

Service Date: September 13, 1994

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

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

ORDER ON MOTION FOR RECONSIDERATION

FINDINGS OF FACT

1. On August 3, 1989, the Commission approved Order No. 5051e, which disposed of all matters pending in Docket No. 83.9.67 except cost of service and rate structure.
2. On August 21, 1984, following a grant for its motion to extend the deadline, the Montana Power Company (MPC, the Company) filed a Motion for Reconsideration.
3. No other party filed a Motion for Reconsideration.
4. That portion of the Motion for Reconsideration that discussed cost of service issues flowing from Order No. 5051d will be addressed in a separate order.

THE EFFECT OF ORDER NO. 5051c ON ECONOMIC
DEVELOPMENT IN MONTANA

5. The Commission's decision to not allow rates to reflect the cost of Colstrip 3 is fully explained in the original order. The decision to deny inclusion is not a purely negotiable item as the Company's Motion seems to contemplate, but is, rather, a technical analysis of the resources of the utility "actually used and useful" to meet the demands of its customers. The Commission largely drew upon MPC's own planning criteria in concluding that Colstrip 3 was not actually used and useful, as required by Montana law before a utility can begin earning a return on its investment in plant. The Commission finds MPC's interpretation of the used and useful statute rather novel. According to MPC, the Montana Legislature enacted this law to accommodate a utility's addition

of resources, not to protect the ratepayer from a monopoly's ability to build excess plant that may be not required to meet consumers' demands.

6. Utility ratemaking is a process of balancing the positions of various opposing interests, intervening parties, and economic theories. Commission findings are based on evidence. A change in the Commission's inclusion of Colstrip 3 must be based on compelling evidence that the original order was faulty. The Commission finds no such compelling arguments in the Company's Motion.

7. In its Motion for Reconsideration, the Montana Power Company has raised a number of issues that are secondary to evidentiary issues it disputes.

8. The Motion asks the Commission to "accept a reasonable middle ground" and allow the Company to receive some compensation for its investment in the Colstrip 3 generating plant. The utility states that only if this compensation is granted will the Commission fulfill its legal duty to balance the interests of the customers and the investors in a reasoned fashion. The Company predicts that if the PSC fails to accept the Company's request for a compromise there will be irreparable harm not only to the reliability of service, financial health of Montana Power, and the future economy of Montana, but also to the entire regulatory environment of Montana.

9. Concurrently with the filing of this motion the President and other officers of the utility have made a number of public statements that the Commission has termed inflammatory. Those statements have generally sought to discredit the order and debate the merits of the case in the media. In that those statements are not part of the official record this Order will address those charges only to the extent that they are mentioned in the Motion for Reconsideration.

10. The Commission finds that the record does not support the contentions that the future economy of Montana is jeopardized by Order No. 5051c. In fact, the record supports the opposite conclusion, that is, Commission approval of the \$96.4 million rate request would seriously damage not only present businesses operating in Montana but rate increases of the magnitude requested could forestall future economic development.

11. The Company's own financial witness, Charles Olson, who testified on the economic development issue, failed to support the claim that the Commission's Order would adversely impact

investors' views about the general business climate of the state or negatively impact general obligation bonds.

12. On page 36 of Olson's rebuttal testimony he states:

A. Yes. If the Montana PSC takes the approach suggested by Dr. Power, it could result in a negative view of Montana's general obligation bonds and a higher cost of capital to the State. Disallowance of Colstrip No. 3 would clearly be viewed as a negative as regards the business climate in the State. In turn, this would make it more difficult to attract industry to Montana and the cost of capital to the State would rise.

13. Under cross-examination, the witness could offer no evidence in support of this statement.

Q. (Shore) Dr. Olson, I'm still looking for the basis upon which you have made that statement, and I have heard none as far as another state where this happened because of a Commission's action or literature that suggests that this happens, anything.

A. (Olson) I cannot offer you any empirical evidence. Its a hypothesis, if you will, on my part.

Q. Both for your statement about the negative view of general-obligation bonds and your views about how this would affect the general business climate of the state?

A. Yes. That's a hypothesis. That is something that could happen. It's not a prediction, but it is a possibility. (Tr. p. 490)

14. Also under cross-examination Olson admitted that an investor's perception of a state's business climate could be impacted more by other factors than regulatory climate (Tr. pp. 487-488). In fact, Olson admitted that in Wisconsin, with three out of the four Triple A rated utilities in the country and a regulatory climate perceived by analysts as very favorable, the bad business climate described by financial publications is due to taxes and other factors.

15. Eight of Montana's major industries formally intervened in the rate case and offered expert witnesses in opposition to the rate increase application. This unprecedented involvement by Montana industry must be regarded as a clear indication of their concern over higher rates impacting

Montana business. Industrial intervenors (Anaconda, Exxon, Stauffer) who limited their participation to the rate design and allocation issues are viewed by the Commission as expressing their legitimate concern over rate impacts on their business.

16. Ideal Basic Industries stated that the rate increase would cost Montana more jobs. ASARCO claimed the rate increase would substantially and directly affect the cost of its East Helena operations. They also stated that the increase is overstated and unjustifiable and urged the Commission to not require MPC customers to subsidize a mistaken Colstrip 3 investment, even if the investment was undertaken in good faith. Conoco Oil testimony pointed out that the rate increases could threaten the future of its refinery operations in Billings by jeopardizing its competitive position. As proposed by Conoco, the over a million dollar a year impact on its operating budget could have forced it to freeze wages, hiring and promotions, and eliminate some employee benefits. Champion International said the \$4.5 million dollar increase it would have experienced would seriously impact production costs and their own competitive position in the wood product market.

17. Two intervenors, Montana Irrigators and Northern Plains, presented expert testimony on behalf of Montana's largest industry - agriculture. Montana Irrigators said the Commission should order a rate decrease instead of an increase. Northern Plains was an active participant and presented policy and technical witnesses because of their concerns about agricultural impacts due to the rate increase and large scale industrialization.

18. Burlington Northern Railroad Co., which opposed the increase, offered a brief that is part of the correspondence file of the case that outlined adverse impacts to its Montana business operations and to its employees and retirees.

19. The Commission found that the collective involvement of Montana's major basic industries in opposition to the rate increase is a powerful statement of the effect of any Commission-approved rate hike on Montana's economic future and financial health of its businesses. It is also a recognized economic principle that adverse impacts on basic industries tend to grow in magnitude because of the effect on the economy. Basic industry payrolls and purchases of goods and services

in a community are known to increase six or seven times over for every dollar expended in a community.

20. In public hearings at 26 locations throughout the state, the Commission heard from Montana's small business community and Montana investors about the adverse impacts of a rate increase of the magnitude proposed by the power company. Some painted a rather bleak picture of the effects on the profitability of their own business operations while others urged the Commission to use its regulatory power to insure Colstrip was necessary and to protect the ratepayer from unfair rates that could result from a decision approving ratebasing of Colstrip 3 without proof of the usefulness of the plant.

21. Jim Anderson, Missoula, a partner in a manufacturing and publishing business, reminded the Commission that a regulator has the responsibility of duplicating the check and balance effect of competition in the marketplace:

When a business analyzes a potential product we make estimates of the probable success and profitability of that product. We are not always right and when we are wrong, we incur losses and so does the investor. If we make enough good choices over time, the gains outnumber the losses and our stockholders and our customers are happy. . . . The competitive marketplace is not tolerant of stupidity or abuse. The customer will not continue to be your sucker forever, and when he becomes unhappy, you've lost his business. Unfortunately Montana Power Company doesn't have the benefit of operating in the competitive marketplace within Montana. It has a monopoly on the distribution of electricity to its captive customers. The problem with a noncompetitive marketplace is that all the normal checks and balances no longer apply. . . . (Sat. Tr. pp. 35-37)

22. Mike Dikun, Bozeman small businessman, urged the Commission to make MPC responsible for what he considers a mistake in business management:

. . . In 1976 they had power projections, power projections of what they would need, and here six, seven years later it has all come out they're using approximately one-fifth of that.

Well, it seems to me that this is a decision that they, as managers of a corporation like Montana Power, have the right to make. But they also have the right to pay for it if it isn't the right decision.

* * *

Well, the decision to go ahead and build the plant was still made by the management of Montana Power. They're the people who made the decision. They should have to pay the consequences, not the ratepayers. (Sat. Tr. p. 26)

23. Charles Norton, a Lewistown investor and businessman testified as an MPC investor that the Commission had a responsibility to shield the ratepayer from assuming responsibility for MPC management error in construction of Colstrip 3:

. . . I should preface my statements, either myself or my wife own stock in Montana Power Company. I also own stock in the Public Service Company of Indiana and the Public Service Company of New Hampshire. These companies have built nuclear plants. But by way of analogy, Colstrip while not nuclear has been, I think, been a poor business decision as have been some of these other plants that have been made.

* * *

I really feel that Colstrip 3 and 4 can be compared to Ford's decision on the Edsel. It was a bad decision. But Ford doesn't just go out and raise the rates on their automobiles. The [Power] company, like Ford or many; other companies that make bad business decisions, have to absorb the cost, and I just don't think its right to try to pass those costs onto the consumer. I think that much of the burden of this, of this Colstrip 3 and 4 and this increase, in my own mind, is going to have to be absorbed by the company. (Sat. Tr. pp 5-6)

24. Mrs. Ronald Pusitti offered the views from a main street merchant's perspective of ratepayer versus shareholder management responsibility for a construction decision:

. . .I'm aware that some decisions of the Public Service Commission are determined by law and that is the way it should be. In this matter, I'm sure that there is no law in Montana that says that customers must pay for business excess or failure. But a decision by the Commission has the weight of law and a decision to grant this rate increase would in effect make it law that customers underwrite business investment mistakes.

. . .The Montana Power wants me to be in their business by asking me to pay for their blunders. But they have not offered to share with me any of their profits. No businessman on Main Street in Lewistown can do what Montana Power is asking to do. If a businessman invests, expands in stock inventory that no one wants and stands to lose his shirt, the city isn't going to say, gee, that's too bad. We'll pass a special tax and everyone in town will pay off your loss and protect your profit. Instead, he'll just lose his shirt because the small businessman has no guarantees. He has a very real incentive to manage his business in a prudent, cost effective manner and try to make a profit.

Now, Montana Power is entitled to try to make a profit. But there is no 11th commandment saying thou shalt make a profit. Let Montana Power and their shareholders be like any other business. They have taken a gamble and the risk by the very nature of their investment is that they might stand to lose money. They should not be protected from lower profits or threats of loss at the expense of the customer public. They should not be insulated from the consequences of their own poor management decision. Let them be like any other business. They have made a very costly mistake, let them eat it. (Sat. Tr. pp. 8-9)

25. Eileen Sansom also of Lewistown testified of her concern that Colstrip 3 was not used and useful and the Commission must, therefore, deny the rate increase.

. . . I am opposed to the Montana Power Company's request for 55 percent electric rate increase. I understand that nearly two-thirds of this increase would go toward Montana Power Company's 30 percent share of Colstrip Unit 3. Under Montana laws, I understand it, ratepayers are not required to pay for energy facilities that are not used and useful. I believe the reason Montana Power Company is asking for this rate increase is because the energy produced by Colstrip 3 is in excess of the needs of Montana consumers. I feel that the Montana Power Company made a mistake when it decided to build Colstrip 3 and 4. Whether that decision was based on available information at the time, I don't feel is important. I feel that now the power produced by the utility is not needed.

And when Montana Power decided to build those plants, they took a risk like all businesses take risks. When management makes mistakes during the risk-taking process, the stockholders and the bondholders should pay. The investors in Montana Power Company have reaped the benefits of the Company's successes, but the ratepayers in Montana have not. Therefore, it seems unfair to expect the ratepayers to insure the stockholders and bondholders of Montana Power Company continue to receive dividend checks.

Rewarding mistakes is bad policy and would set a precedent in Montana which would require the ratepayers to carry the burden for those mistakes. If someone else has to pay for the mistakes of the Montana Power Company, doesn't that in fact encourage the company to make more and not less mistakes. I believe it does.

I would also like to submit to you petitions signed by area residents, primarily senior citizens most of whom are on fixed incomes. These petitions urge the Public Service Commission to exclude from the rate base all or any portion of Colstrip Unit 3 or associated facilities which are not used and useful to Montana ratepayers. The

petition further urges PSC to allocate all costs associated with excess capacity to the utility's investors. Thank you for this opportunity to testify. (Sat. Tr. pp. 18-19)

26. The Commission's experience after conducting hearings of this nature for several years is that the small business community does not generally become involved. However, in the Colstrip case, numerous business people turned out to speak of corporate responsibility, issues like used and useful, and the PSC's obligations. That participation was not caused by academic interest nor was it punitive in nature. Rather, the small business community obviously wished to prevent a rate increase it considered unfair and a threat to business profitability.

27. Some of the business peoples' testimony was more related to their own business and community. Herb Gruss, a Chinook retail merchant, spoke of the effect in his community:

. . . I'd like to speak specifically, being a small businessman and also a consumer . . . of Montana Power Company.

* * *

. . . Granted any business is entitled to a profit, that also includes Montana Power Company. If Montana Power Company made a mistake or blunder or whatever you may call it, well, let them pay for it out of their own pockets. Let their stockholders pay for it, not ask us to pay for it.

* * *

So if Montana Power is granted this increase, just look at what is going to happen to a lot of small businesses here in this town. What we have to do, we have to lay off our help or part of our help, and that is going to help affect the rest of our community. (Sat. Tr. pp. 26-27)

28. Eugene Beckes from Missoula spoke of the effect the rate increase would have on businesses that may already be marginal:

I'm a small businessman here in Missoula. . . It's been going on for about a year and it's meeting with some success. I'm not drowning yet. I know several other small business people in the community here, all of whom are likely to be affected adversely by the proposed rate increase by Montana Power Company, just as I am.

* * *

. . . When prices inflate greatly, it seems to affect the people of less means more drastically than the people of greater means. They have a way of rolling over it, where smaller business people don't. And that's really all I wanted to say. . . (Sat. Tr. pp. 51-52)

29. Mrs. Gerald Bartow who operates a welding and machine shop in Roundup spoke of the consequences on industries serving hard-pressed rural agricultural communities:

. . .I feel an increase would hurt our line of business very much. If we have an increase, we would have to increase our rates, which consequently might mean a closure. (Sat. Tr. pp. 31-32)

30. Several witnesses more fully developed the concept that large rate increases have broad implications and burdens on the Montana economy. Arlene Braun of Missoula stated her belief that the request, if granted would be an unfair burden on the Montana business community:

I think many people this evening have testified very eloquently about the effects on low-income people, but I think there are some broader implications than simply the low-income people. It isn't just a question of the low-income people. They are important, and the effects that the rate increase would have are important on the low-income people, but I think it's the thing to grant a rate increase to Montana Power Company when the Colstrip 3 power plant is really an unfair burden on the economy of Montana. And, you know, we have a number of burdens that we've placed on our economy and our people who try to do business and this is an added burden, and it's an unfair and it's an unnecessary burden.

Several people have testified as to the effects on small business, but there are many larger businesses and there are many long-term businesses who are just sort of making it. And if they go get some additional costs, and we are asked to assume those costs anyway, they simply are not in a competitive position, and that means loss of jobs and perhaps businesses who will simply fade and not come back. So, it's the loss of dollars for the state, jobs for the state and loss of the income for those families, who, therefore, are forced to go on some type of a public assistance program.

I think to grant the rate increase to Montana Power Company would be unfair to the taxpayers. Every local government would be affected. Schools have to operate. Cities, counties, and the state have to offer services, and this would increase the cost of services to be provided, and, again, not a real necessary expenses, but an added expense would be asked of the Montana ratepayer. (Sat. Tr. pp. 86-87)

31. Gary Marbut, a Missoula entrepreneur in energy design and consulting and a political leader of the Montana Conservative Caucus, testified about the effects of a rate increase's effect on the economy:

Finally, another point that I think has not been adequately discussed came up in the Energy Task Force and Steering Committee meeting of the Missoula Comprehensive Planning; that is, studies done by the Bureau of Business and Economic Research at the University and others indicate that for every average dollar that is spent in the community, that dollar is spent again somewhere between 9 and 16 times before it leaves the community, with a notable exception. That notable

exception is energy dollars. You can bet that 100 percent of the dollars that are paid by Montana Power customers for power covered in this rate increase will leave all of the communities of the state almost immediately, and so those costs will have an effect that is much greater than just a specific individual dollar value cost for the power increase. They will have an effect that may be as much as 9 to 16 fold greater than the specific dollar cost that the consumer pays. (Sat. Tr. p. 64)

32. In line with Montanan's interest of pursuing economic development by encouraging development of Montana resources through the Build Montana program several spoke of the impediment that higher utility rates would have on that process. Dick Nicholson, a Chinook farmer, testified concerning an alfalfa processing plant he is considering building:

This study indicated that for an alfalfa processing plant it would take approximately 500 horsepower with electric motors, which at peak capacity would cost approximately \$33,400 at today's rate to run this plant.

Also this plant it's projected to use an additional 20,000 MCF of natural gas which would cost approximately \$90,000 per year.

With the increase that Montana Power has requested, it would cost approximately \$20,000 per year more for the same amount of electricity. This study indicated that at today's prices and costs, a plant of this size with good management would benefit most anybody in Blaine County, like providing more jobs and a market for alfalfa. But with this additional increase it would be questionable whether or not a plant would be cost effective enough to even be built. (Sat. Tr. pp. 16-17)

33. A view of the transcripts identifies over 70 individuals who identified themselves as involved in business or spoke of business impacts.

34. The degree of success of any business in Montana is directly related to the level of disposable income the consumer has to spend in the state for products and services. The record shows several hundred witnesses who testified to the effect on their own family's budget. If more money must be paid out for utility bills it is obvious that either savings or disposable income will be reduced proportionally. A reduction in those key areas adversely affects economic development and prosperity.

35. Mary Arnold from Bozeman succinctly described this phenomenon of income pressures:

My name is Mary Arnold, A-r-n-o-l-d. I'm just a common, ordinary, everyday person who lives here in Bozeman, Montana. I don't earn a lot of money, but I have found when I went back and checked my power bills that of the amount of money I earned a year, almost 20% goes to Montana Power. You kind of turn around and look at that and you say, "My God"; and you add another 50% (sic) on top of this and you come to 30% of your income per year. That's unrealistic. That's unreasonable. It's craziness. There is no need for the people of this state who are sitting right on top of all the coal, where you could ask for all of the water resources you could ever want, to pay 30% of your income for any year in power.

That could seem like it's an over reaction just a little bit, but I think if you turn around and you look at your own power bills, you will find the same thing. Maybe not 30%, even with the 55% addition they're asking in the rate increase, but if you turn around and you figure it out, you may find that you are paying Montana Power a heck of a lot of your own money, and you're not going to just pay it out of your own pocket to them straight. You're going to pay it every time you go to the store, every time you go and buy a new suit, every time you buy clothes, every time you buy anything. Your taxes will go up. You're going to wind up paying Montana Power every time you turn around.

It's about time to think about it. It's about time you turned around and said, "No." (Sat. Tr. pp. 40-41)

36. Montanans from every walk of life - industrial corporation, farmer, small business, and consumer - are on the record and make it extremely clear they see no relationship between MPC's ability to recover the costs for investment in Colstrip 3 and the economic well being of Montana's future. However as compelling as that evidence is, the Commission decision was predicated on the statutory of requirement of "actually used and useful," not subjective economic predictions.

37. Even so, the Commission realizes that it cannot ignore the needs of future ratepayers. The Company's concern that reconsideration is in order to preserve Colstrip Unit 3 for future use by Montanan's is worthy of consideration. The determination to not ratebase Colstrip 3 at this time does not leave ratepayers in the immediate and foreseeable future facing energy shortages or dampened economic development because of lack of a supply of dependable energy. Rather, the Commission has determined that there are several methods available to the Company to meet its future growth in customer energy demand. It has identified alternatives -- renewable resources, cogeneration,

purchased conservation, long-term firm purchases and opportunity power purchases -- along with the Colstrip generating plants as possible means to meet projected growth. The order only contemplates acceptance of the least costly resource to meet ratepayer needs. Contrary to the Company's allegations, this possibility does not preclude future acceptance of Colstrip Units 3 and 4; it does, however, minimize adverse economic impacts by charting out both a short-term and long-term least cost resource acquisition plan for meeting the needs of Montana consumers. That policy will neither jeopardize the economic future of Montana nor hold consumers hostage to the vagaries of the short-term market.

38. Montana Power also claims that reconsideration is in order to protect the financial stability of the utility and allow it to provide reliable service. The Commission is aware of bond market downgrades and drops of stock prices but finds no evidence in this record that the current situation is so harmful that it threatens MPC's ability to provide service.

39. In view of the record as a whole the Commission finds no merit that its request to accept a reasonable middle ground will result in utility rates that are as low as reasonably possible. In fact, that approach would mean the Commission would have failed to live up to its statutory obligation to insure that rates are just and reasonable.

40. Although not mentioned in the Motion for Reconsideration, Montana Power Company has on several occasions said that the unfavorable reaction from Wall Street and the bonding companies to the Commission's order will jeopardize future economic development as investors will perceive Montana as being anti-business. The Commission frequently receives inquiries from businesses considering relocation or a site for a new development. Those requests ask for rates charged for electric service in Montana - not the rate of return for the utility providing the service. Given Montana's historic problems with geographic location and distances from markets, it is far more likely that further rate increases would serve as a greater barrier to development than any perceived benefits of a higher utility bond rating.

USED AND USEFUL: THE COMMISSION'S DEFINITION

41. At page 23 of its Motion, MPC requests that the Commission re-examine its definition of "actually used and useful," on the grounds that it is "unduly restrictive," is inconsistent with past decisions, and "banishes planning and long-term economics from the ratemaking process." "The Company's argument certainly reflects its current position; however, it does not reflect relevant law or the position taken by MPC in the Siting Act proceedings before the Board of Natural Resources and Conservation (BNR). As the Commission discussed in its Order in Docket No. 81.1.2, regulatory commissions, with the blessing of the judicial system, have adopted a variety of standards in determining whether investments should be afforded rate base treatment. One of those standards is whether the investment will be actually used and useful in the test year, the standard adopted in this case. MPC has failed to address this well established precedent in its Motion.

42. The Commission cannot agree that its definition of "actually used and useful" "banishes planning and long-term economics from the ratemaking process." As Robert LaBrie stated in his testimony before the BNR, utilities have traditionally relied on load growth and off-system sales to pay for excess capacity when a large new plant comes on line. Exh. 3, LaBrie, Attachment, pp 6, 7; Order No. 5051c, p. 36. Another MPC witness firmly stated that the kind of used and useful analysis performed in this case is fundamental to the ratemaking process, in his words, "normal not only today but at all times in the past." Examination of Eugene Meyer, Tr. p. 1280. Thus, if this order banishes planning and long-term economics, all utility regulation must be found guilty of the same deficiency.

43. MPC's criticism totally ignores the Commission's analysis that concludes the "actually used and useful" test is the regulatory equivalent of the marketplace test faced by unregulated businesses. If an unregulated business makes investments that turn out not to be useful to its customers it is in precisely the same situation MPC finds itself in today -- it earns no return on its investment. Therefore, to accept MPC's argument means that one must also accept that the free market allows no planning or long-term economic analysis. The real world prohibits such a conclusion. The issue is risk. When an unregulated business makes an investment based on an analysis of future demand, it takes a risk that the demand will not develop. The Commission cannot

accept the position that utility regulation in the form of the "actually used and useful" test was intended to eliminate that risk for utilities. Just the opposite is true.

44. MPC claims that the decision in this Docket is inconsistent with past Commission decisions. It must be noted at the outset that the discussion conveniently ignores the Commission's decisions in Docket Nos. 81.1.2 and 82.7.53.

45. Part of MPC's claim of inconsistency rests on an analysis of this Commission's actions in dockets involving MPC's natural gas utility. (Motion, p. 26) The claim is that on the natural gas side, the Commission has explicitly considered the long-term implications of rate base decisions. In support of the argument, MPC quotes a portion of Order No. 4775b regarding the retention of the Aden properties in rate base. The analysis fails on several counts. It ignores the fact that the Aden properties had been in rate base for a number of years. It ignores the fact that ratepayers had paid for the exploration and development of those properties. Most importantly, it ignores the last sentence of the quoted finding which states that there was insufficient evidence to conclude that properties which had supplied gas to MPC's customers for 30 years were no longer "used and useful." Obviously, given that statement, the Commission would have removed those properties from rate base had such evidence been presented, as it was in this Docket.

46. MPC's discussion of Docket No. 6720, which considered future availability of natural gas supplies, ignores the fact that, at the time of the proceeding there were widespread concerns that serious gas shortages were imminent. There are no such concerns today regarding the availability of electricity. Quite the opposite is true; MPC and the entire northwest are experiencing surpluses that are projected to last for years.

47. MPC's interpretation of judicial decisions does not withstand critical scrutiny. Both decisions merely stand for the proposition that the PSC, in making rate base decisions, must look at the facts presented in approving or disapproving requests for rate base treatment of utility investments.

48. In its Motion for Reconsideration on Page 25, MPC questions the Commission's treatment of "plant held for future use" in Pacific Power and Light Company's (PP&L) Docket No. 83.5.36, Order No. 5009a. MPC referenced PP&L's Finding of Fact No. 58 which contains no

discussion of "plant held for future use;" the Commission assumes MPC meant to refer to Finding of Fact No. 36.

49. In PP&L's Finding of Fact No. 36, the Commission found that \$61,000 of the carrying costs associated with PP&L's "plant held for future use," i.e. land parcels, should be included in PP&L's rate base. This relatively minor addition to rate base was approved by the Commission because PP&L indicated a definite planned use for these parcels, and a reasonable expectation that they would be in use shortly.

50. There is no basis for comparison between PP&L's Docket No. 83.5.36 and its inclusion of \$61,000 of "plant held for future use," and the \$358,000,000 plant investment for the completed Colstrip Unit No. 3 contained in this Docket. Aside from the simple difference in magnitude between the two amounts, the factual situations in the two Dockets are different.

51. In Docket No. 83.5.36, the Commission allowed only PP&L's carrying costs associated with the parcels to be imminently in use into rate base. When PP&L actually places those parcels into service, PP&L will have to apply to the Commission to seek rate base treatment of the plant investment represented on by those parcels. Obviously, a utility's plant investment would include expenses in addition to carrying costs. Upon PP&L's application, the Commission would make its statutory "actually used and useful" determination concerning whether PP&L's plant investment in those parcels should be allowed into rate base. The fact that the Commission initially allows a utility to receive rate base treatment for carrying costs associated with particular property denoted as "plant held for future use," does not, as MPC apparently contends, equate to a PSC finding that the property has been determined to be "actually used and useful." Nor does such allowance equal a PSC finding that whatever is built upon that property, e.g. a generating plant, has also already been determined to be "actually used and useful."

52. Additionally, the Commission's interpretation of the Uniform System of Accounts, Account No. 105 "Property Held for Future Use" is that major generating plants, such as Colstrip Unit No. 3, are not properly includable in that Account. A note to Account No. 105 in the Uniform System of Accounts, page 35 explains that "Materials and supplies, meters and transformers held in reserve, and normal spare capacity of plant in service shall not be included in this account."

MAINTENANCE SCHEDULE

53. At page 28 of its Motion, MPC claims that the Commission has illegally invaded management's prerogative in its analysis of the maintenance Schedule for Colstrip Units 1 and 2. Further, MPC claims the the analysis is not based on evidence. Contrary to these claims, the Commission did not dictate a particular maintenance schedule; rather, based on record evidence regarding resource unavailability, the Commission concluded that MPC had sufficient access to electric supplies to cover deficits caused solely by plant maintenance and that maintenance requirements were themselves sufficiently flexible to avoid deficits. How MPC chooses to take advantage of this flexibility remains a management decision. The PSC's decision merely assumes that MPC, for ratemaking purposes, optimizes the productivity of its existing major resources before new resources are added to rate base.

54. MPC also claims that, because Puget Sound Power and Light Company owns one-half of Colstrip Units 1 and 2 and because regional agreements affect plant maintenance schedules, the flexibility assumed by the Commission's order does not exist. The claim contains no citation to the record. In addition, the claims are not sufficiently specific to serve as a basis for a finding that these circumstances render an alternative maintenance schedule unfeasible or even impractical. Has Puget refused to alter the maintenance schedule? Do regional agreements prohibit maintenance in any months except May and June? Neither the record nor MPC's Motion provide answers to these and other questions.

HANFORD EXTENSION CONTRACT

55. MPC's Motion at page 32 challenges the Commission's inclusion of the Hanford Extension contract as a resource in the test year, on the following grounds: 1) the contract was unavailable when the siting decision was made; 2) the contract, by itself, would not have significantly forestalled construction of Colstrip 3; 3) the contract is undependable, since it is subject to cancellation on one year's notice; 4) the Commission's Hanford decision ignores the BNR's Colstrip decision.

56. MPC's Motion fails to offer any valid criticism of the Commission's analysis on this issue. MPC's own analysis seems to suggest that BNR's determination absolved it of any responsibility to continually assure that the lowest cost resource is made available to ratepayers. The PSC does not believe that the Siting Act was designed to effect such a drastic change in a utility's obligation to offer its service at the lowest reasonable cost. Taken to its logical conclusion, MPC's position would allow it to shed its own low cost hydro resources in order to fit resources to loads when a large new expensive plant comes on line. Such a maneuver would result in severe detriment to the ratepayer. MPC's argument stretches its interpretation of the effect of the BNR determination to the breaking point; not only does that determination preclude examination of Colstrip 3 by the Commission but it now precludes the Commission's consideration of all other aspects of MPC's resources. The Commission cannot accept this fundamental change in the ratemaking process, an important element of which has always been an examination of how a utility meets the requirements of its customers, and to assure that the lowest cost approach is followed. In sum, MPC's position would shield the Company from any scrutiny of its acquisition and use of all resources, not just the ones subject to the Major Facility Siting Act

BIRD PLANT

57. MPC's Motion suggests that the PSC's findings regarding the Frank Bird generating unit are faulty for two reasons:

- a. The PSC's conclusion that Gregg's assertion that Bird is unreliable had no basis on the record;
- b. MPC could not have relied on the Bird plant as a future resource at the time Colstrip 3 was being planned and sited in the 1970's.

58. While it is true that the evidence causing the Commission to state that it was "very dubious about MPC's assertion pertaining to Bird's mechanical condition" is circumstantial, it is the weight of the evidence on the entire record that caused the Commission to adopt Bird as an energy

resource. MPC's assertion that the Commission had no basis on the record is incorrect. The evidence is adequately and straight-forwardly set out in the order:

- a. The only time Bird would be run under the assumptions contained in the Order will be during critical water conditions. It will be the last resource in MPC's menu of resources to be dispatched if water conditions fall to less than median water conditions. At median water, MPC has 1139 MW/months of surplus without Bird. Therefore, water conditions would need to be unusually severe before Bird will be operated. The Commission's Order does not contemplate that Bird will be run regularly.
- b. Even at the worst water conditions (a one-time in 50 year occurrence) Bird would be relied upon at only a 9.4 percent annual load factor. This is very reasonable in light of the load factor achieved in 1980 of 48 percent, which was several years after Bird's shaft was rebored.
- c. Bird was included in MPC's long range plan as available until the year 2000 as a peak or energy resource as recently as February, 1981, again, several years after Bird's shaft was rebored. Why Bird has become as unreliable as the Company claims between 1981 and the present has not been explained on this record.
- d. Gregg did not suggest that mechanical factors had ever been responsible for extended curtailment of Bird's output.
- e. Bird's usage over the years has been very low, somewhat akin to an older car with very low mileage. Just because Bird is an older plant does not mean it is worn out. It is the hours of use and its historic maintenance schedule that are important.
- f. The Commission finds that its reliance on Bird to be valid and supported on the record, particularly at the load factor suggested and only under critical water conditions (see, for example, Lewis' testimony on the following page). Nothing prevents MPC from requesting the Commission to consider maintenance expenses if Bird should become inoperable. To delete Bird as a resource based on the contingency of this happening, however, is premature.

59. MPC's second point, the matter of Bird's fuel availability at the time Colstrip 3 was being planned has been previously discussed. MPC's reasoning implies that the Commission must ignore today's circumstances, i.e., the fact that fuel is available for Bird currently and for the next ten years (Finding 181).

60. Additionally, the Commission is unconvinced by Lewis' contention that Bird was unequivocally unavailable because of the November, 1978 Fuel Use Act. The act provided for exemptions, which MPC received in early 1980:

Q. (Smith) Would you agree that as early as 1980, Montana Power as one of its justifications for obtaining an exemption to the Fuel-Use Act stated that it intended to use Bird as a hydro-firming resource?

A. (Lewis) Yes, I would agree with that, and I think it's just, as I stated, that as a last contingency resource, it was available for that, and is available for that purpose, although we don't show it in that regard.

Q. Do you know if the Bird Plant is presently operated under a special temporary public-interest exemption to the Fuel-Use Act?

A. My understanding is that it is -- we do currently have a temporary exemption, but the amendment to the Fuel-Use Act, I can't remember the date, 1981 or '82, it was our legal opinion that that basically obviated the need for an exemption. But I think we still have the exemption, although we don't anticipate that we really need it, but by virtue of the change in law, we can operate Bird as we choose without the exemption. (Tr. pp. 2050-2051)

61. The Commission finds both MPC's Motion for Reconsideration on the Bird issue to be faulty for reasons stated above.

TRANSMISSION SYSTEM

62. MPC claims that whether or not Colstrip 3 is deemed used and useful, the 500KV transmission lines must be included in rate base, since they increase the reliability and stability of MPC's transmission system (Motion, p. 18) MPC notes that transmission constraints absent the 500 kw system were acknowledged by the PSC in Docket No. 6454.

63. The statement regarding Docket No. 6454 is correct as far as it goes. However, it is misleading in the implication that the Commission found the transmission system unreliable or unstable absent the 500 KV transmission lines. The order in Docket No. 6454 merely noted that the transmission system placed some constraints on the potential for off-system sales. The only relevance that fact had in Docket No. 6454 (or any other docket) lies in the Commission's determination of the level of off-system sales to be assumed. It has no relevance to issues of reliability and stability of supply to Montana consumers.

64. MPC's claim would be well taken if the record revealed that, absent the 500 KV lines, the system was unreliable or unstable. If such were the case, it would be reasonable to conclude that the lines served a useful function even absent Colstrip 3. MPC, however, cites no evidence that supports such a conclusion. It is almost axiomatic that additional transmission lines will increase transmission reliability and stability. But that is not the point. The point in a rate case is whether that increased reliability and stability is required to assure reasonably adequate service. Absent any evidence that it is, the Commission cannot agree that added reliability and stability are sufficient to justify rate base treatment.

65. Based on its continuing jurisdiction, the Commission is aware that the MPC system operated for eight years without the 500 KV lines. Those lines were planned and built only in association with Colstrip units 3 and 4.

PSC'S TEST PERIOD LOADS & RESOURCES

66. The Motion contends that the PSC's order failed to give adequate consideration to load growth or energy reserves. It implied that not only do test year loads need to be considered, but that also some unnamed and unknown future loads must have resources provided for them. It stated: "The PSC must recognize the need for a prudent energy reserve."

67. Although the topic of what constitutes "prudent" was not specified in the Motion, the PSC does not accept the implication that energy reserves were not accounted for as follows:

Surplus at Median Water	-	1,139 MW/Months
Surplus at Critical	-	925 MW/Months

Surplus at Critical with Bird
at 9.4% Capacity Factor - 416 MW/Month

These numbers indicate that even in the most severe water conditions and with the Bird plant running at only one-sixth of its potential capacity factor, 416 MW/months are available for load growth. This, of course, does not take into account the substantial surplus available from other Pacific Northwest resources (Finding 136).

68. The Commission notes that during the hearing energy reserves were quantified as 1 percent of the energy producing capacity of the thermal plants (staff cross-examination of Gregg. Tr. pp. 1680-1681) If this were accepted, MPC's required energy reserve would be 4.5 average MW. Even under the worst case scenario MPC has 34.6 average MW (416 MW/12).

AFUDC

69. MPC incorrectly claims that the sole basis for the Commission's rejection of AFUDC treatment is its opinion that such treatment is more expensive than rate base. Simply ignored is the specific adoption of reasoning contained in testimony of Power and Lazar.

70. In addition, MPC's position ignores the fact that, if AFUDC is allowed, there will be a double collection, since the Company retains all benefits that flow from off-system sales and load growth beyond the test year.

FLOW THROUGH OF CONSTRUCTION PERIOD INTEREST AND OF ARBITRAGE INCOME

71. MPC claims that Order No. 5051c ignores previous rate case treatment of interest generated by the financing of Colstrip Units 3 and 4 and arbitrage income. (Motion, pp. 33-36). MPC claims that because Colstrip 3 has not been included in rate base, these adjustments, which resulted in substantial reductions of revenue requirements found reasonable in previous cases should be returned to shareholders. MPC claims that failure to return \$50 million, claimed to be the amount that reflects these previous adjustments, would constitute "bold confiscation."

72. Order No. 5051c did not treat previous adjustments related to construction related income. The reason is simple: no party, including MPC raised the issue in the course of the proceedings in this case. MPC was well aware of recommendations that all or part of Colstrip 3 be excluded from rate base, and, in fact, discussed the proposed AFUDC treatment that was made in anticipation of rate base exclusion of Colstrip 3.

73. Because of MPC's failure to raise the issue of previous adjustments in a timely manner, the parties have not had the opportunity to examine witnesses sponsoring the adjustment. Neither have parties had the opportunity to brief the issue. An adjustment based only on arguments in the Order would violate basic precepts of due process.

74. The proposed adjustments raise factual and legal issues. For example, there seems to be a real possibility that such an adjustment would constitute retroactive ratemaking. In essence, MPC's proposal claims that because of the exclusion of Colstrip 3 from rate base, previous rates were too low. The \$50 million adjustment would seem to be a "make up", a surcharge to compensate for what MPC believes were unreasonably low rates in the past. Retroactive ratemaking is prohibited in Montana as well as virtually all jurisdictions. Factual issues include: whether \$50 million is the appropriate level for the adjustment if it is found to be legal permissible. There is also the issue of whether there should be offsetting adjustments. For example, it seems logical to consider whether the adjustment shouldn't be accompanied by a corresponding exclusion of incremental debt used to finance the construction of the unit. These and other issues must be exposed to the evidentiary process.

PRICING OPPORTUNITY PURCHASES AND OFF-SYSTEM SALES

75. MPC's primary criticism of the Commission's order in this area pertained to the Order's averages for secondary off-system purchases and sales. The Commission finds MPC's criticism unwarranted. MPC presented average prices for opportunity purchases and sales in its application, as it has done on many occasions. Similarly, the Commission has always used averages in its orders.

76. MPC also contends through an hypothetical example that MPC may receive benefits even if the average of opportunity purchases and sales were equal in value. Although this point was not demonstrated in evidence, the Commission does not doubt its partial validity. Because of partial forced outages, the system would benefit from being able to purchase power if one of its own generators were "down" for a short period. If native loads decreased temporarily and the unit becomes productive again, MPC may, by coincidence be able to sell the same amount of power it had purchased, and at the same price. In this instance, the system would have benefited although no profit would have been realized on the net transaction.

77. The Commission's primary reliance in establishing the difference or profit margin between opportunity purchases and sales in the case was on historical experience (Finding 212). If historical experience had dictated that the Commission use a 0 percent margin for the difference between opportunity purchases and sales prices, it would have done so. However, this was not the case. In most recent years, the difference was much larger than that used by the Commission. MPC's 1983 business plan as presented in McGregors' RBM-8 p. 2 of 3 also showed much larger margins for future years.

78. The Commission also notes that MPC's case depicted opportunity sales of 229 average MW, while the Commission's Order included only 175.9 average MW. If MPC's premise that "Under the forces of the off-system market, the gain for ratepayers is maximized as the margin between sales and purchase prices approaches zero" is accepted, the 25 percent lower sales volumes should provide MPC a higher average profit margin.

79. The Commission finds its original ordering paragraphs with regard to this subject to be valid.

OPPORTUNITY PURCHASE LEVELS

80. MPC's Motion contends that a downward adjustment to opportunity purchases be made to reflect normalized market conditions. It stated that Clark adjusted Corette generation upward for this reason, and that consistency required an adjustment to opportunity purchases. The assertion is made without transcript citation that refute findings 176 and 177.

81. Clark's testimony, upon which the Commission relied, 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 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, p. 6).

82. The Commission finds that the motion provides no additional guidance or evidentiary basis to indicate why Clark's testimony should not be endorsed.

ANACONDA COMPANY CONTRACTUAL LOADS

83. MPC's motion does not provide any evidentiary basis which persuades the Commission to change its order. It merely alleges confiscation. The Commission disagrees and reaffirms its order. While confiscation may have occurred if MPC could not serve the Anaconda load and if the ratepayers had been given the benefit of the deficiency payment, this is not, in fact, what occurred. In those months the load could not be served, the deficiency payment was given to the stockholders. In those months the load could be served, the ratepayer was accorded the benefit to compensate them for supporting the available plant in rate base. This balancing of stockholder and ratepayer interests is both equitable and based on evidence, in contrast to MPC's position.

RATE OF RETURN

84. MPC contends that the fact that the Commission did not use the same methodology to determine MPC's growth rate as it used in MPC's prior Docket No.82.8.54 is an inconsistency that must be explained.

85. MPC's argument implies that if the Commission has not remained rigidly consistent in the method used to determine growth rates from one docket to another, the Commission is necessarily making an incorrect determination. The Commission notes that an administrative agency, by its very nature, is to be flexible in making determinations that will reflect the evidence at a given point in time. Although the Commission did not use an averaging method to determine the growth

rate in MPC's previous Docket, that method has been used previously by the Commission, e.g. Montana-Dakota Utilities Company, Docket No. 83.9.68.

86. In Docket No. 82.8.54, Order No. 4938a, the Commission used Dr. Caroline Smith's industry average weighted growth of 3.33 percent as representing a fair estimate of MPC's growth. In this Docket, Dr. Smith's industry average weighted growth was 4.58 percent or 4.6 percent rounded (Exhibit 59, Table 8); an increase of 125 basis points over her recommendation in Docket No. 82.8.54.

87. The Commission has determined that Dr. Smith's proposed (average) MPC dividend yield of 10.5 percent from her updated Table 9, Exhibit 59 is proper in this proceeding. The 10.5 percent dividend yield taken with Dr. Smith's updated results on Tables 7 and 8, 13.3 percent and 15.2 percent, represent to the Commission an acceptable range of reasonableness for determining MPC's cost of equity.

88. The two most important growth rates - nine-year book value growth and eight-year earnings growth - from the updated Table 7 taken together explain a large percentage of the variability in dividend yields based on Exhibit 59, Table 2. The Commission supports the use of the two most important growth rates in the calculation of cost of equity capital because of the strong statistical correlation of the two growth rates to dividend yields. The two most important growth rates, therefore represent to the Commission a very reasonable low end of the growth range in determining MPC's cost of equity.

89. Incorporating all growth rates over a ten year period serves to give an overall view of MPC's cost of equity in relation to the industry as a whole, over a large enough time period to show definite tendencies. The Commission believes that the all growth rates analysis results in a very reasonable high end of the growth range in determining MPC's cost of equity.

90. The Commission also believes that utilizing 13.3 percent and 15.2 percent offers a reasonable approach to meld together industry and MPC figures on a weighted basis.

91. The Commission, therefore, determined that averaging the results from Dr. Smith's Tables 7 and 8 from Exhibit 59 was the proper method to determine MPC's cost of equity. The

resulting approved cost of equity for this Docket is 14.25 percent ($10.5\% + [(2.8 + 4.7) \div 2] = 14.25\%$).

92. The use of the two most important growth rates from Table 7 of Exhibit 59 of 2.8 percent and all growth rates from Table 8 of Exhibit 59 of 4.7 percent represents the range of reasonableness to the Commission in determining the cost of equity. In Docket No. 82.8.54, the Commission used the all growth rates factor as a reasonable growth factor for MPC (3.33%). This factor has increased substantially since the last case, to 4.7 percent and is not by itself a valid estimate of growth for MPC because it is unreasonably high. In order to achieve a balanced estimate for growth, the Commission combined the 2.8 percent and the 4.7 percent to produce a growth rate of 3.75 percent. The Commission notes that the growth rate approved herein is 42 basis points higher than the growth rate approved in Docket No. 82.8.54.

93. At pages 3 and 4 of its Motion for Reconsideration, MPC claims that the Order's allowed rate of return ignores the increased risk that has resulted from the disallowance of rate base treatment for Colstrip. There are several problems with the Company's position. The primary one is evidentiary. As noted in the Motion, Power testified generally about the potential for increased cost of capital if Colstrip 3 were disallowed. That is the only place on this record where the issue is discussed. MPC's rebuttal case made no attempt to quantify the increased risk. The Commission finds that Power's testimony does not offer a sufficient evidentiary basis upon which to increase the rate of return to reflect the rate base disallowance. How should the degree of risk be reflected? Should it be an across the board increase? Should it be only for the equity portion? Should the rate of return be increased by 1 percent, 3 percent, 5 percent? As with its claims regarding flow through of interest and income, MPC has failed to lay an adequate evidentiary basis that can support its request. Having failed to address testimony opposing rate base treatment for Colstrip 3. Now that the Commission has accepted that testimony, MPC asks for relief that cannot be granted on this record.

94. In addition to the obvious evidentiary problems, there is some question as to whether investors have already reflected the risk associated with the Colstrip investment. Since construction began, MPC's rate of return testimony has consistently emphasized the role of that construction program in the need for higher rates of return. The Commission is aware that investors routinely

examine the size of a utility's construction in assessing risk. Whether this assessment has reflected the possibility of rate base exclusion is an issue that will have to be determined at a later time, since this record offers no answers.

PARTICULARIZED FILING REQUIREMENTS

95. At page 36 of its Motion, MPC challenge the Commission's authority to require that certain information be contained in MPC's next rate case. According to MPC no information can be elicited other than that required under the Minimum Rate Case Filing Requirements Title 38, ARM. MPC's position would have the Commission transform minimum requirements into maximum requirements. MPC has offered neither legal support nor reasoning to support the position advocated.

96. Montana law gives the Commission broad powers to require information from regulated utilities. 69-3-106, MCA; 69-3-202, MCA. MPC fails to explain why it believes these statutes are not relevant in this situation.

DEREGULATION

97. While admitting that Order No. 5051c contains no discussion of deregulation, MPC nonetheless combines testimony of unnamed intervenors with a TV interview of one Commissioner to conclude that the Commission really meant to deregulate Colstrip 3. These kind of allegations and conclusions are nonsense. The Commission speaks only through its orders. One Commissioner's opinion is just that. It goes without saying that, in any case, arguing on the basis of extra record statements is improper.

CONCLUSIONS OF LAW

1. 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.

2. The Commission properly exercises jurisdiction over the Applicant's rates and operations. §69-3-102, MCA, and Title 69, Chapter 3, Part 3, MCA.

3. The Commission has provided adequate public notice of all proceedings and opportunity to be heard to all interested parties in this Docket. Title 2, Chapter 4, MCA.

4. The rate level approved herein is just and reasonable. §69-3-330, MCA.

ORDER

1. The Montana Power Company's Motion for Reconsideration, except for issues relating to cost of service are denied.

2. All motions and objections not previously ruled upon, except those relating to cost of service, are denied.

3. The Montana Power Company shall not alter existing rates until a subsequent order disposing of rate structure issues is issued by the Commission.

DONE AND DATED this 10th day of September, 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
Commission Secretary

(SEAL)

NOTE: You may be entitled to judicial review in this matter. Judicial review may be obtained by filing a petition for review within thirty (30) days of the service of this order. Section 2-4-702, MCA.