basis. Instead of spreading the charges out over a 20-year period, the funds are collected and spent within the year. The PSC approved the USBP rates in December of 1998 and they went into effect on January 1, 1999. This rate stays in effect until July, 2003. She provided a handout for the Committee, **Exhibit 3**.

John Alke, Montana Dakota Utilities (MDU), stated that the MDU began collecting the USBP charge on January 1, 2000. This week, the PSC has provided an order approving their proposed programs. They were not in a position to start the programs until they were approved. The MDU has also filed a petition for a declaratory ruling with the Department of Revenue. Under the 1999 changes to the Act, the DOR determines whether programs are creditable. If the MDU does not receive that ruling this year, the money collected (\$674,000) will revert to the state. There are various agencies in the state that would like to see the money spent in MDU's service territory. While the bulk of MPC's programs were in place before restructuring, MDU has had no such programs. This involves all new money and new programs. He requested that the TAC encourage the DOR to issue the ruling that the MDU has requested. The ruling should be automatic since the PSC has stated the approved programs in its order. The DOR should have no problem stating that the programs are creditable.

SEN. SPRAGUE suggested that the TAC encourage the DOR to move ahead with its ruling or explain the situation to the TAC at a future meeting.

MR. LEUWER questioned whether the activities in question were the same types of activities as were funded by the MPC. **Mr. Alke** believed their proposed activities were more heavily weighted to low income programs.

MR. LEUWER remarked that since the programs are similar to what has been accepted as credible activities, there doesn't seem to be a substantive issue involved.

Mr. Alke further noted that the MPC is a transitioning utility and thereby is required to deal with the USBP. The MDU is not a transitioning utility.

Ms. Young clarified that the MPC, when filing its report with the DOR, did not assume that the filing did not fall within the legislation that held that interested parties could challenge the report. They entered into the 1999 activities with direction from the PSC and input from an advisory committee. They expanded low-income activities and market transformation activities. They added renewal activities that had not existed previously. There were no guarantees to the MPC.

John Hines, Northwest Planning Council, commented that the DOR was placed in the position of reviewing the programs submitted by the utilities. The agency's role is limited to instances where program credits are challenged by a third party. The DOR was placed in an after-the-fact role. The DOR's role was envisioned to determine that the programs were consistent under rule and statute and to respond if a challenge was put forward. This is difficult to do prior to the implementation of the program.

Deb Smith, National Resources Defense Council and Renewable Northwest Project, maintained that the state has done a good job in implementing the first year of the USBC Program. MPC's performance has been stellar. Last month, MPC's David Ryan received the regional coalition's energy conservation eagle award. The region is moving into an energy deficit. The development of distributed renewable resources will make everyone's energy use more efficient. Montana has been a leader in investing in the long term benefits of power supply. She raised a concern regarding the cautiousness of the MDU. The statute was negotiated and the DOR was to review the adequacy of programs. She is hopeful that in the upcoming legislative session the interested stakeholders bring legislation to extend the USBP beyond its 2003 termination date.

< *BPA's Subscription Process*

Warren McConkey, Flathead Electric, reported on BPA's subscription process. The Coop has asked the PSC to approve an assignment agreement whereby the entire Energy Northwest territory would be assigned to Flathead Electric under a territorial boundary adjustment clause of SB 390. The ruling should be made by July 16th.

Energy Northwest, Flathead's for profit subsidiary, is not eligible for the lowest cost-based power from the BPA. The BPA had a request from several newer small public utilities in the region to hold the door open for subscription for a small amount of power. Seventy five megawatts have been set aside, in the

subscription process, to address this request. A record of decision has been issued which set the rules. Energy Northwest has submitted an application and has a contingency contract for 16 megawatts for four years. The contingency involves a legislative change that authorizes ENI to become totally consolidated into Flathead Electric. They are currently paying a 20% premium for the 16 megawatts.

Flathead Electric is reviewing two power supply contracts from the BPA. They are the only cooperative in the state that is not fully subscribed to the BPA. Currently the price for three year contracts is 25 mills from the BPA and 50 mills in the marketplace. The Slice of the System Program is more flexible. A certain percentage of the output of the BPA system is purchased for a certain dollar amount. The amount of power is flexible but the price remains the same.

The cooperatives have drafted legislation to address the restriction on serving communities with more than 3500 population in the Cooperatives' enabling legislation.

SEN. LYNCH questioned the impact on school districts in regard to property taxes. **Mr. McConkey** explained that there was no impact. They have a five year contract in place which includes payment in lieu of taxes. The school districts were held whole and are very happy with the program. Distribution utility tax reform needs to be addressed on a statewide basis.

REP. JOHNSON requested more information on the draft legislation. **Mr. McConkey** remarked that the draft legislation would be voluntary. If a cooperative acquires, by voluntary acquisition, an urban service territory, that territory can be served by an electric cooperative. The amendment adds to the definition of rural areas making them cooperative acquired territories in urban areas. Condemnation rights are not included. The subsequent buyer of the MPC would not need to be concerned that a cooperative would take over an urban area.

MR. MALY remarked that the BPA subscription window will close in the fall of this year. He requested more information regarding the contingency agreement with the BPA. **Mr. McConkey** explained that the contingent contract for 16 megawatts includes a signed subscription agreement with the BPA by July 31, 2000. The window is held open for four years pending the changes in legislation. For the rest of the cooperatives, the window for subscription closes on September 30, 2000. A city in Oregon and two tribes in Washington also have been approved. The City of Missoula is fifth in line.

< *Attorney General's Opinion on Butte Silver Bow's Request to Acquire and Operate an Electric and Natural Gas Utility under Montana Law*

Thomas Bowe, Assistant Attorney General, reported that the AG's Opinion concluded that Butte-Silver Bow as a consolidated government with self government powers has the authority to acquire and operate electric and natural gas utilities within and outside the boundaries of the local government unit. He provided a copy of the Opinion, **Exhibit 4**. Expressly reserved in the Opinion is the issue of what effect the Electric Utility Industry Restructuring and Customer Choice Act has on the actual exercise of the power by a local government. Under the Act, the local government may be subjected to PSC regulation.

REP. QUILICI noted that there are only two consolidated governments in the state, Anaconda-Deer Lodge and Butte-Silver Bow. He questioned how this would affect the other counties that are not consolidated governments. **Mr. Bowe** explained that the key element is the fact that this particular consolidated government has self governing powers. The conclusion of this Opinion would apply to any local government with self government powers.

SEN. SPRAGUE requested that the municipalities interested in purchasing MPC's distribution system provide the Committee with information regarding the proposed operation of the system and the bonding involved.

CHAIRMAN THOMAS summarized that they would be invited to appear before the Committee and discuss the issue. If they are not able to do so, a written response should be provided to the Committee.

V SALE OF MPC'S GAS AND ELECTRIC SYSTEM

Gary Willis, MPC, reported that the process involved in the sale includes four separate properties: coal, oil and gas, independent power production, and the distribution and transmission services. Four data rooms will be available to the bidders. The bidders may purchase all or a part of the energy business. The bidders will not know who the other bidders are or what portion they are interested in purchasing.

MR. MALY provided a worksheet for discussion of prospective owners/operators of distribution utility, **Exhibit 5**. Three types of purchasing entities may be involved in the sale including: 1) IOUs, 2) a consortium of cooperatives, and/or 3) a consortium of cities and towns.

VI ACTION ITEM: LEGISLATIVE AGENDA

MR. WHEELIHAN stated that the Cooperatives have drafted legislation to address the "3500 population" definition in the enabling legislation. The draft legislation would also address the payments in lieu of taxes issue. The draft legislation could be provided to the Committee by mid-July for review. The amendments

are in the cooperative enabling statute and do not address territorial integrity. In regard to the payment in lieu of taxes, the language could be changed to include rural areas that were once Class 9 property acquired by cooperatives remain Class 9 property and are taxed at that rate. This would give the legislature more assurance that the funds would be available in the future.

REP. QUILICI stated that the codes should be strengthened in regard to safe and reliable service. He will work on draft legislation in this regard.

CHAIRMAN THOMAS stated that there is a huge question of regulatory authority in regard to cooperatives or consolidated governments owning MPC's distribution system.

REP. DELL requested review of the hearing process and information on how this situation is handled in other states.

MR. MALY noted that there is an absence of clarity in the statute in regard to a cooperative assuming the position held by a regulated IOU. The definition of public utility may conflict with other statutory language that expressly excludes cooperatives from regulation.

REP. PECK added that another issue is the disagreement between the PSC and the MPC in regard to the specificity of the law in terms of authority.

CHAIRMAN THOMAS requested that the above-mentioned issues be researched by staff.

REP. JOHNSON remarked that it was his understanding that in their bid for MPC's distribution assets, the Cooperatives were willing to base their bid on the tax situation currently applicable to the MPC. **Mr. Wheelihan** explained that the situation which Flathead Electric has faced indicates the political reality of Cooperatives acquiring properties that are taxed at a level which is different from the tax rate paid by Cooperatives. It is important that the local taxing authorities not face a decrease in taxes due to a new owner of the property. It is a matter of public record that it is the desire of the Cooperatives to keep local taxing authorities whole.

MR. COLWELL remarked that taxation is only one element in the bidding and purchasing process. When the PacifiCorp properties went up for sale, Avista bid on the properties. They were unsuccessful. Cooperatives are allowed certain advantages in the bidding process. In reviewing the move to full competition in Montana, it is necessary to look at inequitable situations wherever they exist.

SEN. SPRAGUE acknowledged that our tax system is in need of repair. We have overburdened the consumer to subsidize taxes.

REP. JOHNSON requested that the PSC not appoint a default supplier before the next session of the Legislature.

VII NEXT MEETING

CHAIRMAN THOMAS recommended that the date of the next meeting be changed from September 8th to October 6th. He added that it may be necessary to hold a meeting to address issues dealing with MPC's stock sale. This meeting date would be set by the call of the Chairman.

VIII ADJOURNMENT

There being no further business, the meeting was adjourned.

Sen. Fred Thomas, Chairman