

Service Date: September 10, 2004

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

IN THE MATTER OF the Application of)	UTILITY DIVISION
NorthWestern Energy for Approval of)	
Agreement for Sale and Purchase of Capacity)	DOCKET NO. D2004.3.45
and Energy between NorthWestern Energy)	ORDER NO. 6557c
and Basin Creek Equity Partners, LLC)	

FINAL ORDER

APPEARANCES

FOR THE APPLICANT:

NorthWestern Energy

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Helena, Montana 59601.

FOR THE INTERVENORS:

Montana Consumer Counsel

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National Resources Defense Council and Renewable Northwest Project

Charles E. Magraw, 501 8th Avenue, Helena, Montana 59601.

PPL-Montana, LLC

Michael J. Rieley, 24 West Sixth Avenue, Suite 4A, Helena, Montana 59601.

Before:

Bob Rowe, Chairman
Tom Schneider, Vice Chairman
Matt Brainard, Commissioner
Greg Jergeson, Commissioner
Jay Stovall, Commissioner

Commission Staff:

Eric Eck, Utility Division
Will Rosquist, Utility Division
Robin A. McHugh, Staff Attorney

INTRODUCTION

1. In this Order the Montana Public Service Commission (Commission) considers and makes decisions on an application from NorthWestern Energy (NWE) for approval of an electric power supply agreement between it and Basin Creek Equity Partners, LLC (Basin).

FINDINGS**BACKGROUND**

2. On March 23, 2004 NWE filed an Application with the Commission asking for the following findings on a power supply agreement between it and Basin: 1) The agreement is in the public interest; 2) the agreement resulted from a reasonable effort by NWE to comply with the objectives stated in § 69-8-419, MCA, and the Default Supply Resource Planning and Procurement Rules, ARM 38.5.8201-29, including corresponding methods utilized by NWE in advance of the existence of these rules; and 3) the price, quantity, duration and related terms of the agreement are reasonable.

3. Basin was a successful bidder in response to an August 26, 2002 request for proposal in which NWE sought “price discovery and [to] potentially procure a specific resource type determined necessary to serve the most volatile and market-sensitive portions of NWE’s default supply load (super-peak and peak capacity/energy).” Application, p.2.¹ NWE also determined that this resource type would enable it “to maintain scheduling flexibility, mitigate risk, and pursue complementary resources[,]” including wind. *Id.* The Basin agreement provides for the sale from Basin to NWE of approximately 50 megawatts of capacity and associated energy output for 20 years, with a NWE option for two five year extensions. Physically the Basin project consists of an approximately 50 megawatt power plant, “comprised of nine reciprocating engine generator sets, fueled by natural gas, located in the vicinity of an industrial park in Butte,

Montana,” and to be connected directly to NWE’s high-voltage transmission system and natural gas transmission system. Application, p.3.

4. The NWE Application was noticed on March 26, 2004, and Procedural Order No. 6557 was issued on April 28, 2004. Timely intervention was granted to the Montana Consumer Counsel (MCC), the Renewable Northwest Project and National Resources Defense Council (jointly) (RNP/NRDC), and PPL-Montana (PPL). The Commission denied a NWE challenge to PPL intervention. Notice of Staff Action, Notice of Commission Action, April 29, 2004. Notice of Hearing was issued on June 17, 2004, and a hearing was conducted on the Application on July 21, 2004.

The Record in the Docket

The evidentiary record in this docket consists of the following:

- a. All responses to Commission data requests (TR 7);
- b. Responses to data requests PPL 1, MCC 22 and MCC 24 (TR 7);
- c. Letter from the Southwest Montana Legislative Delegation (TR 12);
- d. The NWE Application (NWE-2, TR 16);²
- e. Prefiled Direct Testimony of Mark D. Thompson (NWE-1, TR16);
- f. First Amendment to Capacity and Energy Sale Agreement between Basin and NWE (NWE-3, TR 19);
- g. Prefiled Rebuttal Testimony of Patrick R. Cocoran (NWE-4, TR 149);
- h. Prefiled Direct Testimony of Ann Gravatt (RNP/NRDC-1, TR 218);
- i. Prefiled Direct Testimony of Michael J. King (PPL-1, TR 240);
- j. Letter from PPL to members of the Southwest Montana Legislative Delegation (PPL-2, TR 289);
- k. Prefiled Direct Testimony of John W. Wilson (MCC-1, TR 290);
- l. August 4, 2004 letter from Caterpillar to Basin (NWE late filed exhibit, TR 184);
- m. Response to question on the number of offers NWE received for peaking and reserves, and whether such offers were tied to gas fired generators or a market-indexed pricing mechanism (NWE last filed exhibit, TR 187); and

¹ The “Application” cited here and below refers to the 8 page document, a part of the complete March 26, 2004 filing.

- n. Examination of witnesses at the hearing; and
- o. Other evidence of which the Commission may lawfully take administrative notice.

Briefs

5. NWE, MCC, RNP/NRDC and PPL submitted initial post-hearing briefs in this docket. PPL filed a reply brief.

LEGAL BACKGROUND

6. NWE is a default supplier of electricity under Montana law. §§ 69-8-208(3) and 210(1). As part of providing default supply service NWE may apply to the Commission for “advanced approval of a power supply purchase agreement.” § 69-8-421(1), MCA.

7. NWE concedes that this Application is technically not covered by § 69-8-421, MCA. Application pp. 6-7. (The procurement process for the Basin resource began after April 24, 2003, the effective date of the section. See Compiler’s Comments, § 69-8-421, MCA.) However, NWE notes that the Commission’s authority to give “advanced approval” is not determined by § 69-8-421, and contends that section is “the appropriate procedural framework for processing the instant application.” Id. The Commission asked for comments on NWE’s request to treat the Application pursuant to § 69-8-421. No comments were received, and the Commission found such treatment “appropriate.” The Commission indicated, however, that it would “modify the schedule and deviate from the requirements of [§ 69-8-421] if it is in the public interest to do so.” Procedural Order No. 6557, p.1.

8. Section 69-8-421, MCA, reads in pertinent part as follows:

- (1) A default supplier may apply to the commission for advanced approval of a power supply purchase agreement that is:
 - (a) not executed; or
 - (b) executed with a provision that allows termination of the agreement if the commission does not find the agreement reasonable.
- (3) (a) The commission may approve or deny, in whole or in part, an application for advanced approval of a power supply purchase agreement.
- (b) The commission may consider all relevant information known up to the time that the administrative record in the proceeding is closed in the

² As used here, “Application” refers to the entire March 26, 2004 NWE filing with the Commission.

evaluation of an application for advanced approval of a power supply purchase agreement.

(c) A commission order granting advanced approval of a power supply purchase agreement must include the following findings:

(i) advanced approval of all or part of the agreement is in the public interest;

(ii) the agreement resulted from a reasonable effort by the default supplier to comply with the objectives in 69-8-419 and the rules adopted pursuant to 69-8-419; and

(iii) the price, quantity, duration, and other contract terms directly related to the price, quantity, and duration of the power supply purchase agreement are reasonable.

(d) The commission order may include other findings that the commission determines are necessary.

(4) Notwithstanding any provision of this chapter to the contrary, if the commission has issued an order containing the findings required under subsection (3)(c), the commission may not subsequently disallow the recovery of costs incurred under the agreement based on contrary findings.

(6) Nothing limits the commission's ability to subsequently, in any future cost recovery proceeding inquire into the manner in which the default supplier has managed a power supply purchase agreement as part of its overall portfolio. The commission may subsequently disallow default supply costs that result from the failure of a default supplier to reasonably administer power supply purchase agreements in the context of its overall default supply portfolio management and service obligations.

9. Section 69-8-419, MCA, reads in pertinent part:

(1) The default supplier shall:

(a) plan for future default supply resource needs;

(b) manage a portfolio of default supply resources; and

(c) procure new default supply resources when needed;

(2) The default supplier shall pursue the following objectives in fulfilling its duties pursuant to subsection (1):

(a) provide adequate and reliable default supply services at the lowest long-term total cost;

(b) conduct an efficient default supply resource planning and procurement process that evaluates the full range of cost-effective electricity supply and demand-side management options;

(c) identify and cost-effectively manage and mitigate risks related to its obligation to provide default electricity supply service;

(d) use open, fair, and competitive procurement processes whenever possible; and

(e) provide default supply services at just and reasonable rates.

10. The Commission's administrative rules adopted pursuant to § 69-8-419 are at ARM 38.5.8201-28.

11. In considering the NWE Application the Commission asks, guided by § 69-8-421(3)(c), MCA, whether 1) advanced approval of the Basin agreement is in the public interest today; 2) whether the Basin agreement resulted from a reasonable effort to comply with the objectives of § 69-8-419 and related administrative rules; and 3) whether the price, quantity, duration and related terms of the agreement are reasonable today.

NORTHWESTERN ENERGY'S APPLICATION

Default Supply Loads, Resource Needs Assessment

12. NWE stated that the total energy required to serve the default supply load is about 5.8 million megawatt-hours (MWH) per year. At times total default customer demand can be as low as 390 MW in off-peak periods or as high as 1,150 MW in peak periods. Default loads fluctuate significantly from month-to-month, day-to-day and hour-to-hour, due to customer usage patterns and unpredictable weather conditions. Within a single day loads vary by hundreds of MW. NWE calculated that the default supply load factor is currently about 58%. Consumption that exhibits a lower load factor is relatively more expensive to serve, other things being equal.

13. NWE stated that the current default supply resource portfolio produces about 4.2 million megawatt-hours (mwh) of energy per year, roughly 71 percent of total annual default supply energy requirements. This energy comes from multiple unit contingent contracts with Qualifying Facilities (QFs, about 92 MW), a 300 MW firm base load contract with PPL Montana and a 150 MW unit contingent, on-peak, shaped contract with PPL Montana. Together, these resources provide less than half (49 percent) of NWE's peak supply needs. NWE currently supplies peak and super peak loads mostly with short-term market purchases.³

14. NWE's portfolio modeling studies showed significant reliability and market price risk exposure during super peak periods. Reliability risks stem from NWE's need to purchase energy during periods of high regional demand when third party suppliers may not be able to sell to

³ The super peak period consists of approximately 2080 hours per year. In the summer season, the super peak time period covers 8 hours in the afternoon and evening. In the winter, the super peak period is split between a 4 hour period in the early morning and another 4 hour period in the evening. See p. MDT-23.

NWE because of their own load requirements.⁴ Similarly, NWE relies on others to provide ancillary services; contracts with neighboring utilities provide NWE about 20 MW of operating reserves and about 20 MW of load following services. NWE asserted that as these other utilities experience load growth, or if additional environmental regulations constrain hydroelectric generation, buying sufficient ancillary services could become difficult. And as such products become scarcer, their cost is likely to increase.

Modeling and Analysis

15. In 2002, NWE began using a planning tool called GenTrader® to model the current portfolio of resources and hourly load requirements and determine the best mix of resources to include in the portfolio going forward. NWE determined that the market portion of the current portfolio is the most expensive and most volatile and that, although the cost of the existing portfolio is not currently excessive, the cost could be much greater if market prices change. According to NWE, although the super-peak load is a very small part of the overall default supply load (about 15 percent of total energy requirements), the higher prices during super-peak periods along with greater volatility indicate that if the portfolio were to experience market prices at the high end of NWE's assumed distribution, the impact could be up to \$60 million. This compares to a possible \$80 million impact if the PPL 300 MW base load contract were replaced with market purchases at the high end of the price distribution.⁵ Given that the PPL base load contract covers approximately 45% of total default supply energy requirements, NWE believes this demonstrates the large risk associated with the super-peak resource shortfall. So NWE's initial strategy was to mitigate this risk by acquiring dispatchable resources and capacity.

16. NWE stated that its portfolio modeling supports the notion that a dispatchable resource like Basin would help reduce the expected cost and risk of the default supply portfolio. NWE's resource planning process uses probabilistic analyses to assess and respond to the myriad uncertainties involved in long-term resource planning and acquisition. The GenTrader® model

⁴ In an August 23, 2002 memo to Mike Hanson and Dennis Lopach, Mark Thompson stated that reliability concerns related to the default supply portfolio were highlighted by two incidents in July, 2002 where NWE's "real time agent was unable to procure enough energy to fulfill the variable hourly load changes...." The memo is included in Exhibit 9 to Mr. Thompson's testimony.

provides both stochastic (random) and intrinsic (fixed) portfolio valuations. Stochastic valuations result from Monte Carlo analyses using over 5,000 simulations. Intrinsic valuations are based on pre-set input values for variables such as electric prices, gas prices and loads. The stress tests NWE performed to isolate specific variables and identify key risk drivers are based on intrinsic valuations. NWE evaluated numerous combinations of generic base load, dispatchable and market purchases under a range of conditions. The Company used a risk-adjusted mean portfolio cost as a leading indicator of portfolio performance.⁶ According to NWE, the risk-adjusted mean portfolio cost decreased as dispatchable resources, like Basin, and wind resources were added to the portfolio. A dispatchable resource would reduce risk by adding a relatively low fixed cost resource to the portfolio that could dispatch economically when market prices increase. Similarly, stress tests using prices that occurred during the 2000 – 2001 Western wholesale market dysfunction indicated that a portfolio with a Basin-like resource would mitigate the impact of high electricity prices. Adding wind along with a resource like Basin further benefited the portfolio under this stress test.

17. According to NWE, the portfolio modeling demonstrated that dispatchable resources would enhance supply reliability by making capacity available. Dispatchable resources would also provide a source of ancillary services and allow NWE to avoid some of the costs of purchasing these services from others. The ability to ramp a dispatchable resource up and down would complement intermittent resources like wind. Combining wind and dispatchable resources would result in a lower overall variable cost and mitigate fuel risk. Dispatchable resources could be used when power prices are high to hedge against wholesale market price spikes, while also accommodating the ability to purchase low cost power from the market when prices are low. And dispatchable resources could provide capacity to back-up unit-contingent resources. NWE asserted that the ability to purchase unit-contingent resources at a discount to firm resources would provide valuable flexibility as the Company works to optimize the portfolio.

⁵ This comparison was illustrated in more detail in Exhibit 5 to Mr. Thompson's testimony (NWE-1).

⁶ The risk-adjusted mean is determined by adding 70 percent of the stochastic mean portfolio cost to 30 percent of the 95 percent confidence level portfolio cost. The affect is to adjust the mean cost upward more for portfolios that have more risk.

Wind Integration

18. NWE asserted that wind power can be purchased at a cost that is typically lower than market or the variable cost of a dispatchable resource, which, in turn, would benefit the portfolio. But because wind speeds cannot be predicted accurately, wind generation amounts are also unpredictable. Load following and capacity would be needed to maintain reliability standards and balance loads and resources within the control area if NWE acquired wind resources.

19. NWE cannot automatically control the output of any existing generation resources to address imbalances between demand and supply. Based on hourly load data and generation variance, NWE determined that 20 MW of load following would be required to integrate 100 MW to 120 MW of wind generation into the default supply portfolio and the Company's control area. Three primary products are available for integrating wind generation. The first product, which costs the least, takes the actual wind generation and returns it one week later in a predetermined schedule. This product does not shape the wind generation; instead it removes the uncertainty by providing a known hour-to-hour schedule of energy. The second product takes the actual wind generation and returns it one week later as a flat block of firm energy. This product is more expensive than the first. NWE stated that these two products require firm transmission from the wind project to the control area of the entity supplying the integration services and firm transmission back to the entity purchasing the integration services. For NWE, this would mean firm transmission over NWE's and BPA's transmission systems at a cost of between \$9.00 and \$11.00 per mwh in addition to the cost of the integration services, which NWE stated could be purchased from BPA for \$6.00 per mwh for the first product discussed above. The combination of integration and transmission costs using these products would make wind uneconomic, according to NWE.

20. The third product, and the one NWE stated most utilities use, involves integrating wind from within the system using a resource already in the portfolio mix, such as hydro or a dispatchable resource. NWE's supply contracts do not include variable hydro generation and hydro resources in Montana provide very little control capability.

21. NWE stated that once its portfolio modeling demonstrated that dispatchable generation could be economically included in the default supply portfolio, it was also clear that such resources would allow the integration of wind at very little additional cost. NWE asserted that a benefit of integrating wind with a natural gas plant with automatic generation control is the

ability to hedge the cost of re-supplying energy anticipated from the wind resource. This energy shortfall would be made up by market purchases under the BPA wind integration product. But, with a gas plant, if market electricity prices are high the gas plant can be dispatched instead.

Optimizing a Dispatchable Natural Gas Plant

22. NWE developed a strategy for optimizing a dispatchable gas plant within the overall default supply portfolio. During periods when natural gas prices are high relative to wholesale electricity prices (similar to conditions in 2003), NWE would sell out of some forward natural gas purchases and purchase electricity at a price less than the variable cost of dispatching the gas plant. NWE could sell capacity and apply revenue credits to default supply costs.

23. If both natural gas and wholesale power prices are high (similar to conditions in 2000-2001), NWE would use forward hedges and natural gas storage to mitigate price volatility. Dispatch of the gas plant would be determined by the difference between market electricity prices and the variable costs of the gas plant. Excess energy and capacity would be sold in off-system markets and revenues credited against default supply costs. Since market prices could increase more than the fuel prices, total portfolio costs could be lower.

24. If both natural gas and electricity prices are low (similar to 1998 and 2002), NWE would evaluate options for forward hedges in both natural gas and electricity markets. The gas plant could still dispatch during short periods of high electric prices. To the extent market prices are low because of above normal hydro conditions, the gas plant will have value in the capacity market since the hydro system can't provide capacity in above normal water conditions when all turbines are loaded providing energy.

Resource Procurement Strategy

25. NWE staff performed the resource needs assessment and portfolio modeling during the summer of 2002 and presented its conclusions to management on August 23, 2002. NWE staff also presented management with a proposed near-term strategy based on the resource needs assessment and portfolio modeling results. The strategy was as follows:

1. Issue an RFP for market-based, dispatchable resources that would provide the specific, resource characteristics needed to optimize the NWE system,
2. Pursue the addition of renewable resources to the portfolio on a sound commercial basis,

3. Begin assessing demand-side resource opportunities and wind integration issues,
4. Continue to work on long-term procurement policies with a diverse committee of external advisors,
5. Implement systems, controls, forecasting and modeling to optimize the portfolio,
6. Manage volatility related to daily and monthly market purchases to minimize the cost of energy for customers.

NWE management adopted the proposed near-term strategy and recommendations.

26. NWE stated that, in hindsight, its actions during 2002 and 2003 were consistent with the intent of the Commission's electric default supply resource planning and procurement guidelines, which were adopted in March 2003. NWE focused on systematically identifying and addressing optimal resource requirements and key risk factors and referred to the emerging PSC guidelines as it selected resources.

27. According to NWE, members of its Technical Advisory Committee indicated that some amount of dispatchable resources seemed to make sense and advised NWE to model and evaluate such resources in the course of identifying an optimal portfolio. One member stated that dispatchable resources are needed to facilitate the integration of wind resources and also provide increased reliability and environmental benefits. This member noted that the Basin project has entered into an agreement with the Environmental Information Center to contribute \$500,000 toward acquiring carbon offsets, with a strong preference for Montana-based projects.

Dispatchable Resource Procurement

28. NWE used EES Consulting (EES) of Kirkland, Washington and Lands Energy (Lands) of Bellevue, Washington to develop and issue an industry standard request for proposals to a diverse set of potential suppliers. NWE designed the specific requirements in the RFP so as to limit the ability of bidders to hide or understate costs. The RFP requirements also facilitated a systematic comparison of bids. The RFP was issued on August 26, 2002 and eleven responses were submitted by the September 12, 2002 due date. According to NWE, the bidders included some of the most experienced suppliers in the national wholesale electricity market and involved a variety of existing or proposed projects across the Pacific Northwest, including four Montana projects. Before issuing the RFP, NWE, with assistance from EES and Lands, developed a rating matrix for evaluating all bids. After bids were received, the rating matrix was applied,

resulting in a short-list of six bidders. NWE did not initially identify itself as the buyer because it did not want to discourage projects being developed near load centers in Oregon and Washington from bidding. NWE knew that ultimately transmission costs would need to be considered, but the Company wanted to obtain the best representation possible of market prices and opportunities. Following discussions with short listed bidders, NWE offered an agreement to Basin.

The Basin Creek Project

29. Basin bid a 48 to 96 MW project using quick-start natural gas-fired technology in the form of either a simple cycle gas turbine or simple cycle reciprocating engines. The offered price included a \$6.50 per KW-mo capacity payment with no escalation and a \$2.15 per KW-mo fixed operations and maintenance (O&M) payment with escalation equal to the Consumer Price Index rate. NWE preferred the reciprocating engine alternative for several reasons. First, this technology would allow NWE to efficiently provide operating reserves and load following, which are ancillary services that are especially needed in the default supply portfolio, particularly if wind resources are included. Second, the reciprocating engine alternative incorporated substantial redundancy because it would rely on nine individual generators rather than one. Third, the reciprocating engines would be more efficient than a turbine at the proposed elevation of the project. Finally, reciprocating engines could be cycled more often without a significant impact on O&M costs.

30. NWE stated that during the initial negotiation process, Basin was very receptive to including NWE in major decisions regarding engine type, substation design, equipment manufacturer, project construction and operation. This process helped NWE gain a thorough understanding of the project and helped Basin in negotiating with equipment manufacturers. NWE stated that Caterpillar demonstrated a commitment to the project by agreeing to a project construction guarantee and agreeing to operate the plant. Caterpillar also agreed to finance construction and may participate in project financing.

31. Through negotiations, Basin agreed to reduce the bid capacity payment to \$5.92 per KW-mo, which amounts to about \$6.5 million over the term of the contract. Basin also agreed to reduce the bid fixed O&M payment to \$1.60 per KW-mo for additional savings equal to \$6.5 million over the term of the contract. Negotiation and analysis of reciprocating engine options

and configurations lead to improved efficiency guarantees which would further reduce the cost of energy from the plant by about \$12 million over the term of the contract. Finally, the original bid was modified to allow NWE, at its discretion, to extend the contract up to an additional 10 years, in two 5-year periods, at a discounted capacity payment of \$3.50 per KW-mo.

Basin Creek Fuel Supply

32. Basin would be fueled by natural gas. NWE asserted that, historically, the volatility of natural gas prices has been much lower than that of electricity. As a result, NWE asserted, exposing the default supply portfolio to natural gas volatility is preferable to exposure to spot electricity prices. Fuel risk in the planned portfolio would be small in relation to the overall portfolio cost since NWE would obtain 83 percent of energy requirements from fixed price base load and shaped resources. NWE estimated that a \$1 increase in the price of natural gas would translate into an impact on the total portfolio cost of less than 1%, other things being equal. However, NWE emphasized that other things would not likely remain equal following a \$1 increase in natural gas prices. Risk related to high fuel prices would only come into play if electricity prices are high enough to make dispatching the plant economic. Therefore, a concern about high fuel prices implies a concern that electricity prices will also be high, and suggests NWE should not continue to rely on short-term markets to serve the top part of the load. NWE's modeling showed that taking on a small amount of fuel risk would be preferable to a full base load portfolio and that the diversity of a dispatchable resource would be valuable for efficiently serving the last 20 to 30 percent of the portfolio's energy requirements.

33. NWE stated it would manage natural gas supplies for Basin using forward transactions and natural gas storage. The Commission would be able to review and evaluate NWE's fuel procurement and dispatch practices on an annual basis.

NWE would procure Basin to serve specific functions within the default supply portfolio. In order of importance, these functions are: 1) enhance reliability of supply, 2) provide ancillary services, 3) facilitate the integration of wind resources, and 4) provide economically dispatchable energy and capacity. NWE asserted that about 60% of the \$4.5 million annual fixed cost of the Basin contract would directly offset ancillary service and capacity payments currently flowing to other utilities. Basin would provide firming for integrating wind resources. And Basin would

provide opportunities to sell excess capacity when the unit is not being used to supply energy to default supply customers.

34. Table 2 summarizes the costs associated with the agreement.

Table 2

	Capacity (MW)	Annual Cost
Capacity charge	50	\$3,552,000
Fixed O&M charge	50	\$960,000
Total:	50	\$4,512,000
Less:		
Load Following	13	\$(1,365,000)
Operating reserves	30	\$(1,512,000)
Total Fixed Cost:	50	\$1,635,000

DISCUSSION AND DECISIONS

35. NWE's current default supply portfolio consists solely of baseload and shaped contracts and short-term market purchases. The addition of Basin to the portfolio would expand the tools available to NWE for managing a range of portfolio costs. The result would be a more diversified and more flexible portfolio. Basin is a small resource. It may provide about 3% of the energy used by default supply customers. But it would contribute to the portfolio in important ways and these contributions would be obtained for reasonable and relatively small annual fixed costs.

36. The Commission approves the price term and quantity in NWE's Application. In reaching this decision the Commission determines that:

1) The proposed contract is in the public interest today,

2) NWE's selection of the Basin resource, and the negotiated price, quantity and duration reflect a reasonable effort by NWE to comply with the objectives in § 69-8-419, MCA, and the Commission's Default Supply Resource Planning guidelines at A.R.M. 38.5.8201-29, and

3) The price, quantity and duration in the proposed contract are reasonable today.

37. PPL was the only party to oppose Basin. PPL asserted that before determining that Basin is a reasonable resource for the portfolio the Commission must reach two conclusions: first, that the portfolio needs dispatchable resources; second, that Basin compares favorably to other resources or products that might supplement or supplant it in the portfolio. PPL-1, p. 10. The bulk of PPL's testimony attempted to show that the Commission could not reach these

conclusions, at least at this time. On the contrary, the Commission finds that the record in this proceeding supports these conclusions.

Montana Consumer Counsel

38. MCC asserted that a resource such as Basin would likely fit with any probable supply portfolio, especially one that includes a significant and economical wind power component. MCC stated that a significant and economical wind power component would be approximately 100 MW with an energy only cost in the 3¢/kwh range. MCC, through witness John Wilson, stated that although he has some concerns with the proposed power purchase agreement, Basin has a number of desirable features and, on balance, he does not oppose Commission approval of the agreement, especially if key concerns are resolved.

39. MCC's first concern regards Article 5.06 of the proposed agreement, which would require a FERC market-based rate filing. The proposed agreement would allow NWE and Basin to review and comment on a draft prior to filing it with FERC. MCC asserted that the Commission and MCC should also be entitled to review any FERC filing before it is submitted.

40. Article 11.03 of the proposed agreement would provide that if NWE were to become insolvent in the future, Basin could suspend the agreement and sell any output to a third party. MCC stated that a suspension of the agreement should only occur if NWE fails to pay under the terms of the agreement. MCC recommends that Article 11.03 be removed.

41. Article 11.02 of the proposed agreement would give NWE the right to "step-in" if Basin fails to deliver power. However, that right would be subordinated to lender's rights. MCC asserted that it would be preferable if NWE could step in and operate the plant rather than having a bank take over. MCC did not recommend any changes to the language in Article 11.02, but stated that NWE's control over operation of the plant if Basin fails might be assured if the operating committee established in Article 4.09 of the Agreement remained unchanged if lenders exercised their rights under Article 11.02. MCC also stated that the priority for revenue distribution in the event of a "step-in" seems out of order in the proposed agreement; lenders would get paid first and project operating costs would be fifth in line. MCC recommended that these priorities be restructured or explained.

42. MCC stated that the assignment provisions in Article 14 would not limit the transfer of control or ownership of the LLC. MCC asserted that Basin should not be allowed to transfer

control of the LLC to anyone without limitation, otherwise the assignment provisions would have little value.

43. Finally, with respect to disclosure of proprietary information, MCC stated that the agreement should permit such disclosure to the Commission.

44. MCC also identified several desirable features of the Basin resource, such as the heat rate and forced outage rate guarantees. MCC stated the capacity charges for the initial contract period and the extended period are in an expected range and are slightly less than such charges for other projects, e.g., Montana First Megawatts. MCC noted that Basin would enable NWE to achieve significant reductions to current expenditures on system load following and reserves.

45. Basin's capacity would come from small individual units and would be expandable in approximately 6 MW increments. This would provide NWE flexibility and limit outage exposure. And NWE would have 2/3 voting control within a plant operating committee, underscoring NWE's involvement and its dispatch control.

46. MCC asserted that Caterpillar's ongoing role with the project and its financing is favorable, but recommended that the Commission require a direct affirmation by Caterpillar of its role in construction, operation, maintenance and financing as a precondition of approval.

47. At the public hearing, NWE provided a copy of an amendment to the proposed Basin power purchase agreement which addressed a number of MCC's recommendations. FERC filings would be provided to the Commission and MCC for review; Section 11.03 of the original agreement was deleted; project operating costs were provided first priority for revenue distribution in a "step-in" event; and the Commission and MCC would be permitted access to proprietary information. NWE also submitted a late filed exhibit containing a letter from Caterpillar affirming its role in the construction, operation, maintenance and financing of Basin, as MCC recommended.

48. With respect to MCC's other recommendations, the Commission directs NWE to ensure that Basin and Caterpillar execute an operation and maintenance agreement that is consistent with the power supply purchase agreement NWE submitted with its Application, including all amendments thereto. The operation and maintenance agreement must enable NWE to call on Basin's capacity and energy to serve the needs of the default supply portfolio as NWE's Application represents would be possible. To the extent a final, executed operating agreement between Basin and Caterpillar prevents the facility from operating consistent with the

terms of the power supply purchase agreement between NWE and Basin, or any successor or assignee, NWE is not entitled by this Order to recover additional costs that result. NWE must also ensure that the operating agreement between Caterpillar and Basin would continue in all material respects in the event of a sale or transfer of control of Basin Equity Partners, LLC. NWE must provide the Commission with a copy of a final signed and executed power supply purchase agreement that satisfies these conditions.

49. NWE's compliance with these conditions will reasonably address MCC's recommendations.

Renewable Northwest Project/Natural Resources Defense Council

50. RNP/NRDC, through witness Ann Gravatt, supported NWE's proposal for advanced approval of the Basin project and highlighted the connection between Basin and new wind resources for the default supply portfolio. RNP/NRDC stated that adding wind power to the default supply portfolio would diversify the portfolio and reduce risks related to over-reliance on a single source of electricity or a single fuel. Because wind power can be developed in a short period of time, it would reduce the risk of over or under building generation. Wind power produces no harmful environmental emissions and, therefore, would help keep Montana's air clean and hedge risks related to possible future environmental regulation.

51. RNP/NRDC asserted that including wind power generated in Montana in the default supply portfolio would produce economic development benefits to local communities. Such benefits would include additional income for farmers from land-lease payments and additional tax revenue. Wind development would also produce construction jobs and additional sales for local vendors of goods and services.

52. RNP/NRDC believes NWE recognizes the advantages of wind power because all four of the preferred portfolios include 150 MW of wind capacity. But while Montana has the best wind resource in the eleven-state Western region, RNP/NRDC asserted that Montana has been called the great underachiever when it comes to development of wind resources. Neighboring states with significantly less wind resources, such as Oregon and Washington, have 637 MW of combined wind power operating and serving customers. Wyoming has developed 300 MW of wind power. NWE and its predecessor, Montana Power Company, have attempted many times to acquire wind power but have not been successful. RNP/NRDC stated that NWE lost an

important opportunity by not finalizing an agreement with one of the 2002 RFP finalists by June 2003; a project could then have been built and operational by the end of 2003, qualifying for both the federal Production Tax Credit (PTC) and an additional accelerated depreciation bonus.

53. RNP/NRDC recommended that if the Commission approves Basin, it should also require NWE to execute a contract for no less than 75 MW of wind power before Basin becomes operational. NWE justified Basin, in part, by pointing to its ability to help integrate wind power. RNP/NRDC recommended that the Commission make the connection to wind explicit. RNP/NRDC asserted that its recommendation would not hinder Basin for several reasons. First, NWE stated that it is committed to including wind in its portfolio. Second, NWE is currently negotiating to acquire output from a Judith Gap wind project. And third, the time required by this proceeding and subsequent approval by the bankruptcy court, along with the time needed to construct the Basin plant, would provide ample time for NWE to either finalize negotiations on the Judith Gap project or complete an RFP and execute a contract for a new wind project.

54. Uncertainty about the PTC should not prevent NWE from pursuing acquisition of wind power. RNP/NRDC stated that the federal (PTC) for wind power is critical to making wind power a cost competitive resource today. The PTC expired on December 31, 2003 but is broadly supported in Congress on a bipartisan basis, according to RNP/NRDC. RNP/NRDC recommended that NWE include provisions in any wind power contract making the contract contingent on the extension of the PTC.

55. RNP/NRDC stated that even if the Commission does not adopt its recommendation, it would still support the Basin plant. RNP/NRDC acknowledged the risks associated with NWE's peak loads and noted that Basin agreed to off-set its carbon dioxide emissions through a contribution to the Oregon Climate Trust.

56. Ultimately RNP/NRDC wants NWE to follow through on its commitment to acquiring wind. The Commission shares this desire. Wind resources can make an important contribution to a diverse, reasonably priced and environmentally responsible default supply portfolio. Wind and natural gas-fired resources complement one another and NWE should assign a high priority to harnessing Montana's abundant wind resources to complement Basin.

57. The Commission supports including wind resources in the default supply portfolio. It does not accept RNP/NRDC's recommendation that Basin's operation be conditioned on execution of a wind power purchase agreement. RNP/NRDC's proposal could unintentionally

compound the lost opportunities RNP/NRDC aptly described. Today, it certainly appears that NWE should be able to execute a wind agreement before Basin is operational. However, circumstances can change. To the extent Basin becomes operational and economic to dispatch, customers should not have to incur higher costs because NWE has not yet executed a wind power purchase agreement due to some unforeseen circumstance. The Commission supports NWE's commitment to acquire wind resources, but that support is not unconditional. NWE should pursue a quality project with credible and knowledgeable counterparties, conceived and sited with due regard for operational, transmission, environmental and other issues. The Commission does not want to jeopardize these goals by creating a "go-fever" attitude, which might produce unintended consequences, such as a contract that fails to lead to a completed project or leads to a substandard project. This could occur if the operation of Basin is conditioned as RNP/NRDC recommends.

PPL-Montana

58. PPL, through witness Michael King, asserted that there is a relationship between NWE's default supply plan and the Basin advanced approval Application. Because of this relationship, PPL asserted that NWE could not determine that a dispatchable resource like Basin should be part of the portfolio before completing the default supply planning process, obtaining Commission comments and revising its plan accordingly. PPL-1, p. 5.

59. In a perfect world, PPL's vision might be appropriate. In this imperfect world, NWE is obligated to prudently procure adequate default supply resources. This obligation is independent of the Commission's default supply planning guidelines and whether the Commission has reviewed and commented on NWE's planning process and methods. As real world events unfolded, NWE was pursuing resource procurement activities at the same time that the Commission was developing default supply planning and procurement guidelines and the legislature was considering mandatory Commission review and comment provisions. Furthermore, portfolio planning and resource procurement are on-going processes; there is never a final plan or a truly finished portfolio. It would have been impossible and imprudent for NWE to completely stop all market activities and ignore possible long-term resource procurement opportunities because the Commission had undertaken a process to develop guidelines that the Company would eventually need to consider. The Commission's guidelines are designed to

facilitate on-going planning and resource procurement. Although there is a relationship between NWE's default supply plan and this advanced approval Application, the Commission will not reject NWE's Application simply because the procurement activity preceded the Commission's comments on the plan and NWE's incorporation of those comments into its planning process.

60. PPL also asserted that NWE failed to make its case for Basin because the groundwork for the portfolio it selected rests on data, assumptions and a methodology that should be reviewed in the context of the default supply plan. PPL-1, p.16.

61. PPL's assertion is misplaced because the same data, assumptions and methodology were contestable issues in this proceeding. In addition, the Commission has reviewed NWE's default supply plan and issued written comments on the plan. Although the Commission recommended that NWE consider enhancing its long-term analytical methods, the Commission's comments were not an impeachment of NWE's portfolio planning approach or modeling assumptions. The Commission determined that the probabilistic analyses NWE conducted using the GenTrader® modeling software were appropriate because they incorporated explicit assessments of uncertainty and, therefore, helped to identify and evaluate risks and interrelationships between variables. The Commission also determined that NWE's analyses have value and that the near-term action plan appears reasonable and supportable in the shorter term. With respect to Basin, NWE's stochastic modeling results can likely be extrapolated over the initial term of the proposed power supply purchase agreement. As MCC noted, Basin would fit with any likely supply portfolio. MCC-1, p. 5. While the Commission highlighted shortcomings of NWE's single-year analysis from an overall planning perspective, the single-year analysis is not by itself a fatal flaw for the Basin advanced approval Application.⁷

62. PPL asserted that NWE's portfolio evaluation process was flawed because assumptions for gas prices, power prices and volatility unrealistically predisposed the analysis to conclude that the default supply portfolio needs dispatchable gas-fired resources. PPL-1, p. 17. PPL specifically criticized NWE's stochastic analysis for not centering the probability distribution for natural gas prices at current forward gas prices, which it asserted are above \$6.00 per mmbtu. PPL-1, p. 27.

⁷ The single year analysis issue is related to the stochastic modeling, not to the analysis of Basin's bid. All bids submitted in the August 2002 RFP were evaluated over the lives of the offers.

63. NWE's single-year stochastic analysis notwithstanding, NWE's approach to pricing natural gas in the stochastic modeling is more valid than the approach PPL suggested. PPL's approach is extremely short-sighted. NWE used natural gas prices forecast by the NWPPC for 2005. The Commission's written comments on NWE's default supply plan found NWE's use of NWPPC information reasonable. In nominal dollars per mmbtu, NWPPC forecasted medium AECO natural gas prices of \$5.03 in 2003, \$4.05 in 2004 and \$3.30 in 2005. Observed prices for 2003 averaged approximately \$5.00. It remains to be seen how accurate NWPPC's forecast is for 2004 and 2005, but the near term downward trend is common to several forecasts, including R. W. Beck, PacifiCorp, California Energy Commission and U.S. DOE Energy Information Administration. PPL's suggestion that current forward gas prices should be used to evaluate the long-term cost effectiveness of Basin is not reasonable.

64. In addition, PPL's criticism focused on NWE's initial modeling, which used gas prices between \$2.70 and \$3.35 per mmbtu. PPL-1, p. 26. But NWE also modeled alternative portfolios using an average gas price of \$4.20 per mmbtu. NWE provided the results in response to data request PSC-5. These stochastic analyses indicate that adding a resource similar to Basin, along with wind, reduces the average expected cost of the portfolio and also reduces the 5th percentile cost, which is an indication of how high the portfolio's cost could be given a range of possible electricity and natural gas prices. Based on NWE's risk-adjusted portfolio cost measure, the same four portfolios are preferred whether NWE's initial natural gas prices or the \$4.20 natural gas prices are used. The shape of NWE's gas price probability distribution is supported by the distribution of observed AECO natural gas spot prices during 2003 and 2004. Based on NWPPC's forecast, NWE's use of a \$4.20 per mmbtu average appears to be a reasonable assumption for stochastic modeling through about 2014. PPL did not dispute this aspect of NWE's analysis.

65. PPL asserted that one of the keys to meaningful stochastic results is using the right expected prices for electricity and natural gas, but that the electricity and natural gas prices NWE used are not consistent with one another. PPL-1, p. 38. PPL reached this conclusion by using two methods. First, PPL analyzed the implied heat rate derived from NWE's model inputs compared to actual market implied heat rates in 2002 and 2003. Second, PPL modeled how Basin would have dispatched during 2002 and 2003. PPL's results showed a lower market

implied heat rate (8.1 mmbtu per mwh compared to NWE's 14.1 mmbtu per mwh) and fewer dispatch hours (about 10% compared to NWE's 38% to 50%).

66. PPL correctly stated that assumptions about electricity and natural gas prices are critical to meaningful stochastic results. However, PPL's findings regarding the consistency of NWE's electricity and natural gas price assumptions were not convincing for several reasons. First, NWE asserted that Basin would be procured to provide multiple services including reliability, ancillary services, wind firming, and economic dispatch of energy and capacity, in that order of importance. NWE-1, p 66. PPL's analysis seemed to assume that Basin would only be used to serve peak energy needs. In reality, the market implied heat rate, as PPL calculated it, would not be the only measure of whether it is economic to dispatch Basin. The GenTrader® software looks at multiple economic criteria when deciding when and how Basin should be dispatched to provide the portfolio the best value. PPL agreed that each product or resource must be considered in the context of the entire portfolio (PPL-1, p.14), but seemed to ignore the full range of Basin's contribution to the portfolio when evaluating dispatch potential.

67. Second, PPL's analysis of how Basin would have functioned as a source of peak supply in 2002 and 2003 might not have accurately captured all dispatch opportunities. PPL used daily price midpoints at Mid-Columbia. PPL-1, Exhibit MJK-10. In response to data request PSC-2, NWE provided actual hourly Mid-Columbia prices for 2002 and 2003. Often there are significant differences between actual hourly data and the price midpoints PPL used. Similarly, PPL used average monthly AECO natural gas prices, rather than daily prices. PPL's use of price midpoints and monthly gas prices might have masked super-peak dispatch opportunities. In any case, applying a portfolio perspective, NWE's stochastic modeling results showed that including a resource similar to Basin, along with wind, would reduce portfolio costs and risks. The stochastic results also showed that acquiring wind without a resource like Basin, and using BPA's integration products, would result in higher portfolio costs.⁸ A portfolio perspective reveals that the dispatch opportunities, and consequently the value of a resource like Basin, would depend on more than just the market implied heat rate for peak power. Finally, because NWE could store natural gas supplies, the cost of gas incurred to dispatch Basin would not necessarily reflect spot market prices at a given point in time. Therefore, the relationship

⁸ See NWE response to data request PSC-5, portfolio #3 compared to portfolio #s 6 and 9 under the \$4.20 natural gas case.

between market electricity prices and NWE's gas costs would not necessarily mirror the relationship PPL described.

68. PPL asserted that Basin would not be able to provide all the services NWE promised. PPL-1, p. 46. For example, PPL seemed to find it inconsistent for NWE to assume Basin could operate at a 50% capacity factor to provide energy at the same time it assumes the project would offset 30 MW of operating reserves and 13 MW of load following from other sources.

69. It is true that Basin would not be able to provide all the services NWE attributed to it at the same time. However, NWE did not make such a promise. Basin would be capable of contributing to the provision of multiple default supply services and NWE's assumption of a 50% capacity factor does not predetermine which services would be provided in what quantities. The only thing a 50% capacity factor implies is that Basin generates about 219,000 mwh of electricity. Some of those mwhs might be related to the provision of operating reserves, others to load following and wind integration, others to peak supply. Situational economics evaluated in the context of overall portfolio management will dictate how, or if, Basin should be run at any point in time.

70. PPL asserted that a prerequisite for determining that Basin should be part of the default supply portfolio is a conclusion that Basin compares favorably to other resources that might supplement or supplant it in the portfolio. PPL-1, p. 10. PPL then concluded that Basin looks expensive. PPL-1, p. 46.

71. PPL estimated the present value of Basin's capacity-related payments to be \$790 per KW, using a 7% discount rate. RDR PSC-17. PPL compared this cost to a NWPCC estimate of \$600 per KW for a simple cycle gas turbine in year 2000 dollars, which when inflated to 2004 dollars at 1.6% per year is \$640 per KW. However, NWPCC's \$600 per KW cost is an overnight cost that does not reflect financing costs and interest during construction. NWPCC estimated all-in costs to be \$679 per KW in 2000 dollars, which is about \$735 in end-of-year 2004 dollars using PPL's 1.6% inflation rate. The imputed cost of Basin is, therefore, generally consistent with NWPCC's cost assumption (if an 8% discount rate is used the imputed cost of Basin matches NWPCC cost assumption). Additionally, since the single cycle combustion turbine NWPCC characterized has an assumed heat rate of 9,900 btu per kwh, the higher cost of Basin could be attributed to its better heat rate of 8,800 btu per kwh.

72. PPL also asserted that Basin's operating costs appear to be high. PPL-1, p. 47. PPL suggested that fixed operation and maintenance (O&M) costs of combined cycle units are generally between \$10 and \$15/KW-year but Basin's are \$19.20 per KW-year.

73. In addition to the fact that Basin is a reciprocating engine not a combined cycle plant, PPL did not explain whether property taxes are included in the \$10 to \$15/KW-year figures they cite. NWPCC's resource characterization information indicates that its fixed O&M cost assumptions do not include property taxes. NWE stated that 20 percent of Basin's fixed O&M costs are related to property taxes. If property taxes are removed, Basin's fixed O&M costs are \$15.36/KW-year, which are in line with PPL's figures.

74. According to PPL, NWE should have conducted an all-source RFP in order to demonstrate that it considered all alternatives before selecting Basin. In response to discovery PPL clarified this testimony, stating that there is not a standard industry practice for resource procurement that is applicable to all circumstances and that when the needs of the portfolio are well understood, narrowly defined RFPs may be appropriate. RDR PSC-14.

75. NWE reasonably determined that the portfolio needs dispatchable resources. The variable nature of NWE's default supply load was well documented in this proceeding. The loss of substantial industrial load under retail choice has resulted in a default supply load factor of 58 percent. NWE-1, p. 20. The default supply load factor is substantially below that of surrounding utilities. The lower load factor makes the default supply load relatively more difficult and expensive to serve, other things being equal. PPL did not dispute the variability of default supply loads; it questioned NWE's chosen approach to supplying these loads.

76. To serve the variable and peak default supply loads NWE could either procure dispatchable resources itself, or contract with a supplier to dispatch resources and/or assemble market products to serve the loads. By procuring a dispatchable resource itself, NWE would acquire a flexible tool for serving default supply loads. Deciding how best to use that tool would require on-going analysis and management skill; current and future gas prices, storage strategies, current and future electricity prices, loads, demand-management opportunities and weather conditions would have to be evaluated constantly. On the other hand, contracting with a supplier to deal with the uncertainty associated with all these variables would make things easier for NWE, but would come at a cost. Such trade-offs should be evaluated and RFPs could provide useful information related to such trade-offs.

77. NWE's decision to confine the RFP to combustion turbine offers may not have been optimal, or preferable under the planning guidelines the Commission subsequently adopted. However, the record in this case does not indicate that NWE's August 2002 RFP is a fatal flaw in this advanced approval Application. First, NWE-1, Exhibit MDT-9, shows that NWE began analyzing default supply portfolio needs in May 2002, prior to the Commission's Order on Montana Power Company's proposed portfolio (see Docket No. D2001.10.144, Order No. 6382d.) By late August 2002, NWE had developed a near-term strategy that included procuring wind resources. That strategy, along with an assessment of the variability of default supply loads and the need to enhance reliability, supports NWE's decision to procure resources that could be controlled and dispatched on an as-needed basis through Automatic Generation Control (AGC describes equipment that automatically adjusts an electric power control area's generation from a central location.⁹).¹⁰ NWE identified a specific portfolio need and designed an RFP to procure resources to serve that need. PPL acknowledged that this is an acceptable industry practice.

78. Second, NWE's late filed exhibits indicate that even if NWE's RFP had more broadly requested variable load products or peaking and reserve products, as Montana Power Company did in March 2001, offers likely would have been tied to gas-fired resources. Further, despite requesting combustion turbine offers in the August 2002 RFP, NWE received bids from a coal-fired power plant developer and several synthetic plants (financially created products that are not tied to any physical assets). TR 72-75. These market products did not offer the flexibility and controllability NWE determined the portfolio needed. The products PPL suggested NWE should have considered, for example, slice of system, dispatchable products not tied to a specific resource, and shaped products, would also likely have failed to provide the flexibility and AGC NWE's RFP was designed to obtain.

79. Third, NWE's actions were consistent with the behavior of other regional market participants in similar circumstances. NWPC found that "[t]he price excursions, threats of shortages and abnormally poor hydro conditions of 2000 and 2001 sparked a renewed interest in

⁹ Duke Energy, *The Energy Desk Book*, Appendix C to NWE's January 2004 Electric Default Supply Resource Procurement Plan.

¹⁰ Exhibit MDT-9 describes how on two separate occasions in July 2002, NWE's real-time scheduling agent was unable to procure sufficient energy to meet variable, hourly default supply load changes. This document also describes "significant short term price instability and transmission constraints for energy delivered to the state."

simple-cycle turbines as a hedge against high power prices, shortages and poor water.”¹¹ Acquiring simple-cycle turbines is an accepted strategy employed by industrial customers exposed to wholesale power prices and utilities exposed to hydro power uncertainty.

80. Given that different approaches could be used to serve the resource needs NWE identified, a diverse portfolio could employ several of these approaches. That would mean procuring some dispatchable resources. In addition, customers benefit if NWE actively and constantly refines its skills as a wholesale market participant, which it would have to do to prudently manage dispatchable resources. NWE’s on-going responsibility for optimizing the dispatch of a gas-fired resource, including fuel management, along with routine prudence reviews by the Commission, should encourage NWE to hone its skills, to the benefit of customers.

81. PPL suggested that the offers NWE received in its August 2002 RFP are dated and that the market has changed dramatically over the last several years. PPL-1, pp. 17-20. PPL asserted that the cost of developing new generation projects today is substantially less than it was two years ago.

82. PPL did not provide evidence in its testimony supporting these assertions. In response to discovery, PPL pointed to cost estimates by, for example, NWPCC. As already explained above, the imputed cost of Basin is comparable to NWPCC’s cost estimates. And although RFP’s are a fundamental aspect of the Commission’s procurement guidelines, they are not the only means of monitoring what is available in the market. NWE’s on-going market surveillance should be sufficient to determine whether markets may have shifted enough to warrant incurring the added transactions costs of refreshing a previous RFP. MCC’s testimony further supports this view. MCC’s witness stated that he had been monitoring the market and concluded that the assessment of Basin in 2002, along with the improvements that have occurred since that time, continue to support its justification today. TR 295.

83. Although PPL questioned whether the bids NWE received in response to the August 2002 RFP were dated, and whether the scope of the RFP was broad enough, neither PPL nor any other party to this proceeding challenged the way NWE processed the RFP, ranked bids and selected winners. The Commission determined in its comments on NWE’s 2004 default supply

¹¹ *Draft Natural Gas Simple-Cycle Gas Turbine Power Plants*, Northwest Power Planning Council New Resource Characterization for the Fifth Power Plan, February 2, 2004.

plan that the solicitation appeared to reasonably comply with Commission guidelines. The bid evaluation analysis NWE presented in this proceeding supports its selection of Basin for contract negotiations.

CONCLUSIONS OF LAW

1. All conclusions of law reached above are incorporated herein.
2. The Montana Public Service Commission (Commission) regulates the rates and services of public utilities. Title 69, Chapter 3, MCA.
3. NorthWestern Energy (NWE) is a public utility subject to the jurisdiction of the Commission.
4. NWE is a distribution services provider and a default supplier of electricity supply. §§ 69-8-103(8)(9)(11) and 69-8-210(1), MCA.
5. NWE is obligated to procure a portfolio of electricity supply to meet the requirements of all default supply customers. § 69-8-208(3), MCA.
6. The Commission may, but is not required, to process this Application according to § 69-8-421, MCA.
7. Pursuant to § 69-8-421(3)(c), MCA, the advanced approval of the agreement presented in this Application, according to the terms of this Order, is in the public interest; the agreement is a result of a reasonable effort by NWE to comply with § 69-8-419, MCA, and the administrative rules referenced in that section; and the price, quantity, duration and related terms of the agreement are reasonable.

ORDER

1. The capacity and facility charges specified in Exhibit B of the power purchase agreement are reasonable.
2. The good faith estimates of charges for fixed and variable operation and maintenance specified in Exhibit D of the power purchase agreement are reasonable. NWE must prudently administer the terms of the agreement related to the determination and collection of actual fixed and variable operation and maintenance charges.
3. The initial 20 year term of the power purchase agreement is reasonable. NWE must assess the potential advantages and disadvantages of exercising the options to extend the term of

the power purchase agreement pursuant to Section 2.03 of the agreement and submit its findings to the Commission for review and comment prior to exercising the options. This assessment may be included in a default supply plan or plan update.

4. Fuel procurement and dispatch activities are not approved in advance. Fuel procurement and dispatch of Basin will be evaluated for prudence in the context of default supply cost recovery applications filed by NWE.

5. NWE must file a final signed and executed power purchase agreement, including appropriate amendments consistent with the Commission decisions in this Order.

6. NWE must ensure that Basin Creek Equity Partners LLC and Caterpillar execute an operation and maintenance agreement that is consistent with the terms in the final signed and executed power purchase agreement between NWE and Basin Creek Equity Partners LLC. NWE must ensure that the operation and maintenance agreement between Basin Creek Equity Partners LLC and Caterpillar will continue in all material respects in the event of a sale or transfer of control of Basin Creek Equity Partners LLC.

DONE AND DATED this 7th day of September 2004, by a vote of 3-2.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

BOB ROWE, Chairman

TOM SCHNEIDER, Vice-Chairman, Voting to Dissent
(To Be Filed)

MATT BRAINARD, Commissioner

GREG JERGESON, Commissioner

JAY STOVALL, Commissioner, Voting to Dissent
(To Be Filed)

ATTEST:

Connie Jones
Commission Secretary

(SEAL)

NOTE: Any interested party may request the Commission to reconsider this decision. A motion to reconsider must be filed within ten (10) days. See ARM 38.2.4806.