

Service Date: September 30, 2014

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

IN THE MATTER OF the Application of) REGULATORY DIVISION
NorthWestern Energy for Hydro Assets) DOCKET NO. D2013.12.85
Purchase) ORDER NO. 7323k

CONCURRING OPINION OF COMMISSIONER ROGER KOOPMAN

Looking at the proposed hydro acquisition from a generalized perspective these past nine months, it was quite natural to get excited over the prospects of these 11 dams returning to the ownership of a Montana-regulated utility. All the obvious attributes that were asserted then, remained equally valid at our moment of decision, and were buttressed by a general (albeit not unanimous) public enthusiasm for the purchase, expressed through 17 listening sessions and many hundreds of letters, phone calls, and e-mails.

These advantages include the reliability and price stability offered by 439 MW of hydroelectric power, dedicated exclusively to the needs of NorthWestern Energy (NorthWestern) customers. Hydro power is notoriously dependable, dams are exceedingly long-lived, and fuel costs (water responding to gravity) are non-existent. Moreover, the unknown costs (however misguided) of future carbon-related regulation and taxation are a non-factor where hydroelectric generation is concerned, since no “dreaded” carbon dioxide molecules are produced.

Then too, it’s comforting to know that, with the addition of the hydros, NorthWestern estimates all but 10 percent of the company’s load will now be supplied through utility-owned assets and long-term purchase contracts. While market-based supply (such as from long-term contracts with PPLM) is not necessarily the evil some people portray, reliance on the market does expose consumers to uncertainty. At present, market prices are lower than the costs that will be borne by rate-payers for the hydro

acquisition, and NorthWestern's own projections indicate that this will probably remain the case for at least the next 7 years – possibly longer. Still, both residential and business consumers place great value on rate stability and predictability, and the currently estimated 6 percent rate increase is a price most Montanans seem readily willing to pay.

For these reasons and others, I eventually determined that the benefits of the purchase clearly outweighed the risks, and joined the majority in supporting approval. While judging – from the best information available – that the acquisition was indeed in the public interest, it must be noted that much of this “information” was predicated on an assemblage of projections, assumptions, estimations, and political predictions that have the potential of being wrong. Thus, NorthWestern's valuation of the hydros and eventual purchase price was significantly based on speculation rather than on hard numbers.

This is not meant as a criticism of NorthWestern, for indeed, how can one say for certain how political trends and influences will affect carbon costs and other regulations? How can one know with any degree of certainty, what factors will affect the future market prices of electricity and electricity-generating fuels – let alone what seen and unseen technological advances may one day fundamentally change our entire energy landscape?

So we go with the best information available, recognizing that, given the speculative nature of the purchase, the Commission and commission staff were charged with an especially high degree of responsibility for scrutinizing every aspect of the proposal. This, I believe, we truly did. But concomitantly, it also means that if an approval is forthcoming, the Commission should take an active role in shaping the final outcome – partnering, if you will, with all parties to create a transaction that will be in the long-term best interests of all Montanans. In this second area, I believe the Commission missed some opportunities and could have done a better job. As it is, this Final Order reflects relatively minimal contributions by the Commission in modifying and strengthening NorthWestern's original application.

As I stated during our approval work session, it is not possible to craft “the perfect deal,” given so many questions that could not be fully answered, and we were certainly not requiring this of NorthWestern. However, the Commission did have an obligation to “blend and balance” the interests of the utility and the rate-payer, and to make

adjustments that “bonded” the legitimate interests of all parties into a strong and equitable transaction – while at the same time not jeopardizing the deal itself. A delicate process, to be sure. But to the best of our ability, we needed to “get it right.” Otherwise, there was little purpose to the previous nine months of hard work we, our staff, and the parties had just invested in.

In my view, what worked to somewhat undermine this process was the all-too-familiar mantra of NorthWestern that if the Commission altered things in any substantive way – such as not allowing the full acquisition price into rate base – the utility would be compelled to “walk away from the deal.” This threat of termination was ubiquitous, and was expressed in terms that limited Commission prerogatives and afforded commissioners as little room to maneuver as possible. (NorthWestern’s own later concessions are hereby noted.) As I stated during the work session, I felt NorthWestern’s “all or nothing, take it or leave it” posture was inappropriate, and did not sufficiently communicate the level of respect they needed to show for the job the Commission had to do. While I largely dismissed these threats as calculated histrionics, the Commission as a whole was evidently swayed by them to a greater degree than I believe was justified.

This Commissioner’s questions and concerns spanned a number of areas, leading me to conclude that the assumptions, projections and methodologies used by NorthWestern ultimately produced a valuation and price point for the dams that was at least \$50 to 100 million too high. I pointed to four areas of particular significance in this regard:

- 1) I do not believe NorthWestern did an especially good or exhaustive job in researching likely future carbon costs. Those calculations, in turn, resulted in placing as much as a 25-30 percent premium on the value of the hydro assets themselves.
- 2) I believe NWE’s annual capital expenditure (capex) estimates for the 11 dams was unrealistically low, and did not take into account unknown contingencies that could cause capex to dramatically spike in any given year. This, too, was a major factor in valuation.
- 3) I believe NorthWestern’s negotiation strategy may have led to a significantly higher successful bid than was needed. Moving from a rejected bid of \$740 million directly to a \$900 million offer seemed, at least on its face, unwise and unnecessary – particularly considering that NorthWestern was undoubtedly the most favorably positioned strategic buyer, with other bidders (if any) valuing the assets at lower

numbers. This alone may have resulted in overpaying by something in the range of \$50 to 75 million or more.

- 4) In evaluating the resource alternatives, NorthWestern utterly dismissed the coal assets (Colstrip), assigning them a negative value (based on the belief that the climate change chicken littles will forever rule American politics.) Furthermore, it appears that they made no attempt at a formal analysis of the market as a resource alternative in itself, again, simply dismissing it. It is difficult for the Commission to compare and contrast alternatives, when the utility itself has not satisfactorily done the work.

The Montana Consumer Counsel (MCC), based on its own legitimate concerns, proposed a series of recommended adjustments that this Commissioner found well-intended but not well-conceived. The MCC approach, in my judgment, visited too much uncertainty and potentially high penalties on the utility, and may have indeed rendered the acquisition uneconomic to NorthWestern. Had a risk-sharing approach like they proposed been a common Commission practice with prior pre-approval dockets, I might think differently. Under those circumstances, NorthWestern may have been a tougher negotiator, guided by a somewhat lower valuation. In this case however, with the negotiations completed, NorthWestern could only feel blindsided by the MCC proposals.

Inherently, there is a perversion of incentive when a regulated utility seeks pre-approval of a major capital acquisition such as this, since there is the underlying assumption that the full purchase price will be borne by the customer in regulatory rate base. Under the current “rules of the game,” the higher the purchase amount for which the utility receives Commission approval, the greater its guaranteed profit for the duration of the transaction – in the case of the hydros, 50 years. While I am not suggesting that NorthWestern intentionally inflated their hydros valuation to fatten profits, it is fair to say that the normal market risks and incentives that drive non-monopolistic, non-regulated companies to acquire assets at the lowest possible costs were somewhat blunted by the system under which the Commission, by law, must operate. The MCC, to its credit, tried to address this anomaly with its bold recommendations. Unfortunately, those approaches, in my judgment, were not workable. But that led me to conclude that while, for the purposes of this docket, the Commission must play by the rules it was given, future state lawmakers should consider creative solutions that re-invent those rules to allow for the

interplay of more cost-conscious, market-based incentives, that will in turn produce stronger utility companies, lower power bills and better served consumers.

Two amendments were ultimately offered by this Commissioner and two by Commissioner Kavulla forwarding the belief that some reasonable adjustments to NWE's proposed revenue requirement were in order. These modest reductions were aimed at lightening the load a bit on consumers, by acknowledging that there were areas where the utility's calculations and projections were problematic, thereby making it appropriate to call upon the company to shoulder at least a small measure of the risk otherwise borne by rate-payers alone.

The Commission majority rejected these amendments, primarily on the grounds that any Commission adjustments to NorthWestern's revenues might cause the hydro deal to fall through and NorthWestern to walk away. Respectfully, it is difficult for this Commissioner to envision a scenario where passage of an adjustment that reduces the utility's hydro-related net revenue from \$60 million annually to \$56 or 58 million would cause NorthWestern to disengage from this still extremely profitable deal.

Perhaps, had the back end of this approval process been organized a little differently, these or other modest improvements could have been incorporated into the original 5-page approval motion that formed the four corners of this Order. As it was, at least two commissioners had no hand in writing the motion itself, and were relegated to offering small amendments with little chance of success.

Indeed, this Commissioner had anticipated a more traditional, multi-day work session, where commission staff made presentations and were heavily engaged in the process, and where Commissioners had ample opportunity for vigorous discussion and debate on each pertinent topic. Confining the decision making process to part of one day, and informally limiting Commissioners to 30 total minutes of comment and questions, did not enrich the process, and did not, in my opinion, bring the most appropriate closure to the previous 9 months of robust communication and tireless effort.

While I am not in agreement with all things stated in this Order, I continue to believe that this acquisition is in the public interest, and I have signed it without serious reservation. Since so much in this docket stood on estimations, projections, and judgment calls, how the Commission's decision will ultimately play out is very much

unknown. We live in the present, trying to predict the future from whatever facts we have at hand. Those predictions will already be inaccurate 24 hours from now, based on events over which we have no control. We must rely on the collective wisdom of 5 commissioners and 35 dedicated staff, and on the expressed desires of the people of Montana. It is a process that, while far from perfect, works quite well.

It's my hope that we can say to our fellow Montanans that, at the end of the day, we did the very best job we could. We have now embarked upon an exciting journey, and history will be the final judge of our work.

ROGER KOOPMAN, Commissioner (concurring)