Service Date: August 3, 1984

DEPARTMENT OF PUBLIC SERVICE REGULATION

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MONTANA

*****

IN THE MATTER of the Application by MONTANA POWER COMPANY for authority to establish increased rates for electric service in the State of Montana. Colstrip Unit No. 3 and related facilities.	) UTILITY DIVISION)) DOCKET NO. 83.9.67)) ORDER NO. 5051c)

APPEARANCES

FOR THE APPLICANT:

Dennis R. Lopach, Attorney at Law, Box 514, Helena, Montana 59624-0514, appearing on behalf of the Applicant

John J. Burke, Attorney at Law, 404 East Broadway, Butte, Montana 59701, appearing on behalf of the Applicant

Daniel O. Flanagan, Attorney at Law, 40 East Broadway, Butte, Montana 59701, appearing on behalf of the Applicant

John L. Peterson, Attorney at Law, 27 West Broadway, Butte, Montana 59701, appearing on behalf of the Applicant

FOR THE PROTESTANTS:

James C. Paine, Montana Consumer Counsel, 34 West Sixth Avenue, Helena, Montana 596Z0, appearing on behalf of the consuming public of the State of Montana.

John Allen, Consumer Counsel Staff Attorney, 34 West Sixth Avenue, Helena, Montana 59620, appearing on behalf of the consuming public of the State of Montana.

FOR THE INTERVENORS:

Patrick L . Smith, Attorney at Law, 2812 First Avenue North, Billings, Montana 59101, appearing on behalf of the Northern

Plains Resource Council

John Doubek, Attorney at Law, 314 Fuller Avenue, Helena, Montana 59601, appearing on behalf of the Montana Irrigators
Richard Pyfer, Attorney at Law, 314 Fuller Avenue, Helena, Montana 59601, appearing on behalf of the Montana Irrigators

Daniel Kemmis, Attorney at Law, Box 8687, Missoula, Montana 59807, appearing on behalf of the District XI Human Resources Council

Jeanne Kemmis, Attorney at Law, Box 8687, Missoula, Montana 59807, appearing on behalf of the District XI Human Resources Council

Donald W Quander, Attorney at Law 1400 Norwest Bank Center, Billings, Montana 59101, appearing on behalf of Idea1 Basic and Asarco

C. William Leaphart, Attorney at Law, 1 Last Chance Gulch, Helena, Montana 59601, appearing on behalf of Champion International and Conoco

Linwood Morrell, Attorney at Law, 30 Rockefeller Plaza, New York, New York 13417, appearing on behalf of Champion International and Conoco

Robert L. Deschamps, III, Attorney at Law, Missoula County Courthouse, Missoula, Montana 59802, appearing on behalf of Missoula County

James Robischon, Attorney at Law, 1941 Harrison Avenue, Butte, Montana 59701, appearing on behalf of Atlantic Richfield, Stauffer Chemical and Exxon

Kurt Krueger, Attorney at Law, Box 3209, Butte, Montana 59702, appearing on behalf of Montana Legal Services (L.I.G.H.T., Butte Community Union and Montana Association of Senior Citizens)

Robert C. Rowe, Attorney at Law, 127 East Main, Missoula, Montana 59802 appearing on behalf of Montana Legal Services (L.I.G.H.T., Butte community Union and Montana Association of Senior Citizens)

Captain Edwin T. Peterson, Judge Advocate, 341st Combat

Support Group, Great Falls, Montana 59401, appearing on behalf of the United States Air Force

FOR THE COMMISSION:

Eileen E. Shore, Staff Counsel
Opal Winebrenner, Staff Counsel
Dan Elliott, Administrator, Utility Division
Eric Eck, Chief, Revenue Requirements
Mike Foster, Rate Analyst
Ted Otis, Chief Rate Design
Mike Lee, Economist, Rate Design

BEFORE:

THOMAS J. SCHNEIDER, Hearing Examiner
JOHN B. DRISCOLL, Commissioner
HOWARD L. ELLIS, Commissioner
CLYDE JARVIS, Commissioner
DANNY OBERG, Commissioner

FINDINGS OF FACT
PART A
GENERAL

1. On September 30, 1983 the Montana Power Company (MPC, the Company or Applicant) filed with the Commission its application for authority to increase rates and charges for electric service. The proposed rates are designed to produce an increase in annual gross operating revenues in the amount of $96,367,013, based on an historic test year ending December 31, 1982, adjusted for known and measurable changes. A major portion of the increase is the result of the addition of Colstrip #3 and related facilities.

2. On October 5, 1983, the Commission issued a Notice of Filing and Notice of Prehearing Conference. On October 31, 1983, pursuant to this conference held October 21, 1983, the Commission issued a Procedural Order.

3. On January 9, 1983, the Commission issued a Notice of Commission Action which amended the Procedural Order. Due to the length of time required to respond to data requests, the Commission requested that MPC waive the nine-month deadline for a period - of twenty-eight days. The Company agreed to this change. On February 3, i984, MPC filed an application

for interim rate relief in the amount of.$81,305,068. On March 20; 1984, the Commission issued Interim Order No. 5051 which granted ~ an increase in the amount of $3,859,009.

4. On March 20, 1984, the Commission issued Accounting Order No. 5051a. On April 2, 1984, the Commission issued Supplemental Order No. 5051b .

5. On March 1; 1984, MPC filed a Motion To Strike in whole or in part testimony on the issue of "need" submitted by Asarco, Champion International, Conoco, District XI Human Resources Council, Inc., Ideal Cement,

Missoula County, Montana Consumer Counsel, Montana Irrigators and Northern Plains Resource Council. On March 9, 1984 the Commission voted to take the Motion under advisement and to allow all parties to brief the issues raised by the Motion at the conclusion of the public hearing in this Docket.

6. On March 6, 1984, MPC filed motions to amend the procedural order and to require the production of certain staff materials. The Company was joined in these motions by Atlantic Richfield, Stauffer Chemical and Exxon. On March 16, 1984, the Commission denied the motions.

7. On March 6, 1984, the Commission issued a second Notice of Prehearing Conference. On March 19, 1984, pursuant to this conference held March 12, 1984, the Commission approved a supplement to the procedural a order.

8. On March 9, 1984, the Commission issued a Notice of Public Hearing in Docket No. 83.9.67.

9. On March 27 through May 30, 1984, pursuant to the Notice of Public Hearing, a hearing was held in the House Chambers in the State Capital Building, the Department of Highways Auditorium, and the conference room of the Commission, Helena, Montana. The Commission also held satellite hearings during April 16-19, 23-24, 1984 in, Missoula, Glasgow, Choteau, Great Falls, Hamilton, Thompson Falls, Superior ,' Malta, Chinook, Havre, Stanford, Harlowton, Butte, Chester, Conrad, White Sulphur Springs, Big Timber, Roundup, Columbus, Whitehall, Billings, Hardin, Red Lodge, Lewistown, Fort Benton, Bozeman and Boulder.

1O. The Montana Consumer Counsel (MCC) has participated in

this Docket on behalf of electric utility consumers since the inception of these proceedings.

11. Applicant proposes a December 31, 1982, test year adjusted for known and measurable changes, to be used as the test period in this Docket. The December 31, 1982, test period is found by the Commission to be a reasonable period within which to measure Applicant's electric utility revenue, expenses, and returns for the purpose of determining a fair and reasonable level of rates for electric service.

PART B

RATE OF RETURN
Capital Structure

12. Applicant's witness, Frank Woy, in his direct testimony presented the allocated electric utility capital structure at June 30, 1983. In his rebuttal testimony, Woy presented the allocated electric utility capital structure at December 3l, 1983, adjusted for the January 1984 issuance of Pollution Control Refunding Bonds as a known and measurable change.

13. Applicant proposed the following capital structure and associated costs (MPC, Exh. FVW - 4 p . 1 of 5):

Description	Ratio	Cost	Weighted Cost
Long-Term Debt	54.14%	10.39%	5.63%
Preferred Stock	8.15	8.52	.69
Common Stock	37.71	16.50	6.22

14. Caroline Smith, who presented expert testimony for the Montana Consumer Counsel, in her direct testimony, developed a capital structure at September 30, 1983. On May 17 during the hearing, Smith filed an updated capital structure at December 31, 1983. In addition to the revision to the capital structure, Smith updated her recommended common-equity return.

15. MCC proposed the following capital structure and associated costs (MCC Exh. CMS-1 updated):

Description	Ratio	Cost	Weighted Cost
Long-Term Debt	54.71%	10.34%	5.66%
Preferred Stock	8.05	8.52	.69
Common Stock	37.24	13.85	5.16
	100.00%		11.51%

Allocation Factors

16. A minor difference in the proposed capital structures is the result of the factors used to allocate the utility capital structure between electric and gas operations. In his updated capital structure, Woy used an 85 percent allocation factor for electric operations shown on MPC Exhibit FVW-4 page 2 of 5. The Company followed the capital allocation procedure approved by the Commission in Order No. 4938a, Docket No. 82.8.54.

17. Smith used an 83.2 percent allocation factor for the electric utility as reflected on MCC Exhibit CMS-9 page 1 of 1 updated. The reason for the difference in MCC's allocation factor is direct assignment of the identifiable debt before the allocation factor is calculated. -Smith testified that failure to remove identifiable debt before computing the allocation factor would result in a mismatch.

18. The adjustment to the calculation of the allocation factor presented by Smith is interesting when viewing the debt portion of the capital structure. The flaw in this approach is that the allocation factor Smith developed is not appropriate as a method to allocate preferred and common equity. Preferred and common equity are allocated to the capital structure in relation to the total amount of debt, not just assignable debt. Also, the Commission gave what it thought was a clear message in the last MPC

electric case, that consistency with the capital structure found there was expected in future cases. The Company filed a capital structure which was consistent with the last order. The Commission finds the allocation factor filed by MPC to be consistent with the methodology defined in Order No 4938a,

Other Debt

19. In MPC Exhibit FVW-4 page 4 of 5, 1:here is a debt category termed "other" in the amount of $ 294,000. The Commission asked MPC what this category represented and was told that this debt was associated with the purchase of land for the Salem Plant. The Commission has long taken the position that plant held for future use should be removed from rate base until it provides service to the consumer. In this instance, the Commission finds the exclusion of this debt from the capital structure to be proper.

Pollution Control Refunding Bonds

20. Both Woy and Smith reflect the refunding of $120,000,000 of Pollution Control Bonds which had a maturity date of June 1, 1984. Woy reflected the original three-year Forsyth debt at its December 31, 1983 balance. In addition, he included the Forsyth refinancing proceeds less the amount held by the Trustee. Smith included only the refinanced Forsyth debt issued in January 1984 on a proceeds and cost basis. The Commission finds that the best reflection of the $120,000,000 Pollution Control Bonds is the treatment proposed by Smith. The effect of the refinancing was known at the time of the hearing and is properly reflected as a known and measurable change.

Cost of Capital

Long-Term Debt

21. The cost of debt reflected by the Company and by MCC is similar. MPC Exhibit FVW-4 page 4 of 5 shows a cost of debt of 10.39 percent. Smith, on her Exhibit CMS - 8 page 2 of 2 updated, reflects a cost of debt of 10.34 percent. As a result of the adjustments which are accepted in the capital structure portion of this Order, the Commission finds the cost of debt to be 10.39 percent.

Preferred Stock

22. The cost of preferred stock is not a contested issue in this case. A-cost of preferred stock of 8.52 percent (unchanged from Docket 82.8.54) is based on the embedded cost of preferred shares outstanding at December 31, 1983. This cost of preferred stock is accepted by the Commission.

Common Equity

Applicant

23. In his recommendation of a 16.5 percent return for common equity, Woy considered the testimony of Company witnesses, Charles Olson and Eugene Meyer Woy indicates that a return of 16.5 percent should "enable the Company to protect its existing capital and attract capital at a reasonably competitive cost." (Exh. No. 2, Direct p. 17).

24. Meyer, in his direct testimony, explained utility financing principles and provided information about market conditions. The importance of a financially sound utility was explained:

> Maintenance of financial integrity is essential if a utility is to have access to the capital markets at all times at reasonable costs. (Exh. No. 2, Direct p. 3).

25. MPC witness Meyer was asked, in his direct testimony, to summarize the financial results the Company must achieve in order to successfully finance its utility construction program:

> I believe the utility construction program will be consistently financeable on a reasonable basis in most markets if the Company initially protects and strengthens its
> A/A3 bond ratings and eventually regains and maintains secure AA/Aa ratings. In my judgment, as an investment banker, certain requirements must be met if AA/Aa ratings are to be obtained and maintained. These requirements are:

1. Pre-tax coverage ratios in the 3.5X to 4.0X range on a consistent basis.

2. Company's debt ratio must be less than 50 percent and the common equity ratio must be maintained at least 40 percent with preferred stock making up the remainder.

3. The Company must lessen its dependence upon the capital markets to the point where its utility operations generate approximately 40 percent of its total utility capital requirements internally.

4. The Company's earnings before allowance for funds used during construction must be above the common stock dividend. (Direct pp. 49, 10).

26. In his direct testimony, Meyer indicated that a return on equity of 17.7 percent would provide his recommended 20 percent market-to-book premium. Over a period of 104 months the average yield for A rated utility bonds has been 1l .78

percent. Meyer then assumed that investors would demand a 3 to 5 percent increase in return to invest in common stock. This produces a return on common stock in a range from 14.78 percent to 16.78 percent, with 15.78 percent as the midpoint. A return of 17.7 percent on the June 30, 1983 book value of the Company ($27.89) produces earnings per share of $4.94. Meyer assumed a payout ratio of 65 percent and a retention ratio of 35 percent. Taking the return on equity of 17.7 percent times the retention ratio of 35 percent, the earnings per share growth rate was calculated to be 6.2 percent. By subtracting the growth factor from the median investor return of 15.78 percent, a yield of 9.58 percent was computed. I Finally the dividend ($3.21) divided by the yield of 9.58 percent produces a market price per share of $33.51. This price is 120 percent of the $27.89 book value (Exh. No. 2, Direct pp. 40-42).

27. In his rebuttal testimony, Meyer indicated that the 12.75 percent return advocated by MCC witness Smith is too low. He stated:

> In the current market, MPC's cost of long-term debt is in the area of 13 7/8 percent, more than one percent over Dr. Smith's recommended return on equity. (Rebuttal p. 3).

28. Meyer did not agree with Smith that investments in common equities may actually be safer than investments in senior securities. He states:

> Smith deals only with the risk that the price will decline and the investors will choose to sell or be forced to sell at a loss. All investors, fixed-income or equity, acknowledge market price declines as a risk. They also acknowledge market price appreciation as a reward. (Rebuttal p.4

29. Finally, Meyer disagreed that investors look only at historic data to evaluate the future investment potential of a company.

30. Charles Olson relied primarily on a discounted cash flow (DCF) analysis of MPC in estimating the cost of common equity. The dividend yield used by Olson is described in his testimony:

> I believe that the best dividend yield to utilize for I purposes of a current DCF analysis, is one based on the indicated dividend rate of $2.68 and a simple average of the high and low prices from April 1, 1983 through August 31, 1983. During this period the low price was $26, the high $28 1/4 and the average $27.12. Using this average price and the current dividend of $2.68, the indicated yield is 9.9 percent. (Direct pp. 22-23).

31. Olson evaluated earnings, dividends and book value data for purposes of evaluating what investor growth expectations for MPC are likely to be. Olson concluded that the appropriate growth rate is between 5.5 and 6 percent. When a dividend yield of 9.9 percent is combined with these growth rates, the result is an investor requirement of between 15.4 percent and I 15.9 percent. (Exh. No. 2, Direct p. 27). t

32. Olson also performed a DCF study of 30 electric companies as an I alternative to the. evaluation of MPC by itself. There were three criteria I used to select these companies: (1) 1982 revenues between $100 million and $1 billion (2) over 80 percent of their revenues were from electric operations and (3) the companies had to have bond ratings of Baa3/BBB or higher. For the period from March 1983 through August 1983, the average yield for the 30 companies was 10.4 percent. Based on his analysis, Olson concluded I that the growth rate for these companies was from 5 to 5.5 percent. When these growth rates are combined with the dividend yield of 10.4 percent, the result is an investor requirement of 15.4 to 15.9 percent, exactly equal to his estimate for MPC.

33. Two other checks on the DCF result for MPC were performed by Olson. An estimate of the cost of equity for five companies which generate at least 20 percent of their electricity from hydroelectric plants was performed. The result was a cost of equity of 16.2 to 16.7 percent, which is greater than the cost of equity indicated by Olson's DCF estimate for MPC. The second check o~ the equity cost for MPC was an application of the' interest premium approach. By adding 5 percentage points to the current MPC bond yield implied an equity requirement of 17.5 percent.

34. Finally, Olson indicated that the 15.4 to 15.9 percent investor requirement should be increased to allow for financing costs and market breaks. His final recommendation is that the cost of equity for MPC should be set between 16.5 and 17 percent.

35. In his rebuttal testimony, Olson agreed with the way Smith calculated the MPC dividend yield. However, he disagreed with her projection of historical growth rates into the future. Olson believes that it is valid to - rely on earrings projections prepared by security analysts.

MCC

36. Smith, an expert witness for MCC, used a discounted cash flow (DCF) model to determine a return on common equity recommendation. In her original testimony, Smith calculated the dividend yield for MPC to be 10.6 percent which was based upon market prices over a six-month period ended December 31, 1983. Using growth expectations of 1.9 to 2.4 percent for MPC the cost of equity was 12.5 to 13 percent. Her original recommendation for MPC's cost of equity was 12.75 percent.

37. During the hearing MPC attorney Lopach asked Smith the

following question:

> Q. Do you think it would be appropriate to update your cost of common-equity capital so as to make it more current and therefore more relevant to the period of time during which the rate, those rates, will be in effect?
>
> A. As a practical matter I do. I think there may be a question about the evidentiary record, but certainly I would agree that the most recent estimate would be the best one, providing the estimate were done properly. (Tr . p . 605).

38. Smith testified twice during the hearing, once on March 30 and later on May 17. At the start of her second appearance, Smith filed a number of updated schedules which represented a revised DCF analysis. The update included data through the first quarter of 1984. Using a dividend yield of 10.5 percent and a range of growth rates, the average of which was 3.35 percent, Smith increased her recommended return on common equity to 13.85 percent.

Commission Analysis

39. The foundation of the cost of common-equity recommendations of the Company and MCC is the DCF analysis. Smith used a higher dividend yield than Olson: The yield Smith calculated included the special dividend declared in December. The Commission prefers the most recent dividend yield in this Docket, and accordingly accepts the 10.5 percent yield filed by Smith in her update.

40. For years Smith has presented DCF studies before this Commission which were based upon 95 electric and combination utilities listed on the New York Stock Exchange. In this case only 90 companies were included. The following companies were removed from Smith's study: Public Service of Indiana, Public Service of New Hampshire, Consumer's Power, Cincinnati Gas, and Electric and Long Island Lighting Company. During cross-

examination Smith explained why they were removed:

> The reason that I excluded them is because of market changes in their dividend yields over the pricing period I and the level of those yields, which indicates to me that I investors are expecting negative growth expectations for those companies, or at least that the historical growth data are obviously not a proxy for what investors are expecting; given the change in their expectations over the period. (Tr. p. 611).

The Commission finds the change from 95 to 90 companies made by Smith to be proper, as it was based upon objective data and the application of analysis. However, the Commission finds that this change in the DCF model should have been described fully in Smith's direct testimony instead of a passing reference in Appendix B.

41. Olson, in his DCF study, estimated the cost of equity for MPC as a single company. Smith developed her DCF study using the 90 companies mentioned above. The Commission continues to favor the industry approach as the preferable way to evaluate the cost of equity for rate setting. The use of a large number of companies eliminates the problems associated with estimating growth for a single company. For this reason, the Commission finds the MCC approach to DCF analysis preferable to that of the Company in this proceeding.

42. The Commission does not accept Smith's use of the single best growth rate in determining a growth rate for MPC. In her original Table B-9, the expected growth for the single best growth rate was 1.1 percent, a value that is unrealistically low. In computing the growth rate for MPC, the Commission finds it appropriate to use an average of the two most important growth rates (2.8 percent) and all growth rates (3.9 percent) from Smith's updated Table Nine. This results in a growth rate of 3.75 percent. This growth factor is reasonable as can be seen by comparing it to the least

squares growth rates for 1972-1982 on MPC exhibit CEO-1 Schedule No. 4 (3.61 percent) . When combined with the 10,5 percent dividend yield, the growth rate of 3.75 percent produces an approved cost of common equity of 14.25 percent. Through cross-examination of MCC witness Smith and MPC witness, Olson, testimony was presented during the hearing that the current yield for 30-year government bonds is 13.5 percent (Tr. p . 4268) . It was also testified to that the most recent bonds issued by the Montana Power Company have a cost of 11 3/4 percent. (Exh. 2, FVW-4, p. 3 of 5). The Commission has found that the cost of equity for this docket should be 14 25 percent; a figure above Smith's recommendation of 13.85 percent, and below the 16.5 to 17 percent recommendation of Olson. The Commission finds that the approved 14.25 percent cost of equity is well within the range of reasonableness for a cost of equity as established in this docket.

Rate of Return

43. Based on the findings for long-term debt, preferred stock, and common equity in this Docket, the following capital structure and costs resulting in an 11.65 percent overall rate of return are determined appropriate:

Description	Ratio	Cost	Weighted Cost
Long-Term Debt	54.62%	10.33%	5.64%
Preferred Stock	8.06	8.52	.69
Common Stock	37.32	14.25	5.32
	100.00%		11.65%

PART C
RATE BASE

44. William Slaughter, a witness for MPC presented testimony and exhibits which supported the Applicant's requested rate base. In its original filing, the Applicant requested a total

electric utility rate base in the amount of $802,107,987. This represented a 13 month average rate base as of December 31, 1982, adjusted for known and measurable changes. Colstrip No. 3 and the 500 KV lines added $358,962,848 to the 1982 test year. In the Interim Order No. 5051 the Commission excluded Colstrip No. 3 and related facilities. The rate base approved in the interim order was $480,029,053.

45. Based upon an analysis of test year loads and resources, the Commission finds that Colstrip No. 3 and related facilities are not used and useful for customers in Montana and should not be included in the electric utility rate base.

46. Two items discussed in the revenue requirements portion of this order reduce the rate base: (1) the unamortized portion of the Hanford deferred liability reduces rate base by $2.1 million and (2) the unamortized portion of the Puget retroactive payment reduces rate base by $763,000.

47. The rate base decreased by $390, 491 as a result of changes in working capital made in the revenue requirements portion of the order. As a result of the above changes the Commission finds the rate base to be $476,775,562.

PART D

MOTION TO STRIKE

Introduction

48. On March 1, 1984, MPC filed a Motion to Strike substantial amounts of prefiled testimony of various Intervenors. The Motion, which was supported by a Brief, was based on the argument that the Certificate of Public Convenience and Necessity granted by the-- Montana Board of Natural Resources pursuant to the Major Facility Siting Act,

precluded the PSC from considering testimony on the issue of whether Colstrip is "actually used and useful.

49. Various Intervenors responded to the Motion. Contained in those responses were requests that the PSC defer action until the schedule for the proceedings allowed adequate time for comprehensive responses. Because of time constraints on both the Intervenors and the PSC, action on the Motion was deferred. At the conclusion of the hearing on the issue of revenue requirements, a briefing schedule was set. Numerous briefs were received from Intervenors, to which MPC subsequently replied.

50. On June 18, 1984, the PSC voted to deny the Motion to Strike and proceeded to determine the merits of the case.

51. On July 3, 1984, MPC filed with the Montana Supreme Court a Petition requesting. that the Court assume original jurisdiction and decide the issues raised in the Motion to Strike. That case is now pending.

52. The PSC finds the legal theories and arguments of the Intervenors persuasive. The following discussion will highlight major points made by the, parties and will supplement those points with the PSC's own experience on the subjects presented.

Statutory Construction

53. MPC's Motion requires the PSC to interpret what is commonly known as the "used and useful" statute, which states in its entirety:

> 69-3-109. Ascertaining property values. The Commission may, in its discretion, investigate and ascertain the value of the property of every public utility actually used and useful for the convenience of the public. The Commission is not bound to accept or use any particular

> value in determining rates; provided, that if any value is used, such value may not exceed the original cost of the property. In making such investigation the Commission may avail itself of all information contained in the assessment rolls of various counties, the public records of the various branches of the state government, or any other information obtainable, and the Commission may at any time of its own initiative make a revaluation of such property .

54. MPC claims that this statute must be interpreted in this case in concert with the provisions the Major Facility Siting Act, 75-20-101 et seq., MCA. (MFSA)

55. The used and useful statute is today, and has been since first enacted, a cornerstone of public utility regulation. The rates consumers pay for utility service are substantially determined by what investments are considered "actually used and useful for the convenience of the public". Thus, MPC's claim is a very serious one, since it would guarantee full ratemaking treatment for any facility subject to the Major Facility Siting Act.

56. The PSC, in recent years, has had occasion to interpret the used and useful statute as it applies to new plants. In Docket No. 81.1. 2, the PSC concluded that part of the Montana-Dakota Utilities Company's Coyote Plant was excess, and made a rate base adjustment to account for that fact. More recently, in Docket No. 82.7.53, the PSC concluded that the used and useful statute precluded ratemaking treatment for an abandoned nuclear plant in which the Pacific Power and Light Company (PP&L) had an interest.
PP&L, like Montana Power, also has a case pending that requests the PSC to include its portion of Colstrip 3 in rate base, despite the fact that it has recently concluded a long-term sale of power to another utility, a sale that is predicated on the costs of Colstrip 3.

57. Obviously, then, the issue of excess generating capacity in the context of the "actually used and useful" statute has been a crucial one in the area of public utility regulation in Montana. Similar issues have faced other regulatory commissions throughout the country.

58. In a recent unpublished article, Mr.,. Basil Copeland, an expert witness who has appeared before the Commission in the past, stated;

> In short, utility systems were significantly overbuilt with respect to current demand. Utilities sought, nevertheless, to include this excess capacity in their rate bases,setting the stage for the current conflict. That is not to say, of course, that ingenious arguments were not soon forthcoming to justify this sudden increase in capacity.

59. Having carefully examined the various briefs in this case, the Commission can only conclude that MPC's legal position is just such an ingenious argument.

60. MPC has expended great effort in constructing a legislative history of the MFSA. The merits of that construction will be discussed subsequently.
Of primary importance, however, is whether an examination of that history is necessary or even relevant to a determination of the issue raised. The PSC concludes it is not.

61. NPRC has correctly pointed out that, where the intent of the legislature can be determined from the plain meaning of a statute, courts may not inquire further and apply other means of interpretation. Whenever possible, courts should derive legislative intent from the language the legislature chose to use. Department of Social and Rehabilitation Services v. Angel, 176 Mont. 253, 296, 577 P.2d 1223 (1978); Department of Revenue v. ASARCO, 173 Mont. 316, 324, 567

P.2d 901 (1977) .

62. The terms "need" and "public convenience and necessity" are not exclusive to the MFSA, but are technical terms that must be interpreted in a number of contexts by different agencies. For example, the PSC is charged with reviewing applications from motor carriers. Only upon a finding that the public convenience and necessity would be served, can the PSC allow the proposed new service. 69-12-323, MCA. Similarly, new health care facilities cannot begin operating until the Board of Health finds a "need" for the proposed service. 50-5-301 et seq., MCA. Neither of these statutes, either implicitly or explicitly guarantee any future economic benefits. This is true even when the PSC exercises rate making jurisdiction, as it does for certain classes of motor carriers. Both, like the MFSA go to the issue of whether there should be a new service or a new facility. MPC's argument-incorrectly seems to assume that these terms have no accepted or technical meaning and that their meaning must be construed for the first time here and only in the context of the Siting Act.

63. Based on its experience with public convenience and necessity determinations under the Motor Carrier Act, as well as its involvement in the Siting Act, both in the legislative and administrative arena, the PSC finds MPC's interpretation of the phrase illogical. It is the PSC's interpretation of that phrase and the statutory intent underlying it, that such a requirement is intended to reduce costs by eliminating duplicative services and facilities. The same seems to be true of the Board of Health's role in making need determinations for health care facilities. Contrary to that interpretation, MPC would convert what are obviously consumer protection statutes and, in the case of the Siting Act,

environmental protection statutes, into revenue guarantee statutes for the regulated businesses. Thus, such statutes would insure higher costs, whether or not reality matched the predictions that must be made in such preconstruction, pre-initiation of service determinations.

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The same seems to be true of the Board of Health's role in

making need determinations for health care facilities. Contrary to that interpretation, ID MPC would convert what are obviously consumer protection statutes and, in l the case of the Siting Act, environmental protection statutes, into revenue guarantee statutes for the regulated businesses. Thus, such statutes would insure higher costs, whether or not reality matched the predictions that must be made in such preconstruction pre-initiation of service determinations.

66. Like the terms used in the MFSA, the phrase "actually used and useful" in public utility law goes back to the very root of public utility regulation. Its meaning has been interpreted' repeatedly by this Commission and virtually every Commission in the country. Ignoring over 65 years of experience, MPC now asks the Commission to adopt the position that this phrase is precisely synonymous with "need" and "public convenience and necessity" as used in the MFSA. No legal support is offered for this position.

67. This complete history is also ignored by MPC's incredible argument that until the passage of the MFSA, a void existed in the law -- who or what agency determines what property is "used and useful." (Response Brief, p . 11) . Under this novel theory 69-3-109, MCA, allows the PSC to value property but not to determine whether the property is actually used and useful. If such is the case, then one must wonder why the "actually used and useful" statute was codified in Title 69 of the Montana Code Annotated, statutes which the PSC is mandated to enforce.

68. The Montana statute gives the PSC the power to value investment that is "actually used and useful for the convenience of the public." "Actual" is defined as "existing

in act; real: in opposition to speculative, or existing in theory only." (Webster's New Twentieth Century Dictionary.)

69. The process mandated by the MFSA involves whether a facility can be constructed in the first instance. As outlined by MPC, it revolves around estimates of what energy will be needed in the future. The Board of Natural Resources, based on forecasts, must indulge in intelligent speculation.
Common sense tells us that speculation as to the future cannot establish fact. MPC's position is akin to saying that because the meteorologist predicts a sunny weekend, it must be so, even if it rains. MPC's strained interpretation of statutory terms utterly ignores the timing differences inherent in a preconstruction process to determine “need" and "public convenience and necessity" and the post construction process to determine whether a
utility's investment is "actually used and useful" for today's ratepayers. In the real world, estimates cannot determine fact, as MPC's fanciful theory would have us believe.

70. MPC continues to ignore elemental rules of statutory construction in its claim that certain provisions of the Siting Act repealed the "actually used and useful" portion of 69-3-109, MCA.

71. Under well settled legal principles it has been deemed that a general repealing clause cannot be considered an express repeal, since it fails to identify or designate any statute to be repealed. A Southerland Statutory Construction '23.08 (1973). MPC's reliance on 75-20-103, MCA, is misplaced, since such general repealing clauses are legally

considered anullity. Id, See also State ex rel. Charette v. District Court, 107 Mont. 489, 494, 86 P.2d 7S0 (1938): "Courts in general, in speaking of these repealing clauses, have held that they add nothing to the repealing effect of the Act of which they are a part...."

72. Neither can 75-20-103, MCA, be considered an implied repeal. Repeals by implication are not favored. Dolan v. School District No. 10, 195 Mont. 340, 636 P.2d 825 (1981); State v. Gafford, 172 Mont. 380, 563 P.2d 1129 (1977). In keeping with that principle, every effort is made to reconcile statutes and render the provisions of each effective. State ex rel. Nagle v. The Leader Co., 97 Mont. 586, 37 P.2d 561 (1934); State ex ref.
Normile v. Cooney, 100 Mont. 391, 47 P.2d 637 (1935), Repeals by implication of the specific provisions of an earlier statute will not be made unless the intent to repeal is clearly manifested or unavoidably implied by irreconcilable provisions. Kuchan v. Harvey, 179 Mont. 7, 585 P .2d 1298 (1978)

73. The PSC believes that the provisions o, the Siting Act can be easily and logically harmonized with the "actually used and useful" provisions of 69-3-109, MCA. Within the limits of proceedings that must necessarily rely on estimates and intelligent speculation, the Siting Act intends to screen out undesirable and clearly unneeded facilities. It is administered by a Board whose expertise is in the area of natural resources. The PSC's consideration looks at very different issues and involves an entirely different ;
set of factual determinations. The issues involve whether, at the time the plant goes into service, current ratepayers require it for their energy needs. An ancillary determination must be made as to what monetary value should be assigned to

those plants.

74. If the legislature indeed intended to repeal the "actually used and useful" statute it seems curious that it amended that statute in 1975, but made no reference to its repeal under the Siting Act's repealing provision. (Sec. 1, Ch. 28, L. 1975). This lapse seems especially peculiar in light of the Siting Act's passage in 1973, and the very visable controversy that surrounded the proposed construction of Colstrip Units 3 and 4 from 1973 when MPC and other utilities filed an application with DNRC, and the Supreme Court's decision in 1979. Board of Natural Resources v. Northern Plains Resource Council, (BNR v. NPRC) 183 Mont. 540, 601 P.2d 27 (1979).

75. MPC's implied repeal theory suffers from other infirmities:

> It has been called the golden rule of statutory interpretation that unreasonableness of the result produced by one among alternative possible interpretations of a statute is reason for rejecting that interpretation in favor of another which would produce a reasonable result. It is said to be a well established principle of statutory interpretation that the law favors rational and sensible construction. , Yunker v. Murray, 170 Mont.- .427, 434, 554 P.2d 285 (1976), quoting 2A Sutherland, Statutory Construction 45.12.

76. Statutory construction should not lead to absurd results if a reasonable construction will avoid it. State ex ref. Ronish v. School District No. 1, 136 Mont. 453 348 P.2d 797 (1960); Montana Power Co. v. Cremer, 182 Mont. 277, 596 P.2d 483 (1979).

77. Such a result would flow from an acceptance of MPC's theory.

The BNR made its determination of need for Colstrip 3 and 4

on July 22, 1976. Colstrip 3 went into commercial operation on January 10, 1984. By MPC's interpretation, the State of Montana has decided that ratepayers must, by law, pay for a plant, based on an eight year old estimate of future l energy requirements, no matter what facts supercede that determination. Although ample testimony indicates that, at least today, MPC itself regularly updates information it uses to plan future resources, its legal theory requires the PSC to conclude that, by law, the State of Montana wishes to ignore completely new factual data in its imposition of new resource costs on MPC's ratepayers. That is, indeed, an absurd result. It is especially absurd if one accepts the view that the Siting Act was designed, at least in part to help assure better resource and environmental planning. Under MPC's theory, once a certificate was issued by BNR, all planning could be abandoned by the utility because it would then be guaranteed a return on invest meet, whether or not intervening conditions changed the estimates that were presented to BNR during Siting Act proceedings. Thus, MPC's theory would transform a law designed to encourage intelligent planning, into one that absolves corporations of any post-certificate planning responsibility for the proposed plant. The absurdity of this kind of approach is exemplified by decisions that allow ρate base treatment for ,abandoned plants, plants that are never expected to produce one kilowatt of power. See Rochester Gas and Electric Corp., 41 P.U.R. 4th 438. Through slight of hand and ingenious legal argument, a pile of decaying metal is transformed into "property . . actually used and useful for the convenience of the public. " 69-3-109, MCA.

78. NPRC has highlighted other logical inconsistencies in MPC's position. If accepted, neither the BNR nor the PSC could judge, based on known facts, whether a plant was

"actually used and useful" at the time it went into commercial operation, since the determination was made in 1976 before anyone know the actual cost of the project. (NPRC Response, p. 9) A statutory scheme designed to encourage intelligent planning has, under MPC's theory become a carte blanche for a utility's investment decisions, including the construction of huge generation plants. The PSC does not accept this interpretation.

Major Facility Siting Act

79. MPC claims that the legislative history firmly supports the legal position put forth in the Motion to Strike. The Commission reiterates that it does not believe the discussion particularly relevant, given the plain meaning of the statutes in question. Therefore, this discussion will be brief.

80. MPC's brief alludes to the pitfalls of relying on legislative history as the basis for interpreting statutes:

> It should be noted at the outset that, unfortunately, gaps do exist in the legislative history of the Siting Act, but nevertheless, it is sufficiently complete so that the evolution of the Siting Act may be-- constructed with a great deal of accuracy and clarity. (Brief, p. 20).

81. The Commission, based on its own examination of that history and on its experience in the legislative process involving the Siting Act, agrees with the statement that there are "gaps" and significant ones; it does not believe that the history can, nonetheless be clearly and accurately "constructed". MPC has accurately portrayed the Siting Act's passage as being based on concerns about the environmental and social impacts resulting from

the construction, operation and maintenance of ma30r facilities. The PSC -- views the Siting Act, like those passed in other states, as essentially and fundamentally an environmental protection statute. The statute itself makes that interpretation clear. Section 75-20-102(2), MCA, states in part, that energy conversion facilities "have an affect on the environment, and impact on population concentration, and on the welfare of this state. Therefore, it is necessary to insure that the location, construction and operation of power and energy conversion facilities will produce minimal adverse effects on the environment and the citizens of the state. " Totally absent from the statement is a reference to an intent for the Act to control or determine the ratemaking treatment of the facilities covered by the Act: The policy of the law, although ignored by MPC in its legislative history construction, is persuasive as to its meaning. Fergus Motor Co. v. Sorenson, 73 Mont. 122, 235 P.2d 422 (1925), State ex ref. McGowan v. Sedgwick, 46 Mont. 187, 127 P.2d 94 (1912). The basic environmental purpose of the Siting Act, as found in this preamble, is consistent with a number of environmental protection statutes enacted during the same period of time; as highlighted by NPRC, "Environmental concerns in Montana were at a zenith in the early 1970's. " (Response, p. 15).

82. MPC, at page 8 of its Brief, claims that one purpose of Siting Acts was to cut through a "maze" of conflicting regulations that had resulted in "undue delays in the construction of new facilities that threatened the ability; of electric suppliers to meet the needs of its customers. " No support is offered for this claim, and the PSC's own experience suggests a very different motive. As stated in NPRC's brief, it was precisely the perceived energy crisis of 1975 that precipitated a concern that the state might be host

to a number of energy facilities that were constructed too rapidly and without proper comprehensive review. (Response, p. 16). As noted by NPRC, the process by which Colstrip units 1 and 2 were constructed was a major impetus for passage of the Siting Act.

83. The PSC concludes that the reason MPC must "construct" a legislative history is because the facts, few though they are, run counter to the theory the Company propounds.

84. The Siting Act's statement of purpose speaks only to the issues related to construction of a major facility. It makes not even passing reference to utility rates that might flow from such construction activities. It seeks to assure to the degree possible that such impacts resulting from such construction are not due to plants not needed by electric consumers.

85. In its construction, MPC tries to show that the Siting Act's "need" terminology is the same as the public utility laws "actually used and useful" language. As previously discussed, the claims ignore a long legal and statutory history and ignore common sense, as well as the timing differences of determinations by the BNR under the Siting Act and by the PSC under public utility law. The construction further ignores the fact that the Siting Act's "need" criteria reaches any corporation that constructs power plants in Montana, whether or not that corporation delivers power to Montana consumers, whether or not that corporation is regulated by the Montana PSC.
Thus, the Siting Act's reach is far broader than the public utility law.

86. In its "construction" of a legislative, history for the

Siting Act, MPC places much emphasis on subsequent statutory amendments as well as amending bills that failed to pass. Substantial emphasis is placed on the fact that, when the Siting Act was expanded to include nonutility as well as utility facilities, the need criteria was not applied to such facilities as fertilizer plants, on the grounds that the free market could adequately assure that such a facility was needed by consumers. MPC's point seems to be that because the Act was limited to corporations traditionally subject to the PSC's regulation, it "obviously" must have intended to usurp that authority. The PSC cannot agree that subsequent amendments dealing with nonutility plants have much, if any, relevance to the intent of the original Siting Act. Such l facilities as fertilizer plants have not traditionally been an object for need determinations, just as hospitals, motor carriers and, in the last ten years, energy facilities have been. The PSC finds no contradiction in the fact that the Legislature chose to rely on the free market to determine the need for a I fertilizer plant, while continuing to recognize that such free market forces were not sufficiently strong, if they exist at all, to protect against the I environmental impacts of unneeded power plants. The State of Montana has chosen to require pre-service, pre-construction need determinations for selected business enterprises -- energy facilities; motor carriers and health facilities. It has chosen to allow the free market to determine the need for most business enterprises; that the Legislature chose to put fertilizer plants into the latter category says nothing to the Commission regarding how the Siting Act affects utility rate regulation.

Collateral Estoppel

87. MPC argues that the Montana Supreme Court's decision in BNR v. NPRC, supra, forecloses PSC inquiry into the issue of

whether Colstrip 3 is "actually used and useful for the convenience of the public" because of the doctrine of collateral estoppel.

88. As MPC's brief acknowledges, this doctrine is related to the doctrine of resjudicata, although, as NPRC points out, it is much more limited in scope. (Response, p. 24). Commission of Internal Revenue v. Summer, 333 U.S. 591 (1948) Davis, 4 Administrative Law Treatise (2nd Editor) Sec. 21:1 (1983).

89. MPC made a similar attempt to freeze a previous determination for all time in Petition of the Montana Power Company, 180 Mont. 385, 590 P.2d 1140 (1979). The Court soundly rejected the argument on several grounds, including a finding that the PSC could revalue rate base property at any time. 180 Mont. at 398. The case involved the same statute that is at issue in MPC's Motion to Strike.

90. The regulatory process should not be frozen in time. Indeed, one of the primary reasons for having administrative agencies regulate public utilities is to enable the state to respond to changing circumstances. The business world for both regulated and nonregulated enterprises is dynamic. As the Court stated in Petition of the Montana Power Company, supra, "Administrative policies change, compelled by changing social or economic conditions or by changing statutory guidelines. " 180 Mont at 398. Such changes in facts, economic or otherwise, have consistently been rejected as the basis of courts rejecting arguments in favor of the application of the doctrine. U. S. v. Stauffer Chemical Corp. 52 USLW 4022, 4023 (1984). From the view of sound public policy, freezing one part of the process makes no sense and. such a result is not required by Montana law. Indeed, that law precludes such a result.

91. All parties agree that the doctrine of collateral includes a four part test to determine whether collateral estoppel applies:

1) The issue must be the same and must relate to the same subject matter;

2) The subject matter of the action must be the same;

3) The parties or their privies must be the same;

4) The capacities of the person must be the same in reference to the subject matter and to the issues between them.

92. As to the first test, MPC asserts that the PSC should not indulge in "detailed etymological analyses" in determining whether the issue litigated in BNR v. NPRC, supra, was the same issue as is now presented in this case. (Motion, p. 34). The claim is that "the ultimate issue before each forum is the same, the purpose of inquiry before each forum is the same, and the nature of the determinations before each forum is the same. Obviously, the issue and the subject matter before the PSC is the same as that previously before the BNR." (Motion, p. 34).

93. As acknowledged by MPC, the Montana Supreme Court has stated that "the precise question" must have been litigated in the prior action before the doctrine of collateral estoppel will be applied. Stapleton v. First Security Bank, Mont. , 675 P.2d 83, 40 St. Rep . 2015 (1983), quoting Gessel v. Jones, 149 Mont. 418, 427 P .2d 295 (1967) . It is the PSC's opinion that MPC's analysis is merely an attempt to avoid the plain meaning of the Supreme Court's statement. The Court has demanded precision, precision that cannot be avoided by appeals to "common sense." (Motion, p. 34.)

94. No "detailed etymological analyses" are heeded to conclude that the issue presented to B:4R and the Supreme

Court in BNR v. NPRC, supra, is very different than that presented to the PSC in' this case. Contrary to MPC's assertion, the ultimate issue and purpose of the inquiry of the BNR is very different than the PSC's. BNR is charged with the duty of reviewing energy forecasts to determine if there is a future need for a plant such that whatever environmental impacts are caused by it are justified. The nature of the determination is to allow or disallow construction of an energy facility. By contrast, the issue and purpose of the PSC's inquiry is to determine whether a particular utility investment will actually serve and actually benefit ratepayers to a sufficient degree that they should be required to reimburse the utility for the investment. BNR makes a build/no build decision; the PSC makes a pay/no pay decision. The question of whether or not Colstrip 3 is presently surplus, is actually used and useful could not have been -- raised in BNR v. NPRC, supra, since Colstrip 3 construction had not even begun. The issues involved in the two determinations are not precisely the same; they are not even similar.

Promissory Estoppel

95. MPC further argues that, because of the BNR determination, the doctrine of promissory estoppel "precludes the Commission from considering the need issue." (Motion, p. 30.) MPC relies on the following definition of promissory estoppel:

> A promise which the promisor should reasonably expect to produce action or forebearance of a definite and substantial character on the part of the promisee and which does induce such action is binding of injustice can be avoided only by enforcement of the promise. The remedy granted for breach may be limited as justice

requires. (Motion, p. 43.)

96. MPC defines the elements of the doctrine as follows: "1) a promise clear and unambiguous in its terms, 2) reliance on the promise by the party to whom the promise is made, 3) reasonableness and foreseeability of the reliance, and 4) the party asserting the reliance must be injured by the reliance. " (Motion, p. 44.

97. MPC claims that the State of Montana made "an implicit -- but clear, and unambiguous promise -- that Colstrip 3 would be included in Montana Power's rate case."

98. The' PSC cannot accept this analysis. MPC mischaracterizes a regulatory relationship as a contractual one. Certainly, a state can enter into contracts in its proprietary capacity. The relationship between a state and a public utility, however, is regulatory -- not contractual. The state acts in its sovereign, not in its proprietary function. In regulating a public utility, the state exercises its police power in the public interest. The state need not and does 'not promise or give up anything in order to regulate.
The limits on the exercise of the police power lie in the Constitution, not in any private agreement between the state and the regulated entity. As noted by MPC itself, "no contract between [a utility and the public is necessary to give rise" to certain reciprocal rights and duties. (Motion, p. 43.) Public -utilities derive their powers from legislative - enactment, not from private bargaining.

99. Terms of the Siting Act and MPC's own actions contradict its claim of promissory estoppel. For example, 75-20-403, MCA, allows the BNR to unilaterally revoke the certificate.

Such a power is not consonant with the characterization of the certificate as a contractual promise. In addition, MPC itself unilaterally altered terms of the certificate) when it arranged with BPA to construct a portion of the transmission line; both the corridor and the construction specifications were changed. Similarly, MPC does not view the certificate as a "promise" it will build the plant. Schmechel acknowledged that, at least for MPC, the certificate is permissive -- not mandatory. (Tr.pp . 1048, 1049) . Further, 75-20-408, MCA, provides for civil penalties for violations. Penalties are a regulatory tool. They are forbidden as remedies for violation of contracts. The remedies available by law for breach of a contract are limited to damages, restitution and specific performance.
Restatement (second), contracts, ' 1 (1981).

100. Even if the certificate granted by BNR could be characterized as a promise, it is not sufficiently specific to allow application of the doctrine of promissory estoppel. Nowhere does the certificate even allude to future rate base treatment. The first element of promissory estoppel that must be established to prove a contract by the doctrine of promissory estoppel is the clear and unambiguous promise, the terms of the promise must be certain, as there can be no promissory estoppel without a real promise." Keil v. Glacier Park, Inc., _Mont. , 614 P.2d 502, 506 37 St. Rep. 1151 (1980). MPC's claim that, the "promise" is "clear and unambiguous," though implicit, strains credulity to the breaking point, and places a similar strain on the English language. The BNR's so-called promise to include Colstrip 3 within MPC's rate base does not even rise to the level of ambiguity because it was never articulated in the first place. Its terms are unknown -- how much of the plant's costs

may be included? Does MPC have a carte blanche to pass off all expenses to the consumer, including ones that are found imprudent? Does MPC have the sole authority to determine when rate base treatment will be granted? A court cannot enforce a promise that is indeterminate. If MPC wants to characterize the certificate as a contractual promise, it should have at least bargained for clear terms.

101. The Montana Supreme Court has consistently disfavored estoppel as a general rule. Tribble v. Reely, 171 Mont. 201, 557 P.2d 813 (1976); Boise Cascade Corp. v. First Security Bank, 183 Mont. 378, 600 P.2d 173 (1979).

This is particularly true when estoppel is urged against the government:

As a result of these policy considerations, we have stated in previous cases that the application of the doctrine of equitable estoppel to government entities will be looked upon with disfavor. The doctrine will be applied only in exceptional circumstances or where there is manifest injustice. (Citations omitted). Chennault v. _Mont. _, 610 P.2d 173, 37 St. Rep . 857

102. Estoppel has no applicability to a change of position with respect to a matter of law; Colwell of Great Falls, 117 Mont. 126, 157 P. 2d 1013 (1945). This means, of course, that even if the estoppel theory were otherwise applicable, it would fail, since the State's alleged change of position with respect to the effect of the certificate on rate base treatment is a matter of legal interpretation.

103. In addition to legal barriers that prevent acceptance of MPC's argument, the factual record in this case does not support MPC's claim that, in constructing Colstrip 3, it reasonably relied on the "promise" that rate base treatment would be afforded on demand. In fact, the record strongly

suggests just the opposite.

104. As far back as 1977, this Commission put MPC on notice that it firmly believed that it had jurisdiction to determine whether the Colstrip plants were actually used and useful. In an order authorizing the issuance of securities, the Commission stated, "Specifically, the issuance of this order shall not preclude this Commission from determining whether or not properties constructed with the proceeds of the securities approved herein are used and useful in the service of Montana ratepayers." (Tr. p. 574, Docket No. 6467, Order No. 4306.) In view of that clear statement of jurisdictional authority, if MPC continued to rely on the certificate as a ticket for rate base treatment, such reliance was neither reasonable nor foreseeable.

105. In the Siting Act hearing itself, the Commission clearly stated its position that it would have to examine whether the Colstrip plants were "actually used and useful. " P. J. Gilfeather appeared before the BNR and clearly conveyed that message. (Exh. 31, McRae, WM-2).

106. It is interesting to note, in view of MPC's present position that the BNR acted as a "quasi-PSC, " its objection to the introduction of any testimony relating to rate impacts during the siting hearings. (Exh. 31,
McRae, p . 11) .

107. MPC's own rebuttal testimony rather clearly demonstrates that it was not relying on the certificate for rate base treatment. An MPC employee included as part of his testimony an excerpt of testimony presented before the BNR that stated, in part:
However, there are disadvantages in building larger plants

that must be considered. A larger plant might imply larger surpluses, and there must be a market for these surpluses. (Exh. 3, LaBrie, Attachment p. 7, Tr. p. 746.)
In either case, they try to minimize surplus capacity because surplus capacity represents investment for which there is no supporting revenue. (Exh. 3, LaBrie Attachment p. 7, Tr. p. 746.)
If the load forecast is overestimated, a plant may be built sooner than is necessary. This could prove I costly because in the absence of the sale of excess power to other utility companies, there might not be enough revenues from the new electric load growth to support the expenses of the new plant. (Exh. 3, LaBrie, Attachment p. 6, Tr. p. 751.)

108. On cross-examination, LaBrie stated that his testimony in the Siting Act proceedings was addressed to additional costs that ratepayers would be required to hear if surplus energy ~ could not be sold to other utilities. (Tr. pp. 746-754.)

109. The Commission finds that this explanation is not credible in view of the plain meaning of the Siting Act testimony. The Commission believes that the testimony demonstrates that, at the time of the BNR hearings, LaBrie, in his capacity as a Company representative, assumed that if surplus capacity could not be sold to other utilities, MPC would have "stranded investments," investments that would be earning no return because Montana ratepayers would not have to pay for investments not necessary for service. Such a situation could not arise if MPC's legal theory were accepted, since all investment, whether or not it created surplus capacity, would automatically earn a return through rate base treatment. LaBrie's Siting Act testimony where he

states that "surplus capacity represents investment for which there is no supporting revenue" is especially strong support for this interpretation. The Commission interprets LaBrie's testimony in this docket as post-hoc revisionism designed to force his Siting Act testimony into a mold that fits MPC's new legal theory. MPC could not have relied on that theory if it were counting on sales to other utilities to cover investment and expenses associated with surplus energy. LaBrie's Siting Act testimony demonstrates that that is precisely where MPC placed its reliance.

110. MPC's claim of reliance is also refuted by Chairman Schneider's cross-examination of Eugene Meyer, Vice President and Director of Kidder, Peabody and Company:

Q. Mr. Meyer, would you consider it to be the norm in the regulatory arena today that the question of used and useful is considered at the time of a major plant addition?

A. I would consider that to be normal not only today but at all times in the past.

Q. It has always been the norm, hasn't it?

A. In my judgment, yes. Tr. p. 1280

111. The Commission is aware that Meyer has not only testified for MPC for a number of years, but has also been closely involved in the Company's financing activities. It is very difficult to understand how MPC would have failed to inform Meyer of its claimed reliance on the BNR's Certificate for rate base treatment for Colstrip 3 as he assisted in gaining financing for the plant. Meyer's testimony unmistakably conveys his professional concern for healthy utility profits. Had he believed the BNR Certificate

guaranteed a very substantial rate increase, the Commission believes Chairman Schneider's question would have elicited a response reflecting that belief. Meyer's statement reflects the Commission's view of the timing of rate base consideration of a utility's investments.

112. The Commission has traditionally disallowed rate base treatment for investments in plant that was not yet completed. In Utility regulation jargon, such investments are labeled construction work in progress." (CWIP). MPC has never challenged exclusion of these investments. In addition, MPC, in 1981, actually supported a bill, HB 395, that would have explicitly required rate base treatment for CWIP.

113. This history strongly suggests that MPC has not relied on the certificate throughout the construction period for Colstrip 3. Had it done so, it would have challenged exclusion of CWIP and HB 395 would have not been necessary, since MPC's theory requires rate base treatment for every dollar of investment after issuance of the BNR Certificate, whether the facility is completed or not.

114. MPC has the burden of proof to show that, as a factual matter, it has relied on the BNR Certificate as being tantamount to rate base treatment. Not only has it failed to meet that burden, but the testimony of a number of MPC's own witnesses has strongly suggested that there was no such reliance.

115 . In the 1979 legislative session, MPC actively supported H. B . 452, which stated:

Notwithstanding the provisions of this chapter, as amended, and any other state law to the contrary, a certificate of environmental compatibility and public need under the provisions of this chapter, as amended, is not

required for the construction of electric generating facilities and associated facilities, including transmission lines, which have been the subject of administrative hearings commenced prior to January 1, 1979, under this chapter. (Tr. p. 1201.)The bill was ultimately vetoed by Governor Thomas Judge, who characterized it as "special interest" legislation. If passed, the bill would have allowed construction of Colstrip 3 and 4 without any certificate from BNR. At the time the bill was introduced and disposed of, the Supreme Court's decision in BNR v. NPRC, supra, was pending. Two points are obvious in relation to this bill and MPC's support of it: 1) Had a certificate guaranteed rate base treatment, that is, elimination of all risk to MPC, its support of the bill was illogical. It is axiomatic business sense that one should always attempt to reduce risk as much as possible. Such risk reduction would have been well worth foregoing the end of litigation that the bill intended. 2) More importantly, however, according to MPC President Paul Schmechel, had the bill passed, thereby eliminating any need for a certificate, MPC and its partners would have still proceeded with construction of Colstrip 3. (Tr. p. l 1201.) Indeed it we, the obvious and basic intent of H.B. 452 to allow that construction to proceed without a certificate from the BNR. There is simply no logic to MPC's claim that it relied on the certificate in its decision to build Colstrip 3 when it attempted to eliminate the statutory requirement for a certificate so that construction could proceed without "legal impediments." (Tr. p. 1201.) With or without a certificate, it is obvious that MPC intended to construct Colstrip 3. It is, therefore, impossible to conclude that issuance of the certificate was the reason Colstrip 3 was constructed.

MPC did not rely on the certificate when it made its decision to proceed with construction.

116. MPC's position, as contained in its Motion to Strike, is a creative patchwork of theory. Despite its imaginativeness, however, it does not withstand the kind of scrutiny this Commission must apply to a position that if accepted, would gut Montana's public utility law. The theory transforms a regulatory statute into the equivalent of a take or pay contract or a hell or high water clause that transfers all risk from the shareholder to the ratepayer. If such were the case, then ratepayers should, logically, own the plant, on the theory that interest follows risk.

117. MPC's various theories, if accepted, would constitute a truly monumental change in regulatory law. The Commission cannot believe the Legislature intended such a drastic result when it enacted the Siting Act, which, throughout its extensive text, does not even allude to such a result, a result which, in this case, would lead to deletion of almost fifty pages of this order and over $60 million flowing from ratepayers to MPC. The Company's position is rejected on the basis of sound legal theory, public policy, common sense, and the facts as presented in this case.

PART E

LOADS & RESOURCES

I. General

II.

A. Test Year Considerations

118. MPC has sought Commission approval to use a calendar 1982 test period, adjusted for known and measurable changes which occurred- during calendar 1983 (Exh. 3, WBS at 2).

Colstrip 3 and related transmission facilities are included although they did not become commercially available until January 10, 1984.

119. Champion International witness, R. Bruce MacGregor, alleged that MPC's filing constituted a partial 1984 test period (Exh. 37 p. 4). He made compensating adjustments to reflect other post-test year events, most of which pertained to Colstrip 3 and the twin 500 Kv transmission lines.

120. The Commission finds the rationale behind adoption of a test year to be the matching principle, and seeks, as nearly as possible to match revenues, expenses and plant within that period. MPC, in criticizing MacGregor explained this in its brief:

Without belaboring the point, it is fair to say that Mr. MacGregor in seeking offsets to the revenue requirement of the capacity additions presented in the Company's filing, would have the Commission mix-match selected 1984 items with adjusted 1982 expenses. The result is a serious mix-match that tells the PSC very little about the actual revenue requirement of Montana Power. (p. 48).

121. The Commission's consistent support of the historic test year adjusted for known and measurable changes is well known as a matter of policy and rate case precedent.

123. The Commission finds it appropriate to consider the proposed addition of Colstrip and related 500 kv transmission to test year plant.

124. The proposed additions constitute a known change, and associated costs are stated at 1983 levels (Exh. 2, Berube, p. 22). In addition, testing began during October, 1983 and

output was available within 12 months of the end of the test year. The Commission finds it prudent to consider the addition of large rate base increments, if they become available virtually within 12 months of the end of the test year.

125. A complete matching of rate base, revenues, and expenses associated with these facilities is important. In this case that matching is accomplished via the determination that the facilities are not "actually used and useful" in the adjusted test year.

B. Operating Criteria

126. MPC operates its electric utility based on various criteria, some of which have been criticized during the course of this proceeding:

a. Critical water determines firm hydroelectric resources;

b. Firm resources must be available to meet firm loads;

c. In the long-term, the present value of the revenue requirement must be minimized.

Point a, Critical Water

127. By way of explanation, MPC's hydro system is affected by water conditions in two drainages, the Columbia drainage west of the Continental Divide and the Missouri drainage east of the Divide. Median water is the level of flow which can be expected from historical records to exceed actual flows 50 percent of the time, and fall short-of actual flows the other 50 percent of the time Critical water, or the critical period on MPC's system is 1934-1938, which was the period when the lowest combined flows at the sites of MPC's hydro resources occurred. (Tr'. pp. 2259-2261) Of course, during this period, generation would have been much less than under median

water conditions. MPC assumes in its operations, that it will need sufficient resources to provide load should the critical period recur on its hydro system.

128. The general philosophy which supports the critical water criteria is the need to serve all loads in all years. Under cross examination, MPC witness Eugene Lewis explained the frequency of critical water conditions
and the impact on system operations:

As I believe Mr. Gregg testified to yesterday, the median the critical period itself has come about once in the 50 year historical record. However, we have approached critical about on average of one in five. He said the Corps. of Engineering studies said it's about one in four. So its about somewhere in that range. Let's say one in four or one in five years. When we approach critical water, as Mr. Gregg stated, that requires the system be operated as if we were entering a critical period. (Tr. p. 1891).

129. Northern Plains Resource Council (NPRC) witness Jim Lazar, on the other hand, proposed that the output of the MPC hydro system be determined based on median water conditions (Exh. 24; pp. 38-42). He reasoned:

a. Economic outages may be less expensive to contract industrials than paying for resources to serve them at all times. (Lazar cited the analogy of how costly it would be to build 20 lane freeways to serve rush hour traffic and of football stadiums large enough to accommodate every fan who wanted to see the Super Bowl.)

b. The critical period in the Columbia Basin is different from the Missouri Basin, thereby providing probable l diversity;

c. Idaho Power Company operates its system based on median water criteria;

d. Hydro firming through the use of combustion turbines has been recommended by the Northwest Power Planning Council. To this end, Lazar recommended, at a minimum, that the Bird generating station be used as a hydro s firming resource to fill the gap between median and critical water conditions.

130. Lewis predicted that MPC would conduct a study during 1984 that would "definitively discuss the economics of critical versus hydro firming with critical". (Tr. p. 2058).

131. The Commission is reluctant to modify critical water assumptions used by MPC to determine test year hydro output. To do so, based upon information in evidence, would not provide adequate consideration of potential impacts. The MPC study may provide. a more adequate basis for consideration of modifying the critical water criteria. The Commission requests that MPC perform a comprehensive study of the issue, including the points raised by Lazar, and submit the report to the PSC at the end of 1984. Lazar's suggested use of the Bird plant as a hydro firming resource will be discussed later in this order.

Point b

132. The policy of providing firm resources to meet firm loads, was discussed at some length by MPC and various intervenors. One of the major points of contention centered around the firmness and availability of using Pacific Northwest surpluses to fill gaps in MPC's resource mix. The surpluses were generally lumped into two groups:

a. short-term surpluses consisting of opportunity or

secondary market surpluses

b. long-term surpluses and conservation

Secondary Purchases

c. Montana Irrigators witness, Anthony Yankel, contended that MPC should plan to purchase secondary power to meet firm loads so that costs could be minimized. In' rebuttal, MPC witness Donald J . Gregg stated:

Q. Mr. Yankel claims that our cost minimization planning criteria is ignored when we fail to plan for purchasing nonfirm power. Do you agree?

A. I do not agree. Cost minimization in the short term operating mode is different than cost-minimization in the long-run of providing sufficient firm resources. Once firm resources are acquired, we do operate them to minimize operating costs. For example, when nonfirm power is available at prices less than our running costs (i.e. cost minimization) we purchase it; but we cannot plan on such nonfirm power to serve firm load simply because it is not always there. (Exh. 18 pp. 33, 34).

133. Yankel cited an example where MPC planned on short-term secondary power to meet load, however (Exh. 18, p. 17). He described the situation where MPC planned substantially longer maintenance periods for its thermal plants based upon better than normal runoff in the Pacific Northwest during 1982 (Tr. pp. 1323, 1324).

134. The Commission finds reliance on the secondary market to meet firm loads year in and year out may not provide adequate reliability.

135. However, it is apparent that California purchasers have success fully relied upon a similar strategy in acquisitions from the Pacific Northwest.

This issue is similar in most respects to the critical versus median water planning discussed above. It is entirely possible that the combination of combustion turbines, secondary purchases, and voluntary curtailment (i. e. Governor's Emergency Curtailment Plan, 1976-77) provide firm resources, which are cost effective as compared to MPC's traditional approach. Again, the record is not adequate to establish a least cost resource strategy. A comprehensive analysis is required.

Firm Purchases

~b 136. The other source of Pacific Northwest surpluses is firm surpluses. These surpluses are forecasted to exist at least until 1988, and possibly until 1994, depending on the forecast consulted and the disposition of the mothballed WPPSS plants (Tr. pp. 2182, 2183).

137. Missoula County witness John Duffield analyzed the addition of the Colstrip 3 facilities by contrasting its cost against a firm long-term purchase from Bonneville Power Administration's New Resource Rate Pool (7f). He contended that the purchase was available and was substantially cheaper than Colstrip 3 over its projected life cycle. He computed that the point of indifference between Colstrip 3 and the purchase would be reached in the base case, if MPC could sell excess Colstrip 3 output off system, long-term for 37.4 mills/kwh, which approximates Pacific Power and Light Company's
sale to Black Hills Power and Light Company of Colstrip 3 based power (Exh. 30 p. 17). In rebuttal, Gregg stated:
Q. Could MPC place a requirement on Bonneville for a firm

- power purchase?

A. Yes, it could. However, under the contractual provisions the Company would have to obligate to Bonneville equivalent resource in order to assure firm service. Essentially MPC would sell a resource to Bonneville and then buy it back as purchase power. While that may sound attractive, one must remember that the rate would be based on all new resources acquired by BPA (plus the transmission system and BPA's administrative costs.) (Exh. 3, Gregg, p . 50) . . In addition, Gregg criticized Duffield's pricing assumptions as too simplistic.

138. Northern Plains Resource Council attorney Pat Smith cross-examined Lewis to determine if actual long-term purchases existed in the market place:

Q. Do you know of any other utilities in the Pacific Northwest, other than BC Hydro, that has a firm contract with a California utility with a term- of over five years, or including five years?

A. Other than exchange contracts, and I believe there are some exchange contracts -- again, I would have to check this with Mr. Cromer -- that may last five years or longer between the Northwest utilities and California utilities. I am not aware of any just one-way firm sales with a term of over five years.
Q. Do you know what the price is on the BC Hydro power sold California, approximately?

A. I think the price was 22 mills, escalating. (Tr. p. 2173).

Conservation

139. Conservation is available for long-term firm purchases. Since the Commission chose to remain with the test year for calculating loads and resources, there is little need to revisit the methods now available for quantifying and costing the conservation resource. However, several important conclusions are in order:

1. A large energy resource, cost competitive with conventional energy resources, is available from conservation. The Commission expects cost comparisons to be done by MPC prior to future procurement of energy from any source. Testimony will be invited in future rate cases to test the exhaustiveness of the utilities internal comparative analysis.

2. Some conservation energy, at any given length of availability, is cheaper than other conservation energy. The Commission would expect the cheapest to be sought first. Certainly, all conservation energy available at less than conventional alternatives should be acquired until exhausted.

3. The slowness with which programmatic conservation purchases are entering the resource mix, may be due to the small number of personnel, excluding auditors, that are charged with the responsibility. Just as this Commission would reasonably expect an expansion of professional personnel to oversee a major generation project, it logically expects more personnel engaged in oversight of conservation acquisition.

Furthermore, the Commission fails to understand the utility's emphasis on being the entire "conservation industry" in its service area. Rather, the Commission expects broader procurement practices, whereby conservation energy is

acquired in large blocks from public and private suppliers, if they can meet competitive price and performance standards. If Montana Power's own programs can meet the same standards, they certainly should be preferred and will be making a valuable contribution to development of the conservation resource.

4. The favorable social impact of placing the ability to avoid energy use into a ratepayers hands needs some direction. If priorities must be made in the timing of a program's direct impact, they should go to the low income residential, school and government bodies closest to their districts, nearing tax limits, irrigators and small commercial customers. From public testimony, these groups clearly are most desperate. This prioritization within programs assumes different programs directed at different classes of customers. Ultimately, the important ranking of programs must be according to their relative cost of the energy expected. On this point, for example, the Commission is not convinced that amounts planned for expenditure on lighting is better spent than purchases of conservation from other sources, such as industrial users.

140. Public sentiment and technical testimony support a much more intensive conservation effort by MPC. The 'MPC appears to have moved slightly in that direction, but its commitment to purchase all available conservation energy at a price below the full cost of conventional alternatives is still in doubt. Reasonable and least cost utility regulation generally demand accelerated programs and purchases.

141. This Commission will withhold detailed evaluation of MPC's various conservation programs,. and their relative cost effectiveness until the next

avoided cost docket. Clearly, by that time MPC will have made more informed judgements and more factual data will be available for scrutiny by all parties.

142. The Commission finds the state of the record on the subject of least cost from resources to be incomplete. It has before it the perceptions of several experts regarding the availability and price of long-term transactions and a limited number of actual transactions. Although the balance of the loads and resources discussion will conclude that output from Colstrip 3 is not needed to serve test year loads, it is likely that some additional resources will be needed in the future. Whether such resources will be provided from conservation, firm purchases, QF purchases, or an MPC investor owned facility is not known at this time. In any event, the price and availability of the firm purchase alternatives will need to be known. It would provide a measure of the value that ratepayers must be charged for the additional resource in order that they be more nearly faced with competitive market place prices. Accordingly, the Commission wishes to have before it at that time, the best and most accurate information available.

143. MPC is therefore directed to assemble a tabulation of all in place or contemplated long-term sales which it is aware of both within the Northwest region and to or from the Northwest region and present them in the next rate case. All pertinent details of the sales should be itemized.

144. The Commission does expect MPC to perform an appropriate life cycle analysis comparing these alternatives when and if rate treatment is sought for additional resources in the future.

Point c

145. The Commission finds MPC's third criteria, that of minimizing the present value of the revenue requirement in the long-term, to be universally accepted. The method of achieving this varied between MPC and intervenors, but no explicit present value analysis was presented in evidence, with the exception of that performed by Duffield. He concluded that compared to either a purchase alternative or conservation, Colstrip 3 was more expensive on a present value basis. Both comparisons were rebutted by MPC witnesses. Again, the record is not adequate to establish a resource strategy which will minimize the present value revenue requirement in the long-term. Crucial unanswered questions were raised on the full range of resource, cost and reliability issues. The record in this case and the Commission's experience in two comprehensive avoided cost investigations reinforces the Commission's commitment to this difficult but critical task. The Commission intends to evaluate future resource additions to the utility system on a basis directly comparable to the alternatives. The Commission expects that the most appropriate technique is a comprehensive avoided cost proceeding. C. Peak vs. Energy

146. MPC did not present a peak load tabulation adjusted for known and measurable changes for the test year. However, MPC's brief presented the following for the 1984-85 forecasted operating year:

Resource (Peak)	1505
Load (Peak)	1211
Contractual Forced Outage Reserves	176

Anaconda Contractual Requirement	83[1]
Total Load Requirement	1470
Available Capacity 35	(2.3%)

147. MPC presented testimony pertaining to peak load experienced during the cold snap of December, 1983 (termed the "megafreeze"), and the usefulness of Colstrip 3[2] in serving the peak (Tr. pp. 1807-1809). However, Exhibit 12, a peak tabulation for the coldest December days, showed energy exports. In cross-examining Gregg on this matter, NPRC attorney Smith presented a letter from Bob Lewis at Bonneville to Gerald Mueller of the Northwest Power Planning Council which explained that ample additional peak resources were available in the region during the cold snap. In addition, Lewis explained during cross-examination that the abnormally high peak experienced during the megafreeze would probably not change the way peak was forecast on the MPC system (Tr. p. 2218).

148. The Commission finds any reliance upon the "megafreeze" peak to justify the need for more resources to be unfounded. It is clear from Lewis' testimony that MPC probably will not rely on it in planning for future resources. In addition, the Company, as well as other utilities in the Northwest, provide reserves to meet abnormal conditions, such as the "megafreeze.

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[1] The load forecast included 2 MW, although Anaconda could take 85 MW until Spring, 1985 when its potential take becomes 12 MW (Tr. p. 1519).

[2] Colstrip 3 generated "test energy" during the cold spell, since it did not become commercially productive until January, 1984.

149. Even if the Commission were favorably disposed to evaluate the need for Colstrip 3 based on normalized peals demand, sufficient information has not been put into evidence to do so. As was noted, no test year peak tabulation was presented. The 1984-85 peak resource numbers do not include the Washington Water Power peaking contract (Arco 1-24 p. 47). In addition, the Commission does not accept the proposition that 83 MW from an expensive baseload resource should be added contingent upon an uncertain future sale to the Anaconda Company. The availability of certain customers, particularly Stauffer Chemical Company, to be interrupted at the time of system peak also needs further investigation[3].

150. Finally, the Commission finds Duffield's testimony on the matter of peak verses energy to be fully in accord with its own opinion:

Q. How will you measure the share of capacity used?

A. The "share of capacity used" is the "used capacity" as a fraction of the normal utilization of the plant. For example, if a plant contributed 100 AV MW energy to native loads in a given year, and the plant has 330 MW capacity and is expected to normally run 70 percent of the time (210 AV MOO), then the "share of capacity used" is 100/210, or .48. These definitions are summarized in JWD Exhibit 1.

Q. Will you apply these concepts to measures of peak load?

A. No. The economic solution to peaking capacity shortages is not to add base-load coal, and the latter is the issue at

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[3] In the event of a peak deficiency, an analysis should be made comparing the cost of interrupting verses the cost of providing resources to serve all customers.

hand. In addition, it is highly unlikely that the Pacific Northwest will for the foreseeable future experience shortages in peak capacity as opposed to energy. Accordingly, I will assume that sufficient peak capacity will be available in the region to meet MPC's needs. The following discussion is limited to an analysis of the extent to which coal-fired plants are needed for system energy. (Exh.30 p. 2, 3).

151. Accordingly, the Commission will consider the actual requirement for energy resources in this proceeding with the full expectation that MPC will apply for appropriate ratemaking treatment in the event it needs to add peaking resources to meet a peak deficit.

D. Colstrip 3 - 500 Kv Relationship

152. As a general matter, MPC has not taken issue with the proposition that the double tower 500 Kv transmission lines were constructed explicitly to provide a transmission path for the output from Colstrip 3 and 4. Indeed, the revenue requirement increase requested reflects the addition of both plant and transmission lines to rate base, since they become available at about the same time. Additionally, the record contains no showing that MPC was constrained by transmission capacity before Colstrip 3 and the twin 500 Kv lines became available. Gregg's testimony implies the opposite:
Additionally, if both lines are excluded, (another of Mr. Lazar's suggestions) no part of Colstrip No. 3 power could be transmitted if Colstrip Units No. 1 and No. 2 are loaded. (Ex. 3, Gregg, p. 16).

153. The Commission finds Colstrip 3 (and 4) and the twin 500 Kv transmission lines to be integral, unitary utility

property. One would not successfully or economically be feasible without the other. The Commission also notes that MPC's share of Colstrip 1 and 2 output was transmitted successfully for many years without the twin 500 Kv lines.

154. The transmission facilities between Colstrip 1 and 2 and Billings appear to be near capacity. Should MPC decide to use existing embedded transmission lines from Colstrip to provide contract transmission to the Western Area Power Administration (WAPA), the cost of replacing this transmission capacity must be covered in the price. The Commission cautions MPC management to consider all of the costs of displacing jurisdictional power onto replacement facilities from Colstrip to Broadview. The Commission's interest here is to avoid any subsidy by ratepayers of transmission arrangements that happen to cross jurisdictional facilities. Serious questions were raised in this Docket as to whether the lines are oversized and whether their cost was reasonable. These questions must be comprehensively considered if Colstrip 3 is found useful in the future.

II. Loads

155. MPC presented actual energy loads of 5,909,972 MWH's for the test year or 674.6 average MW's. Gregg normalized and adjusted actual sales, which resulted in 6,056,340 MWH's or 691.4 average MW's (EX. 2, Gregg, Table 5, DBG-6). He then analyzed system losses, which he calculated to be 79.5 average MW or 8.7 percent of total -load. Total loads and losses were summed, which resulted in 770.9 average MW for the test year, adjusted for known and measurable changes.

156. Intervenors did not dispute the accuracy of MPC's loads or adjustments. Various intervenors, however, did dispute

MPC's service obligation to Stauffer Chemical Co. (included at 57.8 average MW, net of losses) and Anaconda Co. (included at 2.2 average MW, net of losses).

Stauffer Load

157. Several intervenors addressed the economic prudency of serving the Stauffer load, particularly in view of the fact that it had been a customer of Bonneville until its voluntary switch to MPC during 1982. Several points were raised:

a. Stauffer's load is regional, and was shifted to MPC's system simply because of lower rates (Exh. 24 Lazar p. 35).

b. Stauffer should be treated as a "new large single load" within the context of the Northwest Power Act, and charged full incremental cost of service (Exh. 24 Lazar p. 36).

c. "Utilities do not have some absolute obligation to build new facilities to serve all customers. Utilities often refuse to serve especially costly customers unless those customers are willing to make substantial capital contributions or sign long-run contracts. This is true of residential, commercial and large industrial customers. " (Exh. 39 Power p. 16).

d. "I think the PSC should look closely at gradually shedding the larger contract industrial loads and perhaps bringing the remaining ones into small industrial. How ever, I think the equity argument is important and may be sufficient to justify keeping many of the loads in.
But taking the latter seriously, and preserving Colstrip

3 and 4 are not added to the rate base, it is very clear to me that the Stauffer load should be continued only as long as a surplus exists (subject to contract provisions, of course)." (Exh. 30 Duffield p. 31).

158. Industrial intervenors and MPC responded in briefs and attempted to establish through cross-examination, that the obligation to serve was basically a legal obligation provided for under Montana's statutes. For example, the MPC brief cited Polson v. Public Service Commission, 155 Mont. 464, where the Montana Supreme Court ruled that the City of Polson had to permit a customer to tap into a city water line (p. 7).

159. As a general matter, the Commission finds that governing statutes do require utilities to provide service to those requesting it. With regard to Power's pricing testimony, the price to be paid for service is appropriate for the rate design section of this order. With regard to the "new large load" language included in the Northwest Power Act, the Commission finds that the Legislature of Montana would need to modify current statutes before that criteria could be imposed upon Montana consumers.

Anaconda Load

160. Two points were raised by intervenors pertaining to the Anaconda

Company load:
a. Montana Consumer Counsel witness Albert Clark contended that the deficiency payment included by MPC should be excluded.

b. Duffield contended that industrial loads, in particular the Anaconda load, were highly variable.

161. The Anaconda deficiency payment was computed by MPC to be the difference between actual Kw demand and 65,000 kw contract demand per month at present rates. The dollar amount associated with the payment was $4,650,805 at present rates.

162. Clark explained in his prefiled testimony, why he excluded the Anaconda deficiency payment:
I also excluded Anaconda deficiency payments from revenues because such payments are a partial reimbursement for excess capacity resulting from the reduction in Anaconda load. (Exh. 43, p. 8).

163. The Commission does not agree with Clark's reasoning. In the last case the Commission and MPC agreed that the revenues from the Anaconda Company deficiency payment should be used to reduce the electric utility revenue requirement. Since the treatment in that case was based upon existing facilities, the Commission finds that ratepayers should receive the benefit of these revenues.

164. The Company argued during this case that the Anaconda Company could resume operations in the future and require service under their contract. The obligation to serve on the part 'of the Company holds for all customers, not just the Anaconda Company. Lewis, an MPC witness, indicated that the Anaconda load, if mining resumed, would be 38 MW (Tr. p. 192). In reviewing the test year loads and resources the Commission finds that there are two months when the full load of the Anaconda Company could not be met. In a balancing of the interests of the ratepayers and the shareholders the Commission finds that 10/12ths of the deficiency payment

amount ($4,650,805) should be used to reduce the electric utility revenue requirement.

165. With regard to the second point Duffield testified:
The recent surpluses are due in part to the loss of the Anaconda load, but this was not entirely unpredictable. In fact, the variability of the contract industrial load was as high in the 50's and early 60's as it has been for the last few decades. There are high costs to uncertain loads that have been historically borne by residential and commercial ratepayers. Contract industrial customers need to be faced with these costs or, alternatively, have uncertain loads matched with uncertain resources. (Exh. 30, p. 25).

166. NPRC attorney Smith also cross-examined Gregg on this point:
Q. Has the Anaconda load - would you describe the history I

of that load as one that's constant, predictable, or one

that's sort of up and down and more fickle in nature?

A. I think any load is up and down and fickle. This load, somewhat more volatile, maybe, than other industrial loads. I am not sure that it has any more volatility than any other load. (Tr. p. 1512).

167. Recent literature has explored risk differentials in serving various customer classes and the resulting impacts on cost of capital. This record suggests that differential costs of capital may exist for service to various customer classes. The Commission finds that cost of capital by customer J class should be analyzed and included in the cost of service and rate design studies in MPC's next electric rate

case filing.

III. Resources ~

168. The major areas of controversy pertaining to the resource mix which have not been previously discussed are:

a. Whether for ratemaking purposes generation from Corette, Colstrip 1 and 2 and opportunity purchases for the test year as adjusted should reflect actual 1982 levels;

b. Whether the Bird plant should be used to generate energy (primarily during lower than median water years);

c. Whether Hanford Extension energy should be excluded as a known and measurable change;

d. Whether maintenance periods can be shifted to balance the resource mix;

e. What price levels and volumes should be associated with secondary purchases and sales.
Each of these will be discussed in turn, following a brief discussion of MPC's resource system.

169. By way of explanation, MPC owned generating resources consist of the following:

	Energy (Ave. MW)[4]	Peaks (MW)[4]
Hydro System at Median Water	404	518

[4] As explained by Gregg -- MW is analogous to Miles per hour at any given time, average MW is analogous to the average miles per hour over some period of time, in this case a year.

Hydro System at Critial Water	337	518
Thermal System:		
Bird	49[5]	70
Corette	139	180
Colstrip 1 & 2	270	330
Colstrip 3	138[6]	210

170. All resources are stated without consideration given to maintenance.

Each generating unit needs periodic maintenance.

171. Additional resources are acquired in the form of purchases or exchanges with other power sources, conservation and any load shaping ability the Company can acquire.
172. The last major hydro facility acquired) by MPC was the Cochrane Dam, which was built on the Missouri River 'and became commercially available in 1958. The first major thermal facility built by MPC was its Bird plant, an oil or natural gas fired unit built in 1951 at Billings. Bird's purpose was to provide reliability to MPC's then all hydro system in the event of poor water conditions. MPC's first base load coal fire plant, the Corette plant, went into service during 1968 at Billings. The next three coal fired plants, Colstrip Units l, 2 and 3, were constructed at Colstrip and became commercially available during 1975, 1976 and 1984, respectively.

173. The purpose of the coal fired units was, by design, for use in high load factor or continuous run situations. Of course, they are run at times of peak sales, but they are not

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[5] See discussion below.
[6] At test year capacity Factor

turned on and off (cycled) to meet peak demand as other units are. To meet peak sales, the thermal system can be run harder than usual, the Bird plant can be cycled on, water behind hydroelectric dams can be released at a faster than normal rate and MPC can buy from others who either have excess capacity generally or whose systems have different characteristics than MPC's, such as heavy air conditioning demands, and consequently have temporary surplus capacity at the time MPC needs electricity.

174. The transactions among utilities to supply each others' demands is done in a quasi free marketplace setting, with FERC providing price controls which generally establish ceiling rates based upon the fully distributed accounting costs of each facility. Utilities acquire electricity in this manner, on either a long-run (firm) or short-run (opportunity or secondary) basis for the purpose of supplying their own loads or to resell at a profit. If the electricity is acquired from a distant source, energy may be transmitted or "wheeled" over other companies transmission lines at an FERC regulated price .

Point a

175. MPC's Gregg explained the rationale behind adjusting actual test year opportunity purchases and thermal generation:

The opportunity purchases shown are derived from the actual opportunity purchases made in 1982. Since the great bulk of those purchases in 1982 were used to displace our thermal generation, we have here reduced the actual 1982 opportunity purchases to the extent that we have increased actual 1982 thermal production for Colstrip Units #1 and #2 and Corette in the test year. Thus the sum of opportunity purchases,

Colstrip Units #1 and #2, and Corette thermal production in actual 1982 are held constant. And since Corette has the highest running costs of the thermal units (excluding Bird) it becomes the "serving" plant used to maintain that balance. (Exh. 2, Gregg, p. 32).

176. Several intervenors took issue with that. approach. For example, MCC's Clark testified that MPC's approach was based "on the premise that, with median water conditions, as thermal generation increases available opportunity purchases would tend to decrease". (Exh. 43, p. 5).
Additionally, he stated:

I do not disagree with the proposition that with median water, opportunity purchases would tend to be less and thermal generation would be increased. However, the company has not shown that with median water, the marketable energy in any month cannot exceed median hydro plus the sum of actual 1982 thermal generation plus opportunity purchases. I do not believe the market is so limited and therefore reject the adjustment of Corette generation to below expected levels. (Exh. 43,
-3 p. 6).

177. The Commission finds Clark's judgment to be correct. MPC did not adequately rebuts his assertion. Consequently, the Commission finds that Corette generation should be adjusted to 136 average MW for the months of February, March, July, and August.

Point b

178. MPC included the Bird plant in its test year energy

tabulation at zero (0) average MW. It did so for two reasons:

a. Colstrip 3's inclusion in the tabulation resulted in energy surpluses in each month. Since Bird's running costs are higher than any other thermal unit from an operational point of view, it seemed logical to use Colstrip 3 output and to back down Bird.

b. Bird is not dependable.

179. As with other issues, various intervenors raised the possibility of using Bird as an energy resource, primarily to meet load under less than median water conditions. NPRC's Lazar specified that Bird should be used at up to a 70 percent capacity factor under critical water conditions. He reasoned that the use of Bird at this capacity factor may occur "once-in-a lifetime". (Exh.- 24, pp. 41, 42). During less adverse low water conditions, its capacity factor would probably be lower.

180. In rebuttal, MPC contended that the Bird facility was not dependable, and that it should be essentially used as a peaking plant:

Q. In reality, are there other factors which potentially limit Bird's ability to produce energy?

A. Yes, there are. There are at least a couple that are important that I should nave mentioned at that time, I guess.

First of all, Bird's fuel supply is rather insecure. There is insufficient natural gas to fire Bird out of the Heart Mountain field. We have been storing oil for

Bird I so that it will be available on a firm basis for a peaking plant, but the oil supply itself is rather insecure. I think all one need do is think of the turmoil in the Mideast, remember the Fuel Use Act of 1979, I believe, and remember that the crisis of that period can certainly be repeated at the drop of a hat in the Mideast, and we can again be in a very constrained position with – for getting fuel for the Bird Plant.

The plant is now over 30 years old. It has some problems with the shaft. In fact, we had to rebore the shaft four or five years ago to get rid of some cracks in the shaft. You only get one chance to rebore a shaft on a unit of that type. The boiler tubes are getting in rather old shape, and hopefully the unit will last some time longer. as a peaking unit without having to retube

the boiler. (Tr. pp. 1801, 1802).

181. Under later cross-examination by NPRC attorney Smith, MPC witness Lewis addressed the issue previously raised by MPC that there may not be fuel available to run the plant:
Q. In your opinion, is there sufficient oil and natural gas available to Montana Power in the next ten years to run Bird if it needed to for energy purposes?

A. Pardon me?

Q. For energy purposes rather than peaking purposes?

A. For the next ten years, I would, just from a general observation summize that there is probably sufficient natural gas available. There appears to be sufficient oil available,

at least for the next five years, in the general market. I think that the availability of those fuels is always subject to the potential vagaries of world market, and, you know, you factor that in, and you can say, "Well, there wouldn't be any available if, or whatever". But it appears, at least for gas, that we should have gas available to us for ten years. (Tr. p. 2047).

182. Gregg's testimony about the mechanical reliability was the subject of cross-examination in several instances, with the following points being
made:

a. Although the shaft was rebored "Four or five years ago", Bird was included in MPC's long-range plan as available until the year 2000 as a peak or energy resource (Tr. pp. 2035, 2936). Under cross-examination, Mr. Gregg admitted that Bird was run at a 48 percent load factor or 33.8 average MW during 1980, well after the shaft had been rebored (Tr. p. 1322).

b. The Bird plant's average annual MW production between 1951 (the year it became commercially available) and 1982 was 13.96 average - MW. (Tr. p. 2033). It's highest production was during 1962, when it produced 39.55 average MW (Tr. p. 2031).

This information is relevant from two perspectives:

1) During this timeframe, the plant was available and used to meet load during less than median water conditions, and, in fact water conditions approached critical . several times. The point is that, although Bird may occasionally be run at a fairly high load

factor during adverse water conditions, it's average load factor over time would be quite low.

2) Because of the low historic average load factor, the Commission is very dubious about MPC's assertion pertaining to Bird's mechanical condition. Gregg did not demonstrate that mechanical factors had ever been responsible for extended curtailment of Bird's output.

183. MPC took little exception to the economic advantage Bird exhibited as a hydro firming resource. Under cross-examination Gregg specified that the total costs for Bird were 56.65 mills/kwh during 1980, the last year Bird was run at a higher than average capacity factor (Tr. p. 1706). Additionally, other costs associated with it, such as carrying costs, were negligible, since it is nearly fully depreciated. Clearly, its economics are somewhat akin to that of a peaker, i.e. a low capital, high running cost facility is a rational economic choice for low average load factor applications.

184. The Commission finds the Bird plant to be a viable and economic plant to use for energy production. For the most part, it is expected that Bird will be used during periods of lower than median water because of its high running costs, and that its load factor over an extended period will be quite modest. It is reasonable to expect, however, that should the critical period recur (a one time in 50 years occurrence) Bird could be run at the load factor suggested by NPRC's Lazar, 70 percent or 49 average MW. It should be noted that in the test year tabulation, as will be shown later, that Bird needs to be run at only 6.58 average annual MW's to avoid critical water deficits.

184. Since rates are based on median water, no running costs for Bird will be included in this order. (The Commission invites MPC to propose appropriate treatment for actual Bird running costs with its next electric rate filing.) Alternatively, Bird could be ran at 85 percent for 3 months; March, April and October. The likelihood of available secondary purchases certainly provides a reasonable cushion which MPC itself utilizes in its scheduled maintenance plans (FF p. 27).

Point c

186. MPC's energy resource mix did not include output from the Hanford Extension purchase source of supply. Although MPC acquired energy from this source during the test year, its contract lapsed on June 30, 1983. MPC sought approval to exclude Hanford as a known and measurable change to the test year.

187. Hanford output became available to Pacific Northwest utilities during the middle 1960's. Its production resulted as a by product from the manufacture of weapons grade plutonium. It had been shut down in 1971, when the Nixon Administration decided to discontinue the manufacture of the nuclear material, and operation was resumed a year later on a year by year basis until 1977. At that time contracts were signed to run until 1983 (Tr. pp. 1391, 1392).

188. MPC's last rate case filing, Docket No . 82.8.54, included the Hanford resource at. 51 average MW in each month, with the exception of May, June, and July, each of which reflected no Hanford energy. This computes to be 38 average annual MW.

189. MPC was reoffered the Hanford Extension contract during late 1982. Its term was a period to run from July, 1983 - June, 1993 at approximately 40 average annual MW with an initial price of 20-21 mills, escalating (Tr. pp. 1517, 1732). MPC decided not to renew the contract based on the fact that Colstrip 3 was to become commercially available during early 1984 and “was an accomplished fact" (Tr. p. 1730).

190. The Commission finds the following exchange between Commissioner Driscoll and Gregg to be relevant:

> Q. Then one final area. This Hanford problem is really bothering me, and I've read through the data responses, and I think I understand all the arguments that have , been offered for not renewing the Hanford contract that were in the data response: the sporadic shutdowns; during the course of the firm contract earlier; the I possibility that the price would rise to as high as 45, mills from the present level and so forth. But I also see that the contract when it was carried was backed up with a reserve margin to make it firm. It was always considered firm.
>
> I noticed that you would have dropped it several years ago when Colstrip was supposed to have come in, yet you kept it as a firm resource. And I can't escape the observation that somehow Hanford was just dropped to make room for Colstrip 3. And now the only argument that I have been able to develop well in my own mind was the one that was offered by you and Mr. Schmechel that somehow the Hanford plant was less -- the cost benefit was not as great

for Hanford as it was for Colstrip 3 energy.

Would you elaborate on that, please?

A. Well, I have a little problem with your characterization that it was dropped to make room for Colstrip 3. Colstrip 3 was an accomplished fact, as far as we were concerned. And it made no sense to buy additional power which didn't met our planning criteria; that the Hanford purchase would not have deferred an additional kilowatt of requirement on our system in the future that we had planned.

The next capacity expansion in our plan, comes in about 1993, which is when the Hanford purchase, extension purchase, would have ceased. So, it didn't defer anything out in the future. It came along too late to defer Colstrip 3.

Q. Excuse me. Are you interjecting still another planning criteria besides firm resources to meet firm loads? Is there something else that we haven't heard about until now?

A. No. It's the same criteria: the least-cost mix of resources to meet that long-term future load.

Q. Then is –

A. If I may be allowed to continue.

Q. Excuse me.

A. The Hanford extension didn't defer a single thing. It I couldn't defer 3 or 4. And the next requirement on the system is out in '93. And it obviously couldn't defer that because that proposed contract runs out in '93. In addition, it had major uncertainties for us.

Q. If the Hanford 40 megawatts -- I believe you were carrying that for energy -- were in the resource port folio at this time as a firm resource, which is what I think you were carrying it as, would there be less need for 40 megawatts of energy off the plant that we're looking at allowing into rate base with this hearing?

A. There would be 40 megawatts of surplus to have to manage, and we would be paying for that 40 megawatts something in the range of 21 to 40 mills when we could be producing it at Colstrip for 10 or 12 mills, maybe 14 mills. It just doesn't make sense.

Q. Are you saying that you're asking the Public Service Commission to allow Colstrip power into the rate base for 14 to 20 mills?

A. I'm saying that that is the marginal -- or the incremental cost of that production.

Q. So, you're just talking about the variable operating cost and not the full fixed and variable cost of the Colstrip 3 plant.

A. That's correct. ,

Q. Okay, if we were to compare the cost of the Hanford resource as a firm resource with the fully allocated

cost of the Colstrip resource as a firm resource, what's the comparison?

A. Well, we've all heard the numbers. Somewhere in the range of 60 or 70 mills for Colstrip fully distributed versus this purchase for ten years when we don't need it, of something like 20 to 40 mills. (Tr. pp. 1729-1732).

191. The Commission takes serious exception with Gregg's statement "Colstrip 3 was an accomplished fact, as far as we were concerned. " The subject of greatest contention in this proceeding is whether or not Colstrip 3 is "used and useful" to MPC ratepayers. The rate basing of Colstrip 3 is far from an accomplished fact.

192. The Commission finds consideration of the used and useful criteria must be in the context of the test year, as adjusted. The used and useful standard does not second guess management decisions over some prior period, I but rather it is a marketplace test to be applied in the context of current circumstances, in this instance, the test year. Since the Commission's basic responsibility is to act as a surrogate for the competitive marketplace, it finds Gregg's "accomplished fact" reasoning to be faulty. The competitive marketplace is unconcerned with past management decisions of whether or not a plant should be built. Rather it efficiently determines the present day usefulness of the plant.

193. The Hanford resource was acquired by MPC in the form of purchase power, and should not cloud the test year used and useful determination of MPC's incremental Colstrip 3 resource. Neither should Colstrip 3 be determinative of the Hanford resource. Hanford must be evaluated on its

own merits.

194. The record contains several references to firm long-term transactions by which the 20-21 mill/kwh Hanford price can be compared. The fully distributed cost of MPC's most recent investor owned rate base resource additions, Colstrip 1 and 2, was shown to be 30.4 mills/kwh (Duffield Exh. 30, p. 6). Another gauge of price was the firm five year sale of BC Hydro energy to California. As was discussed previously, its price was 22 mills escalating. Yet another gauge would be the Black Hills Power and Light Company purchase from Pacific Power and Light Company of 15 average MW in the first year (1984) at 37 mills/kwh, escalating. Clearly, from the standpoint of comparable price for firm contracts, the Hanford price of 20-21 mills was reasonable. The Hanford resource is less expensive than
Colstrip 1 and 2.

195. Although Hanford has been relied upon by MPC since the early to mid 1960's as a firm resource, both Schmechel and Lewis contended there may be an element of unreliability with it, particularly with its use during peak periods (Tr. pp. 845, 2062). However' under cross-examination Lewis ultimately specified two reasons why MPC did not renew the contract, neither of which pertained to energy reliability:

a. It wouldn't be available to defer MPC's projected 1990-91 peak deficit, (Tr. p. 2065) and

b. It was more expensive than Colstrip 3 running costs (as opposed to fully distributed costs). (Tr. p. 2065).

196. With regard to the first point, MPC has been relying on Hanford primarily as a baseload energy resource for several

years, although it has also been available to meet peak (see late filed exhibits). The Commission -- finds unreasonable the proposition that a reasonably priced 40 average MW baseload energy resource should be abandoned because of its alleged uncertain availability to meet peak. The Commission, was presented with evidence that showed Corette and Colstrip 1 and 2 availability as being uncertain during the December, 1983 peak (Exh. 12). Plant or resource potential availability during peak periods is the reason peak reserve margins are and have been carried for all resources, including Hanford:

Q. Mr. Gregg, I'm a little confused about why Hanford would affect the reserve requirements in view of your answer that purchases don't carry reserve requirements.

A . Well, yeah, that's a good question . The -- in the forced outage reserve calculations, the -- during the periods when the -- when we had the Hanford extension in place, it was assumed that we had a unit sale out of Hanford and the purchasers were responsible for any reserves associated with that. Now that's a, that's a slight departure from what I generally said about purchases. We are not carrying the reserves, for instance, for the WPPSS No. 1 plant. That's Bonneville's responsibility under the contract.
(Tr.pp. 1671, 1672).

Additionally, if MPC finds itself peak deficient, it can provide specifically for peak resources. For example, in the test year it has included two peak purchases: 50 MW from its long series of agreements with Washington Water Power and 100 MW from its long-standing Bonneville Power Administration peak/energy exchange.

197. In considering the second point even if the Commission

were to accept MPC's assertion that the relevant Colstrip 3 costs to compare Hanford against were running costs (which it does not), the two resources would be essentially equal in cost during the test year:

Running Costs	Hanford	Colstrip 3
Energy	A) 20-21 Mills/kwh	C) 16.54 Mills/kwh
Transmission	B) Included in energy charge	D) 3.65 Mills/kwh
Total	20-21 Mills/kwh	20.19 Mills/kwh

A) Tr . pp . 1i31, line 16 and 1732 line 10
B) Tr. p . 2066, lines 11 and 12 ,
C) Exh. 13, #1, Test Year Production Costs - Colstrip 3
D) Exh. 14, #1, Test Year Operating Costs - Twin 500 Kv lines

198. The Commission finds that consideration of total costs, however, to be the relevant consideration since it is those costs ratepayers are asked to absorb n rate requests. In this light, Colstrip 3 and the twin 500 Kv lines would cost 78.07 mills/kwh in the test year (Exh. 13, 14).

199. The Commission finds that it cannot accept MPC's known and measurable change to exclude Hanford from the test year. Both in terms of energy reliability and cost, Hanford is, as it. has been, a viable and economic resource. The Commission will include Hanford as a resource at 21 mills/kwh at 40 average annual MW, or 53 average MW for all months except May, June and July.

Point d

200. The Commission intends to remain cognizant of providing optional generating plant maintenance schedules so that both fixed and running costs can be minimized. The decision of the Montana Power Company not to accept the Hanford extension

contract is contrary to the utilities obligation to meet its customers 1cad demands with least cost resources. Under cross-examination by Montana Irrigators' attorney John Doubek, Mr. Gregg explained how the Company planned its maintenance:

Q. And in that connection, you indicated that you cannot always plan for maintenance, say, a year ahead of time, but how long ahead of time would you be able to plan for maintenance?

A. Well, normally, we do plan for maintenance about a year ahead in order to schedule the following year's operation. And the normal scheduled maintenance on each of these

units is somewhere in the range of three to four weeks, recognizing that we have to get a lot of maintenance done in short periods, while there is a good likelihood of secondary on the market to help us cover that outage in the springtime.

Q. And you can plan for that secondary power being available a year ahead of time, then? Is that what you're saying?

A. No, we can't. We can't. That's the point. We don't really have a good feel for how much of that secondary is going to be available until late winter, early spring.

Q. But you evidently have a pretty good handle for being able to plan for maintenance a year ahead of time.

A. We have to plan for maintenance a year ahead of time just to plan the annual operation and so that the plant personnel can get their own maintenance plans in order.

Q. And in fact, that's what the Company does, then, correct?

A. Yes . (Tr. pp . 1301, 1302).

201. The Commission finds peculiar MPC's reliance on the "good likelihood of secondary on the market to help us cover that outage in the spring time", especially in light of their adamant adherence to the "firm resources for firm loads" criteria that was discussed earlier.

202. The Commission's loads and resources findings to this point have I produced a monthly tabulation reflecting surpluses in each month with the exception of May and June, each of which reflect a 36 average MW deficit.
These months are, of course, the months of heaviest runoff in the Pacific Northwest. They are also the months in which Colstrip Units #1 and #2 are scheduled for maintenance. Using MPC's philosophy, it may be proper to plan on meeting the May-June deficits from potentially available secondary in
those months. The Commission will decline this ~ course of action, however.
Rather, it finds the Colstrip Unit #1 maintenance should be performed in March and Colstrip Unit #2 maintenance should be performed in October.

Both months have firm surpluses large enough to absorb the maintenance related deficits. The shift in maintenance schedules also results in firm surpluses for the months of May and June; therefore, as adjusted all months in the test year reflect firm surpluses with critical water, without Colstrip 3.

203. One final point with respect to maintenance pertains to MPC's

flexibility in the event abnormal conditions arise which differ from those ~ presented in the "normalized" test year. Doubek cross-examined Gregg on this point:

Q. Mv question, maybe you can answer it, is that, isn't it the that Colstrip No. 1 was not even scheduled for maintenance in 1982?

A. That's what that tabulation would appear to say.

Q. Isn’t it true, then, that that indicates that as conditions change, so will the amount of maintenance taken?

A. Yes. (Tr. p. 1324).

204. The Commission finds MPC's expressed flexibility in this area to be adequate, although its main concern from a rate perspective is the normalized test year.

205. The Commission finds the following firm loads and resources tabulation at critical water:

THE MONTANA POWER COMPANY

POWER OPERATIONS

TEST PERIOD LOADS AND RESOURCES

	JAN82	FEB82	MAR82	APR82	MAY82	JUN82	JUL82	AUG82	SEP82	OCT82	NOV82	DEC82	TOTAL
1. MEDIAN HYDRO	415	369	346	434	424	467	460	349	379	356	423	424	4,846
2. HYDRO MAINT.	-3	-6	-13	-18	0	0	-3	0	0	-7	0	0	-50
3. CORETTE	136	136	136	32	136	136	136	136	136	136	136	136	1,528
4. COLSTRIP #1 & #2	267	267	267	267	133	134	267	267	267	267	267	267	2,937
5. BPA REA W1EEL	20	20	14	13	12	17	18	20	15	10	13	15	187
6. BPA PEAK/ENERGY TRADE	-29	-30	-29	-30	-29	-29	-29	-30	-29	-30	-29	-29	-352
7. WPPSS #1	80	80	80	64	24	24	64	80	80	80	80	80	816
8. COGEN/SML, PROD	1	0	0	1	0	0	0	0	0	0	1	1	4
9. HANFORD	53	53	53	53	0	0	0	53	53	53	53	53	477
l0. TOTAL RESOURCES	940	889	854	816	700	749	913	875	901	865	944	947	10,393
11. LOADS AND LOSSES	888	835	762	717	698	718	727	740	735	756	823	855	9,254
12. SURPLUS WITH MEDIAN WATER	52	54	92	99	2	31	186	135	166	109	121	92	1,139
13. ADJUSTMENT FOR CRITICAL WATER	(37)	(5)	(0)	(100)	(87)	(116)	(143)	(81)	(101)	(12)	(70)	(50)	(802)
14. ADJUSTMENT FOR BIRD AS A HYDRO													

FIRMING RESOURCE	49	49	49	49	49	49	49	49	49	49	49	49	588
15. SURPLUS WITH CRITICAL WATER	64	98	141	48	(36)	(36)	92	103	114	146	100	91	925
16. MAINT. REDISPATCH			(133)		134	133			(134)				0
17. ADJUSTED SURPLUS WITH CRITICAL WATER	64	98	8	48	98	97	92	103	114	12	100	91	925
18. BIRD CAPACITY INFO. ADJUST.-REDUCT. IN BIRD TO REFLECT ZERO · DEFICITS	(49)	(49)	(8)	(48)	(49)	(49)	(49)	(49)	(49)	(12)	(49)	(49)	(509)
19. SURPLUS AT CRITICAL WATER WITH BIRD AT 9.4% CAPACITY FACTOR	15	49	0	0	49	48	43	54	65	0	51	42	416

206. It should be noted that Colstrip 3 output is not required to meet test year loads with the adjusted firm resource mix at critical water. The Commission, therefore, finds that Colstrip 3 and the related twin 500 Kv transmission lines are not used and useful, and should not be included in rate base.

Point e

207. The final loads and resources discussion, that pertaining to secondary off- system purchases and sales, can be given perspective by summarizing values associated with them in the case:

MPC 83.9.67 (Colstrip 3)

Loads-Resources, Partial

	Out of State Sales Mills/ kwh				Opportunity Purchases Mills/kwh			
	Gross Revenue	MWH Volumes	Unit Rate	Ave. MW	Gross Expense	MWH Volumes	Unit Rate	Ave. MW
A. July, 1980-June, 1983 Actual	152,925,146	5,822,837	26.26	222	49,011,825	3,810,663	12.86	145
B. Projected per 1983 Business Plan:								

1983	23,920,000	1,455,000	16.44	166	15,758,000	1,852,000	8.51	211
1984	27,671,000	943,000	28.44	108	522,000	52,000	10.04	6
1985	39,786,000	1,284,000	30.99	147	992,000	95,000	10.44	11
1986	43,314,000	1,336,000	32.42	153	-	-	-	-
1987	45,794,000	1,326,000	34.53	151	-	-	-	-
C. Rate Case Application	34,746,841	1,796,600	19.34	205	7,551,918	504,840	14.96	58
D. Interim Filing	39,374,558	2,004,577	19.64	229	11,039,474	712,560	15.49	81
E. 1983 Actual (Purchases through September)	17,014,466	1,157,690	14.70	132	8,758,890	1,449,910	6.04	221

A. MCC DR 1-5

B. MCDR 1-18

E. MCCDR 1-5 & MCCDR 5-II

208. The difference between MPC's application and the interim filing was the inclusion in the interim case of purchases which were directly resold off-system. MPC became aware of this deficiency during discovery, and it is accepted by the Commission.

209. MacGregor suggested that the 1984 projected off- system sales prices as included in the 1983 business plan be used to adjust for any anomaly in MPC's prices. Both he and Yankel contended that MPC did not account for normal market conditions as a factor in adjusting test year off system sales prices:

> Presumably under more normal circumstances, the price of opportunity sales would be higher as well as the revenue from off system sale, thus creating a larger market for thermal power from ~ MPC. The Company increased maintenance expenses by $1,373,000 over actual levels to reflect the normal use of outside labor during maintenance shut downs when a lot of work must be compressed into a short priod of time. However, it made no offsetting adjustments to revenues which would reflect what actually happens to the price commanded by the Company's off system sales when water conditions in the Northwest begin to approach normal. (Yanker, Exh. 18, p. 18).

Gregg explained that no adjustment to opportunity purchases or sales was made because price changes were not known land measurable. He also explained that market conditions controlled market prices. (Gregg, Exh. 3, P. 39).

210. MacGregor presented testimony and schedules pertaining to the profit margin between opportunity purchases and sales.

Schedule RBM-8, page 2, showed actual 1980 to have the highest profit margin (20.37 - mills/kwh) while actual 1982 had the lowest (7.71 mills/kwh). This filing, as adjusted in the interim case, was significantly below any of the above (4.15 mills/kwh). MacGregor's adjusted profit margin, shown on schedule RBM-8 p . 1, was 10.31 mills/kwh.

211. MPC witness George Hess presented testimony in MPC's last electric filing, Docket 82.8.54. regarding profit margins:

> For the most part Mr. Gregg assumed that opportunity purchases would be sold at nearly cost. For example, for the month of January Mr. Gregg assumed that opportunity purchases would be 20 average megawatts. That is 14,880 megawatt hours which he priced at 20 mills for a cost of $297,600 That additional energy, after taking 10 percent losses, -was then resold at a price of 22.24 mills per kwh which yields only $297,838. After paying $179 Montana Consumer Counsel tax on the revenue, $4 in state income taxes and $25 in Federal income taxes, the utility operating income was increased by only $30. To assume only $30 of profit on $300,000 of out-of-state sales is nonsense. (Direct pp. 8, 9).

The same example with MPC's profit margin in this case would produce $55.58 of profit, an equally nonsensical result.

212. The Commission finds the 1983 actual profit margin of 8.66 mills/kwh to be the logical alternative to MPC's proposal. Although it is similar to the lowest historical margin presented, (1982's 7.71 mills/kwh), the Commission finds it to be reflective of market conditions during the test year. It is also reflective of the surplus

energy situation in the Pacific 7 Northwest because of its similarity to 1982, which was a better than median hydro year. In addition, use of the 1983 amounts should quiet MPC's concerns regarding the known and measurable criteria.

213. The Commission finds opportunity purchases to be 81 average MW at a price of' 15.49 mills/kwh and out of state sales to be priced at 24.15 mills/kwh. Since firm surpluses total 94.9 average MW in addition to the 81 average MW of opportunity purchases, out of state sales volumes are found to be 175.9 average MW.

Hanford Deferred Liability

214. Under cross-examination by staff attorney Opal Winebrenner, MPC witness Jerold Pederson explained the nature of the Hanford deferred liability:

Q. First of all, is it correct that there is a deferred liability associated with that extension agreement from November, 1977 to June, 1983 that is for power that was taken but not paid for? Is that correct?

A. There is a liability that has been accrued on the books over the period of time that we received the energy from the Hanford extension. We have obligations to pay what are called relocation costs for a period through 1996. We accrued that total cost during the period of time that we received the energy, so I believe the answer would be yes to your question. (Tr. pp. 3385, 3386).

He further explained that the liability was $3.7 million at the end of 1982 and $4.2 million at the end of 1983, the year the 1977-1983 extension was terminated. Full repayment of the liability would occur in 1996 through a series of annual $390,000 payments which commenced in 1980. Several pre1980

payments were also made which totaled $600,000. Pederson was also questioned about how the liability was reflected in rates:

Q. Mr. Pederson, was the approximately $3.7 million, or I'm assuming the monthly payments for that accumulated liability, when was that put into rate base, or how was it put into rate base, or rates?

A.- I would assume that it would have been reflected in rates over the period of time that we received the energy, the accrual in excess of the operating cost. You pay both operating costs on an annual basis and these other costs which were to be paid principally on the relocation on a delayed basis. They were all accrued during the years in which the energy was received.

Q. Is this deferred liability interest-bearing?

A. No.

Q. Have you, in the accounting of this sum, used it as an off-set to working capital?

A. In the determination of rate base

Q. Yes.

A. I don't believe that it has. (Tr. p. 3387).

Staff attorney Winebrenner cross-examined MCC's Clark on the proper disposition in this case of the deferred liability and annual payments:

Q. Mr. Pederson testified that the deferred liability was reflected in MPC rates; that is, the accrual in excess of the annual operating costs during the period of time that

MPC received the Hanford energy

Now, in your opinion, Mr. Clark, would you suggest any ratemaking adjustments be made based on that testimony?

A. It's my belief that the ratepayers during the time the , energy was being received paid more than Montana Power paid out; therefore, the accrued liability. There, you have essentially the same situation. What you have is a I rate-base offset required to recognize the customer-contributed nature of the capital. And then you have to provide some way to get this credit back to the ratepayers. There are -- you have the option, once again, of immediate flow-through -- or flow-back. If you do that, then you have to -- then there would be no rate-base offset because you would no longer have the accrued liability on the books, and you would have to provide for the annual amortization of the $390,000 through 1996.

Alternatively, you could amortize it back over some reasonable period of time and recognize the customer-contributed nature of the liability. And a reasonable period of time would, again, be -- or could, again, be the five-or-six-year period, approximating the period of time over which the energy was received. Or, if you wanted to stretch it out longer, the amortization could be to the 1996 period.

A policy decision has to be made on whether you want to give it back immediately or whether you want to amortize it back over some reasonable period of' time. Those, basically, are your alternatives. (Tr. pp. 3611, 3612).

215. The Commission finds that MPC has had the use of an

increasing amount (JL ratepayer supplied capital since 1978 at effectively a zero percent rate of interest. The Commission will not attempt to credit ratepayers for the time value of money, but rather it finds that the deferred liability should be prospectively returned to ratepayers as rapidly as possible. According, the Commission directs MPC to credit ratepayers with the $4.2 million balance, over a two year time period. One half the amount, or $2.1 million should be credited against rate base to reflect the continued availability to MPC of this amount, on average, over the two years . The annual payment of $390,000 should be applied to expense as an offset to the adjustment.

Puget Retroactive Payment

216. Several MPC witnesses were cross-examined by PSC staff attorneys on the nature of a retroactive payment Puget Sound Power and Light made to MPC for use of transmission facilities. (Tr. pp. 1686-1690, 3355, 3356, 3501, 3502). The essence of their explanation was that Puget underpaid MPC by $1,526,000 for the use of 230 Kv transmission facilities during the period 1976-1983. The transmission facilities and payments made by Puget had been reflected in rates during this period. The retroactive payment level was not agreed upon by MPC and Puget until 1983, however, and

therefore did not provide an offset to the return and expenses paid by ratepayers during 1976-83 on the transmission facilities. Staff attorney Winebrenner cross-examined MCC's Clark on the proper disposition of the payment:

Q. Right. Now, Mr. Clark, it appears' that the 1.5 million

approximate retroactive payment from' Puget to Montana Power Company has been removed from, the proforma revenues. Has it been?

A. It is my understanding that it has been.

Q. Now, given that payments from Puget were meant to offset amounts that had been included in Montana Power's rate base that were used to serve Puget, in your opinion, do you believe that the retroactive payment of the 1.5 million should be passed through to the ratepayer?

A. Yes, I do, given the assumption that the plant was in rate base during the period 1971 to -- I'm sorry, 1975 to 1981.

Q. And how would you propose to make such a pass-through?

A. I guess the first alternative would be to flow it back I immediately, to make a one-year revenue credit. I

Alternatively to that, you could flow it back over some reasonable period of time, and a reasonable period of time in this case may be five or six years or the approximate length of the -- to which payments relates. But if you do that, you need to recognize the noninvestor supplied nature of the capital and provide for a rate-base reduction. (Tr. pp. 3609, 3610).

217. In accordance with Clark's recommendations, the Commission finds that the $1,526,000 retroactive payment should be credited to ratepayers over a two year period of time, and that the average unamortized balance of $763,000 should be deducted from rate base to reflect

ratepayer supplied capital over the amortization period.

2l8. MCC witness Clark recommended ended an allowance for funds used during constructive (AFUDC) for that portion of Colstrip 3-related investment not given rate base treatment. (Exh. 44) MPC, through Woy, supported this approach. (Exh. 3). By contrast,- Lazar and Power have vigorously opposed such treatment. (Exhs. 24 and 39).

219. AFUDC treatment was afforded investment associated with the Coyote plant that was excluded from rate base in the MDU case. Docket No. 81.1.2. The Commission finds that such treatment is not appropriate in this case. The basis for that conclusion rests both with the testimony in this case and in the Commission's own experience with MUD in a subsequent case. No party opposed AFUDC treatment in Docket No. 81.1.2. By contrast, such treatment was opposed by substantial evidence in this case, on grounds with which the Commission agrees. The Commission's experience with MDU also suggests that the utility was better off than it would have been if rate base treatment had been afforded. In ratepayer terms, ratepayers paid more for AFUDC treatment than they would have if rate base treatment had been afforded. Absent evidence to the contrary, the PSC does not believe that the "actually used and useful" criteria is intended to achieve in such a result.

MCC Adjustments

Lobbying Expenses

220. In response to PSC data request No. 7-25 MPC indicated

that "Lobbyists expenses charged to 1982 electric operation and maintenance expenses which total $34,834 were not eliminated in the original filing for Docket No. 83.9.67". Clark, an expert witness for MCC reduced expenses by $35,000 (rounded) to eliminate lobbying expense. MPC in its interim filing reduced O & M expenses by $37,252 to remove lobbyist travel and living expenses which had been included in the original filing (p. 129 of 250 Interim Workpapers) . The Commission finds a reduction of $37,252 to eliminate lobbying expenses to be appropriate.

Pro Forma Interest Expense

221. MCC witness Clark calculated pro forma interest expense using the same procedure approved by the Commission in past decisions, including MPC Docket No . 82.8.54. The method involves taking the weighted cost of debt times the utility rate base plus construction work in progress (CWIP). The Commission approves the use of pro forma interest to give recognition in current rates of the deduction of interest on construction borrowings. Since there are regular additions to rate base from construction, there is no reason to ignore interest which is currently deductible. In this docket the Commission finds $33,135,966 in interest expense.

Other Adjustments

223. MCC made adjustments to revenues and expenses as a result of revised power supply costs in the Company's interim which the Commission received after MCC filed its testimony. These changes are accepted by the Commission and are incorporated in the loads and resources section of this order.

224. MCC made an adjustment for excess coal profits for plants Corette, Colstrip 1, 2 and 3. The Commission in the Captive Coal portion of this order uses the MCC methodology as adjusted to reduce coal profits by Western Energy on sales to Corette and Colstrip 1 and 2. Since none of the Colstrip 3 plant is being included in the ~ rate base for the test year, no related captive coal adjustment is necessary or proper.

225. MCC suggested that output from the Corette station be increased to 136 MW in every month except April. The Commission concurs with this recommendation, which is discussed in detail in the loads and resources section of this order.

226. Two other adjustments relating to Colstrip 3 were proposed by MCC: (1) reversing two "normalizing" adjustments which were five year averages for test year operating and maintenance expenses and special maintenance; and (2) eliminating 100 MW of capacity MCC witness Clark designated as being excess capacity. Both of these adjustments would have been considered if the Commission had included all or part of the output of Colstrip 3. However, since none of the plant is being included in the ratebase for the test year these two adjustments are moot.

Champion International Adjustments ;

227. MacGregor, an expert witness for Champion sponsored seven revenue requirement adjustments as follows: (1) recognize termination of Colstrip Construction Trust; (2) adjust capitalized interest to properly reflect income tax benefits; (3) restate 1982 rate base to be consistent with Colstrip 3; (4) normalize capacity utilization of Colstrip 3; (5) recognize peaking capacity cost changes; (6) conform

system sales revenues to Colstrip 3 in-service data and; (7) price off-system sales to reflect power cost increases.

228. During the hearing MacGregor withdrew his first adjustment which related to termination of the Colstrip Construction Trust. MacGregor was cross-examined about his first adjustment:

Q. Now, as I understand it, you have striker your Adjustment No. 1, is that correct?

A. Yes, which is the adjustment of RBM-2.

Q. Was that decision made in light of information submitted by Montana Power in the rebuttal testimony?

A. That was done in light of Montana Power Company updating their capital structure, to be more or less consistent with what my schedule was intended to do by way of an update. (Tr. p. 2935).

229. In his second adjustment, MacGregor proposed to reflect additional capitalized interest expense which would reduce the MPC revenue requirement by $12,508,640. MacGregor increased the CWIP balance to reflect the average balance for 1984. He also proposed to apply an interest rate of 10.5 percent to CWIP. The Commission finds that the capitalized interest adjustment proposed by MacGregor to be improper. Use of a 1984 average balance for CWIP creates a mismatch with the 1982 test year in this docket. The Commission is satisfied that the pro forma interest adjustment provides a proper reflection of test year interest expense.

230. MacGregor proposed in his third adjustment to restate

the 1982 rate base to be consistent with Colstrip 3. At page 12 of his direct testimony he explained the reasoning for this adjustment.

> If it is reasonable to adjust 1982 actuals to include Colstrip 3 and the 500 kv line at 1984 values when structuring the test year, it is consistent and equally reasonable to adjust the 1982 actual rate base to a 1984 value.

231. Since the decision in this case excludes Colstrip 3 and related facilities this adjustment is moot. However, the Commission would not have accepted this adjustment in any event. MacGregor implied in his testimony that the test year before the Commission was 1984. This is not accurate, the test year of 1982 was adjusted to reflect the major plant addition of Colstrip 3. The presentation of a 1982 test year adjusted for a major plant addition is correct given existing regulatory practice in Montana. Attorney Lopach questioned MacGregor on this point:

Q. Did you review the past practice of the Montana Public Service Commission on ratemaking treatment of generating plant additions to see if Montana Power's approach is consistent with that precedent?

A. No, I didn't. I reviewed Montana's filing and gave my judgement as to what I thought were appropriate adjust meets to be made. (Tr. p. 2970).,

232. In future rate cases, witness MacGregor should consider examing the minimum filing standards and past rate orders to develop a proper back ground for recommending adjustments.

233. The forth adjustment which dealt with normalization of the capacity utilization of Colstrip 3 is moot.

234. The fifth adjustment sought to reduce the revenue requirement by $900,000. Instead of reflecting the test year amount of $1,800,000 for a peaking power contract with Washington Water Power, MacGregor recommended using the 1984 level to be consistent with adding Colstrip 3 costs. This adjustment is rejected as being beyond the test year.

235. Sales volumes based on calendar 1984 are recommended by MacGregor in his sixth adjustment. This adjustment is based on Colstrip 3 being added to rate base and is therefore moot.

236. The final adjustment by MacGregor is an increase in the price for off-system sales. The price for off-system sales is discussed in the loads and resources section of this order.

Revenue Requirement

237. The following tables show that additional annual revenues in the amount $4,106,915 are needed by the Applicant in order to provide the opportunity to earn a return of 11.65 percent:

Schedule I
MPC Balance For Return

Revenues	$230,602,617
Total O&M Expense	$126,401,694
Depreciation	15,810,436
Amount of Computer Software	228,953
Amount of MPSC/FERC Plant Dif.	1,458,187

Amount of Milwaukee Line		94,914
Amount of ITC - Dr.		-0-
Amount of ITC - Cr.		(377,585)
Prov. for Def. Inc. Tax-Accel. Depr.		5,634,086
	Kerr Rents	(239,522)
	MPSC/FERC	713,092
	Mt. Corp. Lic.	(291,647)
	Arbitrage	1,066,032
	Accel. Amount	(76,500)
Taxes Other Than Income Taxes		18,282,074
Income Tax Federa		l 7,369,278
Income Tax State		1,124 223
Total Cost of Service		$177,197 715
Balance for Return		$ 53,404,902

Schedule II

MPC Revenue Requirement

Rate Base	$476,775,562	
Rate of Return	.1165	
Required Return		$55,455,352
Less: Balance for Return		53,404,902
Revenue Deficiency		2,159,450
Times Tax Multiplier		4,153,226
Allocation to REC customers		146,311
Revenue Increase		$4,106,915

COLSTRIP COAL

Introduction - Colstrip Coal History

238. Both MCC witness Dr. John W. Wilson and MPC witness Paul

Schmechel provided testimony in this case detailing the history of MPC's involvement with the Colstrip coal properties. Wilson relied extensively upon MPC annual reports in his testimony to provide background information about the period of the coal properties acquisition and several subsequent years:

Q. IS THERE EVIDENCE THAT WESTERN ENERGY WAS ORIGINALLY CREATED AND VIEWED BY MONTANA POWER ESSENTIALLY AS A VERTICAL EXTENSION TO SUPPLY FUEL FOR POWER PRODUCTION?

A. Yes. Western Energy did not even exist when the

Montana Power Company acquired the Colstrip leases from the Northern Pacific in 1959. That coal was acquired b, the electric utility as a' contingency to meet future generating needs in the event that planned hydro additions fell through. In its 1959 Annual Report the Company stated:

"The Colstrip reserves give your company an almost unlimited supply of low-cost fuel for steam electric generating stations."

Likewise, in the 1960 Annual Report, Montana Power stated:

"If the Buffalo Rapids projects are delayed, the Company will be able to meet its 1964-65 and future requirements . . . utilizing the low cost coal reserves which were acquired from the Northern Pacific Railway Company at Colstrip, Montana in 1959."

In 1962, the Company stated:

The indefiniteness of obtaining power from
Buffalo Rapids and High Mountain Sheep creates
no serious problem for your Company because,
due to foresight in acquiring very substantial
coal reserves in southeastern Montana, we are
in the favorable position of being able to build
steam electric plants as and when necessary. "

Likewise, in 1963 the Company stated:

"We plan to meet (our) future requirements
from steam electric plants utilizing our enormous
reserves of low cost coal at Colstrip in southern
Montana and from the High Mountain Sheep and
Buffalo Rapids hydroelectric developments. "
Throughout this period, the Colstrip reserves were

owned directly by the Montana Power Company and were
explicity earmarked for the electric utility's own future
generation needs." (Exh. 63, pp. 9-11)

239. Schmechel's testimony generally agreed with the
chronology set out in the annual reports, although he
provided the insight that the 1959 acquisition was made with
the idea of developing a commercial market in addition to
supplying MPC's future generating needs . (Exh s 2,
Schmechel, pp. 16-18)

240. Both Schmechel and Wilson detailed events which occurred
just proceeding and following Western Energy's (WECO)
formation:

1963-1965	- MPC expanded its coal reserve holdings from 70 million tons to 850 million tons. (Exh. 2, Schmechel, pp. 17, 18)
1964	- It was determined that the Corette plant "will utilize low-cost fuel from the Company's extensive coal reserves at Colstrip in southern Montana. " (Exh. 63, p. 11)
1966	- A mining plan for the Colstrip properties was developed by John T. Boyd and Associates. It was prepared with consideration given to both utility and commercial use. (Exh. 2, Schmechel, p. 20)
	- Western Energy energy was formed as a successor of Western Gas Company, an inactive company . (Exh . 63, p. 12)
	- Construction of the Corette generating station was com . menced. (Exh. 63, p. 11)
1967-69	- Negotiations were undertaken with Consolidation Coal to engage in a joint venture to develop the Colstrip proper ties. (Exh. 2, Schmechel p. 21)
1968	- MPC's first production from the Colstrip properties was realized under the direction of WECO to supply MPC's newly competed Corette generating station. (Exh. 2, Schmechel, p. 21)
1969	- WECO's first commercial sale was consummated under a short-term arrangement with Minnesota Power and Light (Exh. 2, Schmechel, p. 21)

- MPC's annual report alluded to future MPC generating related coal production from WECO:

> "It is anticipated that tonnage will increase as additional generating plants are added by your Company. " (Exh. 63, p. 13)

1970 - MPC developed plans and ordered equipment for the Colstrip 1 plant. (Exh. 63, p. 13)

1971 - MPC and Puget signed an agreement that they would move ahead jointly in the planning of the Colstrip 1 and 2 generating stations. (Exh. 3, LaBrie, p. 2)

- Construction of Colstrip 1 began at Colstrip. (Exh. 63, p. 13)

Race Base Treatment for Coal Properties

241. The Commission concluded preliminarily in its last MPC electric order (Docket No. 82.8.54, Order No. 4938a) that it was unaware of sound reasons Why the WECO coal properties used to serve the Corette and Colstrip generating units should not be rate based. The order reasoned that MPC owned gas properties were in rate base and that the different treatment between the gas and coal properties "seems to be an historical accident". Specifically the Commission found:
In view of this information, there is a serious question as to whether the coal reserves used to provide coal to the Corette and Colstrip plants should not be considered part of utility plant. Logically, it seems difficult if not impossible to distinguish between coal supplies and natural

gas supplies. The latter are part of the rate base and are provided to ratepayers at cost, including the cost of capital. Just as natural gas is the fuel used to provide gas service for ratepayers' utility service, social is the fuel used to provide electric customers with electric service. It is not clear to the Commission why one (natural gas) should be considered an integral part of utility service and the other (coal) should be considered a nonutility function whose ratemaking treatment is based on comparable profits and prices rather than the actual cost of service. (Finding No. 171, Order No. 4938a).

242. The order found that newly presented evidence established that coal reserves and mining equipment were, by contract, committed exclusively to utility operations. It also found that coal reserves held by WECO were purchased by MPC with the intent to use coal for future power plants. Accordingly, the order directed MPC to address the potential rate basing of coal properties in its next filing. In response, MPC presented testimony of witness Paul Schmechel in this filing.

243. Previous Commission orders have considered the captive coal subsidiary - electric utility percent issue in light 'of whether inter-corporate transactions appeared to result in a reasonable rate of return. Order No.
4938a stated:

Transactions between affiliated companies have long been a matter of concern to public service commissions because of the potential for the utility evading effective regulation by capturing excessive profits from its nonutility subsidiary. This special concern has been noted and endorsed by the Montana Supreme Court:

When one of the expenses submitted by MDU is caused by transactions with a subsidiary company, the scrutiny applied by the PSC must be all the more intense . 632 P.2d at 1089. (Finding No. 129, Order No. 4938a)

244. The Commission has concluded on a number of occasions that WECO’s profitability was excessive. For example, Order No. 4938a found that its profitability should be limited to that earned by comparable natural resource companies. The information presented in Docket No. 82.8.54, however, raised the spector that transactions between WECO and the electric utility were not at arms length. It also raised the spector that during WECO's formative years it was very financially dependent on MPC, particularly its electric utility.

245. Staff attorney Eileen Shore posed a hypothetical to MPC witness Charles Olson which pointed out the critical importance of the arms length criteria:

Q. Let's go back to the microwave example for a moment, except please assume that the microwave equipment was never included in utility plant, in rate base; however, please also assume that its depreciation expenses were included in utility expenses, it received substantial no-interest loans from the utility, and its employees received such benefits as employee discounts for electricity.

In that situation, do you think that the competitive-price approach would still be appropriate?

A. I just want to make sure before I answer that I under

stand the nature of the hypothetical. I thought you said that I had never been included in rate base, but

depreciation expense had been charged to the utility cost of service. And that's pretty difficult for me to conceive of. I don't know or can't think of any situations in which something isn't in rate base but the depreciation is charged to the cost of service. Usually those two things go hand in hand.
But assuming, then, that that is in fact what your question is and that is the nature of the situation, some kind of sharing arrangement would have to be worked out. It's clear, given your assumptions, that the rate payers have been charged with a portion of the cost of service .

Q. And it would be true that if competitive prices were charged in that situation, basically the ratepayer would I be charged twice; once through his utility rates and once through the price of the fuel?

A. That's probably true to the extent that some of the capital costs had been previously picked up by the ratepayers.

Q. In view of that, is it true that the competitive-price approach depends on an entirely arm's length relation ship between the utility and its subsidiary?

A. Yes, it does. (Tr. pp. 508-510)

246. The Commission is vitally concerned that factors such a those referenced in the above hypothetical not be existent in the formation or operations of WECO. Their presence at any time would have destroyed the arms length nature of the relationship between WECO and MPC, and their effects would

carry through to present day operations in the form of double charges, i.e. charges reflected in WECO's competitive pricing that were also paid years ago. These concerns were uppermost in the Commission's mind when it asked MPC to address the rate base treatment for utility related coal properties .

247. Schmechel's testimony in this docket addressed various of the Commission's concerns. He testified about certain aspects of WECO's history as well as reasons for formation of a subsidiary. He reasoned that the subsidiary form of corporate organization was superior to including the properties in the electric utilities rate base for several reasons:

a. MPC intended to develop a commercial coal business, in addition to providing its' own generating fuel . Schmechel reasoned that a different level of risk was inherent in the new business. (Exh. 2, p. 18)

b. Other factors, which according to Schmechel, were related to point a: Development expenses for the commercial portion of the business would not be properly inculpable in rate base, allocation problems would arise if the properties were rate based, the perceived acceptability of subsidiary sales to the present utility at market value, the susceptibility of the coal business to labor strikes, the ability of the subsidiary to engage in separate debt financing and the subsidiaries ability to engage in a separate financial research and development program.

c. The price of coal to the electric utility would be higher if the properties were rate based because it would have to bear the full cost of management and

operation of the coal mines and related facilities, and would, therefore, be a less efficient operation.

248. Risk. Schmechel testified that increased risk existed during WECO's formation as a new business and in particular, increased risk was attendant to its decision to sell coal in the commercial marketplace. Cross-examination by staff attorney Shore, however, established the following points:

I. MPC purchased the coal reserves in 1959 with the thought of using the coal for its own generating plan's needs. (Tr. p. 1094)

II. Although WECO was not incorporated until 1966, there was no doubt that Colstrip coal would be used at the Corette generating plant fuel supply as early as 1964. (Tr. p. 1217) Corette became operable in 1968.

III. MPC's first commercial sale, a short-term arrangement with Minnesota Power and Light, was consummated in 1969. (Exh. 2, p. 21)

IV. The original equipment, purchased for $1,500,000 in 1959 from Northern Pacific Railroad (NP), was the primary mining equipment used by WECO between 1968 and 1974. (Tr. pp. 1101-1103)

V. WECO did not reimburse MPC's electric utility for employee discounts received by Western employees in past years. (Tr. p. 1112)

VI. WECO received substantial interest free loans from MPC between the years 1966-1971. (Tr. pp. 1113, 1114)

249. The above points, taken together, clearly indicate that

WECO's was a low risk new business. It had a long term contract with a parent generating utility, it needed to purchase very little additional equipment and what it did need to purchase could have probably been financed with 0 percent interest loans from its parent and retained earnings from profits on coal sales to its parent. The Commission is not persuaded that the formation of a subsidiary insulated the utility from substantial risk, or any risk at all over and above that which would have existed had the coal operations been rate based.

250. The issue of present day WECO risk has been addressed in previous Commission orders:

As noted previously, Dr. Wilson claimed that Western Energy, because of its relationship with MPC is a less risky proposition than other coal companies that do not have a guaranteed customer. (Tr. p. 815) That claim was not contradicted by MPC, and in fact, the Commission takes note that in another docket, MPC has asserted that Western Energy is a relatively low risk proposition.
(Docket No. 82.3.9, Tr. pp. 101-102) Finding No. 137,
Order No. 4938a)

251. Allocation Problems, Development Expenses. Development expenses related to the commercial portion of the business would not be properly includable in rate base, as Schmechel asserts. The Commission however, is hard pressed to understand why this would be determinative of whether or not a coal subsidiary should be formed. It is clear that those costs could be allocated to the commercial side of the business, even though Schmechel testified that difficulty in doing that may arise. MPC routinely makes a myriad of allocations within its operations, such as allocations of

common plant between its gas and electric utilities and nonutility operations and salaries allocations between those operations, such as its legal department's salaries. Schmechel also could not disagree with the assertion that allocation of expenses within WECO would be no more complicated than allocating Colstrip 3 costs among the five owners. (Tr. pp. 1111, 1112)

252. Labor Strike. . Schmechel admitted on cross-examination that neither WECO nor MPC had suffered from any labor strikes during the entire period of their corporate existence. (Tr. pp. 1084, 1085) Schmechel attempted to point out, however, that the existence of a subsidiary would somehow insulate the electric utility from the effects of a strike. (Tr. p. 1085). The Commission is unconvinced that this is in fact the case, especially when the parent utility is entirely dependent on the subsidiary for its coal supply.
Additionally, to electric utility maintains a 30-60 day supply of coal in "dead" storage to protect it against the threat of strikes (Tr. p. 3216-3218).

253. Debt Financing. It is well known, that utilities are more highly leveraged i. e. have more debt than competitive business ventures. While Schmechel's assertion that WECO could issue debt independent of MPC is true, he did not point out the advantages of this ability. The Commission does not understand . how WECO's separate existence would allow a greater level of debt to be issued than if the utility related properties were rate based.

254. Research and Development Expenses. Schmechel pointed out that had the coal properties been rate based as the gas properties had been, development expenses would need to have been paid up front by ratepayers rather than being paid for

by WECO. While the development expenses incurred by MPC's gas utility are indeed paid up front if the well drilled is unsuccessful, those expenses associated with successful wells are not. They are capitalized and recovered on a unit basis over the productive life of the well. The undeleted portion is earned on through rate base treatment. The point is, however, that at least a portion of WECO's development expenses would have been capitalized and recovered over units of production if the properties had been rate based. Of course, Western Energy recovers those expenses in a similar manner from its customers.

255. Efficiency. Schmechel asserted that the subsidiary operation was more efficient than a utility operation would have been. His assertion was based on the premise that the utility operation would be much smaller and only related to MPC's needs. The following contrary points were established during cross-examination:

I. The original equipment purchased ' from' NP for $1,500,000 in 1959 could have served most of the requirements for Corette and Colstrip 1 and 2. (Tr. pp. 1101-1103) The' ability to use this inexpensive equipment to serve much of MPC's utility needs would have provided tremendous cost savings to rate payers, if the low investment had been in rate base;

II. A coal operation the current size of WECO would not be precluded by rate base treatment. The utility related segment could be allocated directly to the electric utility for rate base treatment. (Tr. pp. 1111, 1112)

III. Schmechel appeared to retract his assertion that Western is more efficient than a rolled in utility operation would be:

Q. Mr. Schmechel, is it your opinion that the price of coal that is supplied to the Montana Power Company and its partners, particularly the Montana Power Company, is below what it otherwise would have been under a utility operation, considering an original-cost standard, the utilities' access to lever aged capital, and capital structure and cost of Capital?

A. Mr. Chairman, I think what you're into is asking if I would consider that we could roll the clock back some 18 or more years, which we can't do, and if we had started out as a utility operation in-our coal business, I am sure that the productivity of the people would be as good as the productivity is under many nonregulated mining operations. But we can't roll the clock back. It has been 18 years of operation under Western Energy Company . It's been an efficient process. It is one that has produced a very low-cost fuel to the utility, and it just is -- it's a long, lot of years that have passed, and it is a little difficult to consider now what might have been that long ago.

Q. And you're not prepared to offer an opinion about whether or not the cost-based rates under a rolled-in operation similar to the natural gas operation would have resulted in a unit cost which is less than the market price that you have established?

A. No, I am not prepared to offer an opinion about that, Mr. Chairman. I think - -

Q. Okay.

A. I think, though, that people in Montana Power Company, whether they would be operating a coal mine or whether they would be operating power plants or gas facilities, would be very efficient people. (Tr. pp. 1213, 1214)

256. In addition to the above discussion, the Commission finds the following points germane to the relationship of the coal properties to MPC:

a. Colstrip related depreciation was charged to electric utility expense starting in 1963, three years prior to the formation of WECO (Tr. pp. 1115, 1116)

b. Colstrip related salaries were probably charged to electric operations before the formation of WECO. (Tr. pp. 1116, 1117)

c. Other utilities' coal properties are included in rate base. (Tr. p.1121)

257. The Commission finds that the factual circumstances discussed above reinforce the Commission's preliminary conclusions as stated in Order No. 4938a. It is clear that WECO's formation and its operations were not at arms length. Utilities are required to provide service at the lowest reasonable rate, and the Commission is required to allow rates that reflect the lowest reasonable costs. In view of

those requirements and under the facts presented here, rates should reflect the fact that coal reserves held by WECO were acquired by MPC for utility service, and should be treated the same as natural gas supplies developed by the utility. Under the present approach, ratepayers gain no advantage from the fact that Colstrip coal and facilities were acquired at a very low cost. That acquisition price advantage goes entirely to MPC's shareholders. Had MPC not formed WECO, but simply held coal reserves it acquired in Plant Held for Future Use, there would be no doubt today that those coal supplies would be supplied to MPC's ratepayers at cost of acquisition plus operation and maintenance expenses.

258. The Commission finds that the portion of the Western properties and related expenses used to supply fuel to MPC owned generating units included in rate base should be allocated to the electric utility and included in rate base. The Commission finds, however, that the record of this proceeding does not contain sufficient cost information with which to make the allocation. Accordingly, since the Commission anticipates MPC will file another electric rate case in the near future, it directs MPC to include therein the allocated costs and expenses. Failure to do so will be viewed as a failure to file a sufficient application. In the meantime, the Commission will use Wilson's comparative rate of return approach as the closest available proxy for appropriate rate treatment.

Captive Coal

259. As in a number of recent electric rate increase requests involving all major electric utilities subject to the Commission's jurisdiction, MCC has contested the reasonableness of coal expenses claimed by MPC. In this case,

the issue centers around whether payments made by MPC to its wholly owned subsidiary, Western Energy, 'for coal supplies should be allowed in their entirety. Western Energy supplies all coal requirements for MPC's Corette
and Colstrip plants.

260. In his prefiled direct testimony, MPC witness W. P. Schmechel testified that the coal expense claimed was reasonable and should be allowed.
In support of this claim, Schmechel noted thee coal supplies for MPC's generating stations had been acquired at extremely low cost when viewed against industry standards; that negotiations for the Colstrip 1 and 2 plants were led by MPC's partner Puget Sound Power and Light Company, who had worked hard in assuring that the coal price was competitive; that the independent bidding process conducted by the Arthur D. Little organization concluded that Western's prices were the lowest, over the long-term, of any of the offered prices (MPC Exh. 2, pp. WPS-27 through 30).

261. MCC witness J. W. Wilson challenged the reasonableness of the profits earned by Western Energy, and recommended a downward adjustment in allowed expenses to reflect a 15 percent return on investment. According to Wilson's calculations, Western Energy earned a 24.25 percent return on equity in 1982 (MCC Exh. 64, JW-10, p. 1 of 2). Wilson based his recommendation on a comparison of Western Energy's returns with those of six other coal companies. The returns of the six companies in 1982 were far below Western Energy's (MCC Exh. 64, J.W. 2, p. 1 of 7).

262. Wilson further compared Western Energy's returns with rate of return projections made by Value Line for the six companies (MCC Exh. 64, J.W. 4). Projections for return on

total capital averaged 10.2 percent and return on net worth averaged 14.0 percent.[7]

263. Based on this information and a limited DCF analysis, Wilson concluded that the market cost of equity capital in the coal industry is not in excess of 15 percent (MCC Exh. 63, p. 19).

264. Finally, Wilson compared Western Energy's returns with all industrial sectors of the economy. That analysis revealed that while profits in 1981 averaged about 14 percent, 1982 results were considerably lower (MCC, Exh. 63, p. 20).

265. The Company's methodology concerning the captive coal issue was the "market price" approach. MPC witnesses Schmechel, Olson, and LaBrie presented evidence that an independent, competitive coal market exists and that the terms of the Western contracts, and the prices paid pursuant to them, compare favorably with what would have been available on the open market (MPC Exhs. 2 and 3). Other areas of discussion included by the witnesses are the comparability of Wilson's coal companies and the validity of the calculated coal profits of Wilson's comparables; the reasonableness of a 15 percent equity return for Western Energy; and the nature of the coal supply contracts (MPC Exhs. 2 and 3) .

266. This Commission has been faced with the captive coal issue on a number of occasions in rate cases involving the

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[7] 'Wilson noted that these were not strictly comparable to Western Energy because they were made for the consolidated companies and therefore included both coal-related activities and the companies' other activities.

Pacific Power and Light Company (PP&L), Montana-Dakota Utilities Company (MDU), and MPC. In considering evidence on the issue in at least five rate cases, the Commission has become thoroughly familiar with the issue, and the various methodologies employed. The utilities in all of these cases has consistently argued for a marketplace approach which compares the price paid by the utility for its coal supplies with prices paid for non-captive coal by other buyers. This has been called the traditional approach.

267. The Consumer Counsel has advocated two methods. In the case leading to Montana-Dakota Utilities Co. v. Bollinger, _Mont. , 632 P.2d 1086 (1981) the Consumer Counsel advocated what has been called the California approach, which attributes the utility's 'rate of return to the coal subsidiary. It was this method which was disallowed by the Montana Supreme Court. In this case, use of the California approach is not an issue. The method advocated by the Consumer Counsel is considered a variation of the traditional approach, since it uses profit data from other coal companies, rather than the utility, in determing a fair rate of return for the coal subsidiary.

268. Transactions between affiliated companies have long been a matter of concern to public service commissions because of the potential for the utility evading effective regulation by capturing excessive profits from its nonutility subsidiary. This special concern has been noted and endorsed by the Montana Supreme Court:

> When one of the expenses submitted by MDU is caused by transactions with a subsidiary company, the scrutiny applied by the PSC must be all the more intene. 632 P.2d at 1C8S, 38 St. Rptr. 1224

269. In reviewing transactions between Montana's major

utilities and their coal subsidiaries, the Commission believes that in order to assure ratepayers that they are not reimbursing the utility for excessive coal expenses, the Commission must find that neither prices charged by the subsidiary nor the profits enjoyed by the subsidiary are excessive, when compared to other comparable coal companies. Thus, when the Commission reviewed MPC's coal expenses following reversal by the Supreme Court, it found that when adjustments were made to comply with the Court's decision, the coal subsidiary's profits were very close to those originally found reasonable (Docket No. 81.1.2, Order No. 4799a) . Similarly, in a recent case involving PP&L, the utility presented evidence that when the same kind of adjustments were made to the Consumer Counsel's calculations, the coal subsidiary was reaping a modest and reasonable 14.9 percent profit (Docket No. 82.4.28, Tr. p. 588). In the next PP&L case, Docket No. 83.5.36, the coal subsidiary was found to be reaping a return on investment of over 32 percent, and a captive coal adjustment was accordingly levied (Order No. 5009a of Docket No. 83.5.36, pp. 38-42). There was no serious challenge in this docket as to what Western Energy's profits actually were. By contrast, that was a major issue in the PP&L cases. In all three cases, the utility had already presented evidence that prices charged were comparable to those charged by other companies.

270. In making its decision, the Commission found weaknesses in both approaches used to determine the captive coal expense. The Company's "market approach" was fairly thorough. However, as explained on page 41 in Order No. 471 4a of Docket No. 80.4.2, from the Department of Justice report "Competition in the Coal Industry":

> In practice, however, because of the nature of the coal

> markets, identification of the appropriate competitive prices is virtually impossible. Coal prices are not some broad national aggregate but are tied to a very specific location and quality factors. In addition, a significant portion of the steam coal is sold by long-term contract. Thus it may prove difficult to estimate an appropriate set of market prices to use to check a utility's accounting price of coal. (emphasis added) (Tr, pp. 47, 48 of Docket No. 80.4.2)

One of the very prominent weaknesses in the market approach is that coal from outside areas of the generating units require varying degrees of transportation and related costs which ca n greatly distort the comparability of using shipped coal versus a minemouth operation. Although the market may show the economic advantage of a minemouth operation, the relative comparability of the coal prices may be forfeited because of inordinate, dissimilar costs such as transportation.

271. In captive coal situations, a subsidiary of the utility is supplying coal to the utility as a result of a contract between the parent utility and its subsidiary. MPC maintains that the Colstrip 1 and 2 contracts were the result of arm's-length negotiations between Western Energy and Puget Sound Power and Light (Puget), as would normally be the case in a competitive market. As a result of the parent/subsidiary relationship in this very important aspect of electric utility operations, the Commission must scrutinize carefully the effects of all Western Energy contracts involving MPC on the rates paid by the ultimate customers. The Commission must determine a, reasonable level of coal expense much the same as it would determine any other operating expense of a regulated utility. The mere fact that

MPC is a participating owner in the Colstrip 1 and 2 plants, which consume Western Energy coal, necessitates that the Commission carefully scrutinize these coal costs that are being charged to MPC ratepayers. The Commission's major concern is that of expenses that MPC's ratepayers are being reasonably charged, regardless of the claim that the subsidiary is supplying its parent with fuel as a result of an arms-length transaction negotiated by a generating partner. This cost must be closely scrutinized simply because of the parent subsidiary relationship.

272. Wilson's use of comparable coal companies to test the reasonableness of a captive coal company's profits proves some useful guidelines for determining a reasonable level of profitability for Western Energy. There are, however, some problems with the comparability of companies used by Wilson. Perhaps most prominently, is his inclusion of eastern mining operations with characteristics significantly different from the Western operation. As Wilson pointed out, these problems are in significant part caused by the unavailability of public financial information for coal companies (MCC Exh. 63, p. 17).

273. The comparable companies study shows that a 15 percent return on equity does not appear to be an unreasonable level of profits compared to the somewhat lower average of 9.78 percent equity return for six companies who have substantial coal operations and whose financial statements are publicly available.

274. Because of the difficulties inherent in finding truly comparable coal companies with which profit comparisons can be made, the Commission finds it reasonable, as a check to admittedly imperfect data, to look at other areas

of the economy for profitability figures. Wilson presented evidence showing that other sectors of the economy earned approximately 11 percent on average in 1982 (MCC Exh. 64, JW-8, p. 1). Of even more significance in the Commission's opinion, is the profitability of corporations denoted as natural resource or coal companies on MCC Exh. 64, JW-7 and JW-8. Page 1 of Exhibit 64, JW-7 shows a 1982 equity return of 13.2 percent for petroleum and coal products companies. Exhibit 64, JW-8 shows a 1982 equity return of 13.1 percent for natural resources (fuel) companies, down from 18.6 percent the previous year. On pages 2 and 3 of Wilson's Exhibit 64, JW-8, he supplied an exhibit which listed the various companies making up the natural resources (fuel) section on page 1 of Exhibit 64, JW-8. As a late file exhibit, Wilson also listed the companies on this exhibit which have coal operations pursuant to Commission request during the hearing (Tr. pp.4448, 4449). For those companies listing coal as a marketed fuel, the average equity return for 1982 was 12.43 percent compared to 14.99 percent in 1981. All these figures point to the reasonableness of Wilson's proposed Western Energy equity return of 15 percent. The commission is fully aware that an economic recession in 1982 causes industry return figures to decrease compared to 1981 figures. Since 1981 represents a more normal year economically, the 1981 equity return figure of 14.99 percent for natural resources (fuel) companies marketing coal compares favorably with Wilson's recommended coal profit level of 15 percent.

275. As discussed earlier, the Commission has a duty to closely scrutinize the reasonableness of a regulated utility's expenses when those expenses are generated by a subsidiary of the parent utility. This parent-utility subsidiary-coal supplier relationship exists between MPC and

Western Energy, and affects the riskiness of the Western operation.

276. It is an axiom in the financial community that the determination of what a reasonable profit is depends to a large extent on the risk involved in that particular business. The higher the risk involved, the higher the profits that investors expect to compensate for their risk or loss.

277. Wilson claimed, in his direct testimony, that the Western operation has relatively low risks due to its relationship to MPC, and the consequent protected market environment (MCC Exh. 63, p. 22). The subsidiary enjoys the security of a captive market through its long-term contracts with its parent MPC as purchaser, either through direct contracts or participation as a generating partner. MPC, on the other hand, enjoys a secure coal supply from the Western subsidiary, insulated in some instances from the high cost of coal transportation. The Commission takes note that in another docket, MPC has asserted that Western Energy is a relatively low risk proposition (Docket No. 82.3.9, Tr. pp. 101, 102).

278. Wilson elaborated that an analysis of Value Line's safety, price stability, and earnings predictability indicates that the coal industry, as a whole, is only marginally more risky than other publicly traded firms. Additionally, captive coal operations are less risky than the coal industry due to the utility-sheltered aspect of these transactions (MCC Exh . 63, pp . 23, 24).

279. The Commission agrees with Wilson's risk analysis. Western Energy should not be able to charge a coal price to MPC, to be paid by MPC's ratepayers, that reflects profits

far above other coal operations and other natural resource companies, many, if not all, of which do not enjoy the risk reducing characteristics enjoyed by Western Energy.

280. Taking all this information into account, the Commission concludes that nothing in this record suggests any reason why Western Energy should earn profits funded by MPC's ratepayers that are far above all but the most profitable coal operations and also far above other natural resource companies, many if not all of whom do not enjoy the risk reducing characteristics enjoyed by Western Energy. The Commission acknowledges the inherent difficulties involved in comparing Western Energy with other coal companies. Therefore, the Commission finds that MPC should be given the benefit of the doubt by use of more readily available information for natural resource companies. Based on all of the information presented, the Commission finds that fuel expenses claimed by MPC that reflect a 20 to 25 percent profit figure are excessive and should be reduced to reflect expenses that would yield profits to Western energy of 15.85 percent, as discussed below.

281. In determing a reasonable rate of return for Western Energy, the Commission took into account many factors. In the ' Montana Power Company (MPC) Docket No. 82.8.54, the Commission utilized the 1981 average of equity returns for natural resource (fuel) companies of 18.6 percent as a reasonable return for MPC's coal subsidiary Western Energy. This return figure can be seen on page 1 of Exhibit 64, JW-8. Because 1982 was a very poor year economically. for the coal industry, the Commission feels the use of the 1982 equity return for natural resources (fuel) companies of 13.1 percent (MCC Exh. 5A, Exh. 64, JW-8, p. 1 of 3) would be unreasonable as representing a normal coal return level. As a way of

providing a more normal year return figure, the Commission finds the averaging of 1981 and 1982 equity returns for the natural resources (fuel) companies to be proper in this proceeding. The resulting equity return to be utilized in calculating Western Energy's allowable profit level is 15.85 percent. This return figure compares very favorably to 1982 equity return figures for the industry categories of petroleum and coal products (13.2 percent), natural resources (fuel) (13.1 percent), and industries as a whole (11.0 percent) as well as Wilson's recommended return of 15 percent.

282. The Commission believes that the most reasonable approach to calculating Western's return figures is to look at the actual results of operation. Because Western is an unregulated enterprise, it is improper to apply regulated-industry type adjustments to its financial statements. Western's net income for 1982 was $14,166,000 and its year-end equity was $63,875,000. The resulting 1982 return on equity, on a year-end basis, is 22.18 percent, a considerably higher level than the return level of 15.85 percent discussed above. The year-end figures for 1981 show a return on equity of 23. 14 percent, only a slightly higher return level than 1982 even though the rest of the economy, including coal industry, was suffering through a recession in 1982. This is a further fact which points to the necessity for making a coal expense adjustment in this proceeding.

283. The Commission finds that the above analysis indicates that a captive coal adjustment is proper in this proceeding. Based on all of the information presented, the Commission finds that the coal expenses claimed by MPC that reflect an approximate 22 percent profit level for Western in 1982 are excessive and should be reduced to reflect expenses that

would yield an equity return to Western Energy of 15.85 percent.

284. In calculating the captive coal adjustment, the Commission finds the use of Western Energy's actual 1982 year-end total stockholders equity to be proper in determining Western's allowable return and, thus, MPC's allowable Western coal expense. This approach is consistent with the Commission's preference for analyzing Western's actual profit levels without attributing ratemaking adjustments to Western's financial statements. Use of Western's actual year-end total equity provides consistency in comparing the equity return figures of Western and the various companies in the natural resources (fuel) industry, whose figures are all based on year-end equity (Tr. pp.4444, 4445)

285. Wilson, under cross-examination by attorney Shore of the Commission, agreed with this approach:

> Q. Is there any reason why year-end equity shouldn't be used for Western Energy if the comparison is made between Western Energy and the natural resource companies?
>
> A. No. You could make a comparison on the basis of year end. In fact, I think that if you're making a comparison with other companies where figures are computed on a year-end basis, it wouldn't be inappropriate to make the computation for Western Energy on the basis of year-end figures (Tr. pp. 4445, 4446).

286. Wilson, in his calculation of the required adjustment to

coal expense to reflect a 15 percent equity return for Western, proposed to utilize a tax multiplier based on the marginal Federal income tax level of 46 percent (MCC Exh. 64, Exh. JW-10, p. 1 of 2). The Commission finds this approach to be a ratemaking type adjustment and, therefore, is improper in calculating the proper amount of captive coal adjustment in this proceeding. The Commission finds that the proper tax multiplier should be based on the ratio of actual 1982 Western taxes to actual net income to be consistent with the approach of utilizing actual results of operation in determining a captive coal adjustment. This decision is consistent with the approved tax multiplier utilized in calculating a captive coa1 adjustment in the Montana Power Company Docket No . 82.8.54. That approved tax multiplier was based on the ratio of actual 1981 Western Energy Company taxes to actual net income, as proposed by Wilson in that proceeding. For further justification of this decision, refer to Tr. pp. 4438-4444, 4450-4452:

Q. So, your answer suggests that using a marginal tax rate is a standard ratemaking treatment, is that right?

A. Yes. (Tr. p. 4441)

* * * * *

Q. Dr. Wilson, in your discussion with the staff on effective tax rate versus incremental tax rate, is it your view that, given the Commission's decisions in the past where ratemaking adjustments were not recognized, the tax issue is a ratemaking adjustment?

A. I think the tax issue is a ratemaking

adjustment.... (Tr. p. 4450)

287. In calculating his proposed coal adjustment, Wilson utilized a ratio of the computed excess Western revenues to total Western revenues. This ratio was applied against MPC's proposed test year coal costs. The Commission finds this approach to be in error as it violates the Commission's intention of adjusting only those Western transactions involving MPC, either directly or indirectly. By saying that a certain percentage of total Western revenues is excess, Wilson is going beyond the boundaries limiting this adjustment to MPC-related Western Energy coal sales. This expense adjustment must only pertain to coal sales to Western's parent, MPC. The Commission finds, therefore, that the calculated excess revenue of coal sales to MPC must represent the theory that MPC's portion of Western Energy excess revenues equals the ratio of Western sales to MPC compared to total Western sales. This decision is consistent with the method approved in the Montana Power Company Docket No. 82.8.54, as proposed by Wilson in that proceeding.

288. The captive coal adjustment in this proceeding is, therefore, calculated as follows:

	(000)
Year-End Equity-Financed Earnings Base	$63,875
Allowed Rate of Return	x .1585
Allowed Return	$10,124
Actual Return	14,166
Excess (Net of Tax)	$ 4,042
Tax Multiplier	x1.4325
Excess	$ 5,790
MPC Percent of Sales	x .1458
Excess on Sales to MPC	$ 844

Plus Pro Forma 1982 Increase	96
Test Year Adjustment for Captive Coal	$ 940

289. Based on the above calculations, the Commission finds a decrease to MPC's Western Energy coal expense in the amount of $940,000 to be proper in this proceeding. The Commission's approach recognizes that price comparisons are not controlling in the analysis of affiliated transactions; rather, it is the cost of the commodity, including the element of return or profit, which must be examined. Because of the Commission's decision to disallow Colstrip 3 into rate base the related coal expense from that, plant was eliminated from this calculation.

290. The classification of coal reserve operations as a nonutility or utility function becomes important to electric ratepayers due to the different ratemaking treatments afforded to the coal fuel expense. It is not clear to the Commission why coal reserves of Western Energy Company should be considered a nonutility function with its ratemaking treatment based on comparable profits and prices. Public utilities are required to provide service at the lowest reasonable rate, and the Commission is required to allow rates that reflect the lowest reasonable costs. In view of those requirements, it is reasonable for the Commission to question why MPC's electric rates should not reflect that coal reserves held by its subsidiary, Western Energy, should not be given rate base treatment for ratemaking purposes. If MPC had not formed Western Energy, but had simply held its coal reserves as Plant Held for Future Use, the coal supplies would be expensed to MPC ratepayers at the cost of acquisition plus operation and maintenance costs.

PART F

OTHER ISSUES

Colstrip Unit 3 Plant Costs

291. As the Commission's final determination in this docket is that Colstrip Unit 3 and its related facilities are not used and useful, the Com J mission did not have to make any determination concerning the value or cost of Unit 3 for determining how much of MPC's investment in the Unit would go into rate base.

292. In the future, it is possible that the Commission will again be confronted with a request that all of or some portion of the Colstrip Project be included in MPC's rate base. Should the Commission, at that time, find that any portion of Colstrip is used and useful, the Commission will have to determine the amount of MPC's investment in the plant that should be allowed into rate base. Under 69-3-109, MCA, the Commission is required to determine the value of the property that a utility seeks to have included in rate base, but "is not bound to accept or use any particular value in determining rates; provided, that if any value is used, such value may not exceed the original I cost of the property. (emphasis added). It is obvious that the Commission would have to determine whether or not the cost of the Colstrip Project, as presented by MPC, is reasonable.

293. During the hearing in this docket, and in its 1982 Annual Stockholders' Report, MPC has referred to the Colstrip Project as "the largest construction project of any kind in the history of Montana."

294. MPC witness, Daniel Berube, Assistant Vice President of the Colstrip Project Division, testified at the hearing that the Project's magnitude was beyond the construction experience of MPC. In order to have the necessary experienced construction guidance and oversight on the Project, MPC and the other Colstrip owners contracted with the Bechtel Corporation to manage the Project's design and construction.

295. For the Commission, the sheer magnitude of the Project presents enormous difficulties in reviewing whether or not the Project was constructed in the most cost-effective manner possible, and in making the ultimate determination of how much of MPC's investment in the plant should be included in the rate base. For example, the immenseness of the Project requires hundreds of contracts and subcontracts to accomplish the myriad of construction components that must be coordinated into the final completed plants. Each of these agreements should be reviewed or independently audited to determine whether the costs of construction were reasonable.

296. During the discovery phase of this docket, the Commission staff took a random sampling of Project subcontracts, and found instances where the procedure used to review the cost reasonableness of the subcontracts appeared questionable.

297. Under cross-examination, Berube was extensively questioned about the Project's subcontract bidding process, and how the process was monitored to insure that the bid that was awarded was, in fact, the least cost choice. Bechtel, in order to review the reasonableness of subcontract bids received and to ultimately recommend to the Project which bid

should be awarded, did its own engineering estimate. Bechtel's estimate was to be used as a basis for cost comparison to the bids received from subcontractors.

298. The Commission staff's random sampling indicated that there were instances where Bechtel's engineering estimate was completed after the subcontract bids were received. Further, in most of those instances, Bechtel's engineering estimate was higher than that of the highest subcontract bid received.

299. To the Commission, such examples of Bechtel's procedure for assuring subcontract cost containment raise questions concerning how effective Bechtel's procedures were overall in containing Project costs.

300. The Commission is cognizant that a small sampling of subcontract bids does not provide concrete proof that the Colstrip Project was not managed in the most cost effective manner possible. On the other hand, the questions raised by the random sampling give the Commission pause. The Commission should not have to accept the Project cost figures provided by MPC as being unquestionably reasonable. However, the immenseness of the Project and the limited resources of the commission place the Commission in exactly that position.

301. NPRC witness, James Lazar, testified concerning the problems inherent in attempting to determine whether or not the Colstrip Project costs, as presented by MPC, were reasonable. In his prefiled direct testimony, he stated:

> It is essentially impossible for any party to determine what portion of the investment at Colstrip was made prudently, and what part represents unjustified costs created by contractor irregularities, management errors,

or premature commitments, within the context of a contested case proceeding.

I recommended that the Commission retain a qualified consultant, with both engineering and accounting expertise, to audit the construction expenditures, and determine the level of expend times which would have been necessary had the Company proceeded in a prudent and careful fashion.

Once a detailed audit is available, a new docket could be convened, and a value of the project established.

302. During the Commission's Billings satellite hearing held April 23, 1984, Mark Dodd, a former Colstrip Project engineer, who was terminated by MPC, testified. Dodd made numerous allegations concerning how the Project was operated from a cost-containment basis. The Commission has made no findings concerning the validity of Dodd's allegations. Dodd's testimony is cited here as another indication of the magnitude of the problem that the Commission will face when, if ever, a determination must be made concerning the reasonableness of the cost of the Colstrip Project for rate basing purposes.

303. In order for the Commission to carry out its statutory duties to assure that the amount of a utility's investment in plant that is rate based reflects a cost-effective and reasonable cost for that investment will, in the case of MPC's Colstrip Project, require an independent audit of the Project.

Extra Dividend from Rattlesnake Land Exchange

304. On January 30, 1984, the MPC Directors authorized

payment of a special, one-time dividend -- an extra dividend -- of 20 cents per share of common stock. The extra dividend reflected the $7 million approximate after-tax gain that MPC received as a result of the Rattlesnake land exchange consummated with the federal government. During cross-examination by Consumer Counsel Paine, MCC witness Mr. Woy explained that the 20 cents per share dividend did not reflect the total amount of gain MPC realized from the land exchange. The 20 cents per share paid out was based on the number of shares outstanding as of MPC's dividend record of January 4, 1984. Based on the average number of outstanding shares in 1983, the dividend per share was 37 cents.

305. Montana Power had owned property in the Rattlesnake Area located near Missoula for a number of years. In 1983, Congress designated the Rattlesnake Area as a federal wilderness and recreation area. MPC conveyed its Rattlesnake property to the federal government for inclusion in the wilderness and recreation area, and in exchange, MPC received coal-bidding rights, under the 1920 Minerals Leasing Act, from the federal government. These coal bidding rights are available to MPC for approximately 12 years, from November, 1983 through November, 1996.

306. Under cross-examination by Consumer Counsel Paine, MPC witness Woy explained that the $7 million gain "was the difference between the valuation of the coal-bidding rights as was determined by the federal government and the book value of the land, the water-shed lands we called the Rattle snake lands. " (Tr. p. 173) Although the gain that MPC achieved did not produce any immediate cash for MPC, the gain was taxable. The result was that MPC was able to reduce its tax loss by the gain of approximately $7million (Tr . p .

173).

307. Prior to 1980, MPC had owned the Mountain Water Company that provided water service to Missoula, Montana consumers. MPC's Rattlesnake property was part of the watershed serving Missoula, and according to Woy, was "at one point a number of years ago, . . included in the rate base of the water utility prior to its disposition." (Tr. pp. 170, 171).

308. In 1979, MPC sold the Mountain Water Company to Park Water I Company, retaining the Rattlesnake watershed land rather than including it in the transfer of water system assets to Park.

309. The Commission finds that further investigation of MPC’s decision to retain the Rattlesnake lands following the water system sale, and MPC's I subsequent realization of a substantial gain from the recent Rattlesnake land exchange is necessary. When the MPC-owned Rattlesnake lands were first included in the then MPC-owned Mountain Water Company rate base, the Missoula ratepayers apparently paid for that property through their rates.
The rates paid by Missoula consumers were based in part on the value of Mountain Water Company's rate base. Since MPC did not include the Rattlesnake water-shed lands in the sale of Mountain Water Company to the Park Water Company, it is possible that the sale did not fully compensate Missoula ratepayers for their contributions to a rate base that had included the Rattlesnake lands. If this is indeed true, the Commission questions whether MPC should have distributed the approximately, $7 million gain realized from the recent land exchange as an extra dividend to MPC's common stockholders.

310. The Commission directs MPC to provide further

information on this question, including an explanation of the accounting treatment of the Rattlesnake lands, prior to MPC's sale of Mountain Water Company to Park Water Company, and following the sale. Specifically, MPC should address whether or not its accounting treatment of the Mountain Water Company sale and transfer of assets handled the Rattlesnake lands in compliance with the Uniform System of Accounts, for Class A and B Water Utilities and for Class A and B electric utilities. The Utility Plant Instructions that should be addressed are Number 5 “Utility Plant Purchased or Sold,” Number 7 "Land and Land Rights and Number 10 "Additions and Retirements of Utility Plant. " The Commission further directs MPC to provide this information within twenty days of the service date of this Order.

CONCLUSIONS OF LAW

1. All Findings of Fact are hereby incorporated as Conclusions of Law.

2. The Applicant, Montana Power Company, furnishes electric service to consumers in Montana, and is a "public utility" under the regulatory jurisdiction of the Montana Public Service Commission. '69-3-101, MCA.

3. The Montana Public Service Commission properly exercises jurisdiction over Montana Power Company's rate and operations. '69-3-102, MCA, and Title 69, Chapter 3, Part 3, MCA.

4. The Montana Public Service Commission has provided adequate public notice -of all proceedings, and an opportunity to be heard to all interested parties in this Docket. '69-3-303, MCA, '69-3-104, MCA, and Title 2, Chapter 4, MCA.

5. The Montana Public Service Commission must determine whether Montana Power Company's investment in Colstrip Unit No. 3 and its related facilities will be "actually used and useful for the convenience of the public." '69-3-109, MCA. The Commission concludes that Montana Power's Colstrip investment is not “used and useful", and therefore, cannot be included as part of MPC's rate base. This determination is hot precluded by the Major Facility Siting Act, 75-20-101, et. seq., MCA.

6. The rate level approved herein is just, reasonable, and not unjustly discriminatory. '69-3-330, MCA and '69-3-201, MCA.

ORDER

THE MONTANA PUBLIC SERVICE COMMISSION HEREBY ORDERS:

1. The Montana Power Company's Motion to Strike is DENIED.

2. The Montana Power Company application to increase rates to generate revenue to recover costs associated with the Colstrip Unit 3 plant and related facilities is DENIED in total.

3. The Montana Power Company application to increase rates to generate revenues in the amount of $4,106,915 to recover operating costs on the MPC electric system is GRANTED.

4. The Montana Power Company shall file rate schedules which reflect an increase in annual electricity utility revenues of $4,106,915, on a uniform percentage increase for all customer classes except the Irrigator class.

These rate schedules will be interim schedules pending the final approval by the Montana Public Service Commission of the rate design that will be developed as a result of Order No. 5051d of this Docket. When the approved rate design is developed, the Montana Power Company shall file final rate schedules in conformance with that design.

5. All other motions or objections made in the course of these proceedings which are consistent with the findings, conclusions, and decision made herein should be granted; those inconsistent should be denied.

6. This Order is effective for service rendered on and after the 30th day of July, 1984.

DONE AND DATED this 3rd day of August, 1984, by a vote of 5-0.
BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

_____
THOMAS J. SCHNEIDER, Chairman

_____
JOHN B. DRISCOLL, Commissioner

_____
HOWARD L. ELLIS, Commissioner

_____
CLYDE JARVIS Commissioner

_____
DANNY OBERG, Commissioner

ATTEST:

Madeline L. Cottrill
Secretary

(SEAL)