Service Date: July 28, 2004

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

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IN THE MATTER of NORTHWESTERN	)	UTILITY DIVISION
ENERGY'S Application for Electric Supply	)	DOCKET NO. D2004.6.90
Deferred Cost Account Balance and Projected	)	
Electric Supply Cost	)	INTERIM ORDER NO. 6574

INTERIM ORDER

Findings

Background

1. On June 7, 2004, NorthWestern Energy (NWE) filed its electric default supply tracker filing with the Montana Public Service Commission (Commission). NWE filed this application late for the second time in two years. In Docket No. D2001.10.144, Order No. 6382d, the Commission stated: "A filing for approval of interim rates to recover electricity supply costs for the period July 1, 2003 through June 30, 2004 must be made no later than June 1, 2003." The Commission again reminds NWE that annual electric default supply tracker filings must be filed no less than 30 days prior to the proposed effective date of the rate change (which is normally July 1st). The filing contained the following elements: 1) the electric supply deferred cost account balance for the 24-month period ending June 30, 2004 and the projected electric load, supply and related costs for the twelve month period July 1, 2004 through June 30, 2005; 2) a request to continue the monthly electric tracker; 3) a request for authority to recover costs and corresponding lost revenues associated with Demand Side Management (DSM); 4) a request to recover costs associated with the Tiber Montana Hydro Project and the Thompson River Co-Gen LLC project; and 5) a request to include the Public Service Commission (PSC) and Montana Consumer Counsel (MCC) fees in the electric default supply cost.

2. The first annual electric default supply tracker filing was assigned Docket No. D2003.6.77. An interim order was issued in that Docket with the deferred account balance for the 2002/2003 tracking period set at zero pending a final order in that Docket. Due to the Company's bankruptcy, the Docket was suspended. NWE proposes that the Docket No. D2003.6.77 and this docket be processed simultaneously under a combined procedural schedule.

3. In the transmittal letter NWE indicated that it had become aware of the possibility that Commercial Energy choice customers might return to Electric Default Supply. The filing did not reflect the addition of any of these customers in projected loads. If and when customers actually return to default supply, NWE proposes to reflect this change in the monthly tracker filings. On June 10, 2004, Patrick R. Corcoran, NWE Regulatory Affairs, sent an email to Staff indicating that the following choice customers would be returning to the default supply on or about July 1, 2004: Commercial Energy will return all of its electric customers. The return will begin about June 18, 2004 and continue through July 2, 2004. Commercial Energy's load now is approximately 22-25 MW. PPL is returning Interstate Brands to default supply. That load is approximately 700-800 kW. Jupiter Sulphur will return to default supply effective July 1, 2004. That load is approximately 1.5 MW. Thomas Operating is returning to default supply effective July 1, 2004. That load is approximately 700-800 kW.

4. Due to the material amount of load returning to the default supply, the staff on June 10, 2004, replied to Mr. Corcoran via email that the filing needed to be changed to include the loads described. Mr. Corcoran agreed to make an updated filing to include the loads returning to the default supply. NWE made an updated filing on June 18, 2004.

5. The updated filing estimates the returning load to default supply to be 200,554 MWh (217,336 including line losses). The original filing proposed average rate was $40.584 per MWh after losses, but because the returning load will most likely be supplied from the short term market, the average per MWh cost is estimated to increase to $41.084. The total incremental cost due to the returning load is estimated to be $2,770,791.

6. NWE Schedule No. ECCGP-1 (Electric Customers Choice Guidelines and Procedures) , paragraph 8, states that if a group of choice customers with an annual average monthly demand greater than 5,000 kW returns to default supply, the default supplier must make an assessment of the impact that such a return will have on other default supply customers. Since these loads are

returning piece meal over the next few weeks, it is unclear if there is a group that meets the 5,000 kW requirement. NWE conducted the required analysis in total.

7. On July 8, 2004, the Commission issued Notice of Opportunity to Comment on Specific Issue Related to Choice Customers Returning to Default Supply. This Notice sought comments, for purposes of this interim decision, "on the application of Montana law to the former choice customers identified … who have returned to default supply." The Notice referred to §69-8-201(5), MCA, and Schedule No. ECCPGP-1 and asked "… whether the former choice customers identified must pay, or may be required to pay, an amount sufficient to protect small default supply customers from the impact on annual average default supply unit costs of the former choice customers' decision to return to default supply." Comments in response to the Notice were filed by NWE, MCC, AARP, Commercial Energy of Montana, and the Large Customer Group.

8. In the June 16, 2003 filing, Docket D2003.6.77, NWE requested approval to reflect the electric supply deferred cost account balance of $8,178,379 for the twelve month period ending June 30, 2003. This balance includes a cost overcollection of ($593,935) and $8,772,311 of under recovery directly attributable to the startup of the new electric tracker. NWE's June 2002 tracker filing included one-half month revenues of authorized rates under the new tracker for service on and after July 1, 2002. NWE's billing system began to reflect these new rates in customer bills on a prorated basis at that time. This means that approximately one-half of the July metered usage, and related revenues, actually covered costs related to power purchased under the "buyback contract" with PPL Montana which expired June 30, 2002. According to NWE these revenues did not cover new default supply costs, and therefore, should not have been included in the tracking period.

9. On July 1, 2003, the Montana Consumer Counsel (MCC) filed comments on NWE's application for interim relief in Docket No. D2003.6.77. MCC commented that NWE claimed an under recovery of $8,772,311 of so-called startup deferred supply cost expense. The Company claimed that the startup expense was attributable to a full month of default supply purchase costs in July 2002, but only a half month of default supply revenue. While NWE acknowledged that it did in fact collect revenue for a full month of service in July 2002, the company argued that due to its metering and billing cycle, one-half of this amount was to pay for June 2002 consumption and one-half for July consumption – with the remaining one-half of July costs reflected on

August bills, and so on. NWE argued that energy revenues always lag energy deliveries by half a month, and the Company proposed to charge ratepayers for the difference. NWE's tracking calculations included only eleven and a half months of revenue, but twelve months of electric default supply expense, even though the purchases are at some point matched with revenues. It appeared to MCC that the startup deferred supply cost expense issue was an improper accounting adjustment that should not have been included in the electric supply deferred cost account balance. It should be considered, if at all, within the context of the Company's overall working capital needs as part of a proper revenue and cost lead-lag study in a general rate proceeding.

10. MCC questioned whether the electric supply deferred cost balance of $8.2 million was truly appropriate for interim treatment. NWE did not challenge the MCC position for interim purposes. NWE proposed and the Commission accepted that the 2002/03 Electric Supply Deferred Cost Account Balance should be set to zero for the purpose of determining interim relief in Docket No D2003.6.77.

11. In this filing, NWE again provided testimony on the issue of under recovery in the month of July 2002. On further review the Company determined that its initial presentation in Docket No. D2003.6.77 should have included a full month of July 2002 supply revenues. This adjustment reduces the $8,178,378 by $2,485,401 resulting in a revised amount of $5,692,977. This balance was carried forward as the deferred account starting balance for July 2003. The below insert shows the computations for the revised amount.

2002-2003 TRACKER PERIOD:					
	Jun-03 Filing		**Jun-04 Filing**		**Difference**
Month of Jul02 only:					
Revenue	$ 6,882,280	1/2 month	$ 12,282,895	Full month	$ 5,400,615
Expenses	$ 15,654,591	No interest	$ 15,678,541	Incl Interest	$ 23,950
Jul02 (Under)/Over	**$ (8,772,311)**		**$ (3,395,646)**		**$ 5,376,665**
Aug02 - Jun03:					
Revenue	$ 162,056,884	Jun03 Est	$160,803,427	Jun03 Act	$ (1,253,457)
Expenses	$ 161,462,951	Incl estimates	$163,100,758	All actual	$ 1,637,807
Aug02-Jun03 (Under)/Over	**$ 593,933**		**$ (2,297,331)**		**$ (2,891,264)**
Net 2002-2003 (Under)/Over	**$ (8,178,378)**		**$ (5,692,977)**		**$ 2,485,401**

12. For the period July 2003 through March 2004, with estimates for April, May and June 2004, default supply revenues were anticipated to be $206,368,669. Supply expenses for the same period equaled $201,413,859. This produced an over collection of $4,954,810. The June 2003 deferred account balance of $5,692,977 when combined with the over collection of $4,954,810 for the 2003/2004 default supply tracking period results in a balance of $738,167 as of June 2004.

2003-2004 TRACKER PERIOD:	
	Jun-04 Filing
Jul03 - Jun04:	
Revenue	$206,368,669
Expenses	$201,413,859
Net 2003-2004 (Under)/Over	**$ 4,954,810**

13. The 111 MW unit contingent contract with Duke Energy expired on June 30, 2003. In the spring of 2003 representatives from NWE and Duke met on several occasions in an attempt to extend this agreement. In the end, a term extension was not executed due mainly to differences in the perceived value of the energy. On many occasions throughout the year, however, NWE purchased energy from Duke at each day's prevailing market price. These purchases are included with other short-term transactions.

14. In the forecast for the 2004/2005 tracking year NWE forecasted total billed sales to be 5,356,889 MWh. Projected loads returning to default supply total an additional forecasted load of 200,554 MWh. With the returning load, forecasted total billed sales are 5,557,442. Adjusting the total billed sales for the YNP load reduces the MPSC only default supply load to 5,538,195. The billed sales figure needs to be adjusted for transmission line losses to compute the "Total Supply Requirements" or the total amount of energy the Company actually needs to procure. Line loss factors are based on information from Docket No. D97.7.90. Additionally, billed sales are adjusted through a cycle billing adjustment to shift the billed energy to the calendar month in which it was actually delivered. NWE needs to procure a projected 6,006,242 MWh, including YNP, approximately eight percent more than is actually delivered to customers, when shifted to a calendar month and adjusted for transmission and distribution line losses.

15. In terms of resources for the 2004/2005 tracking year, the portfolio retains the 300 MW base-load and 150 MW unit-firm-on-peak resources from PPL Montana as well as the unit-contingent Qualifying Facility (QF) resources. In addition NWE has included 102,960 MWh from the Thompson River Co-Gen project and 18,120 MWh from Tiber Dam in the forecast. The rest of the resources will be procured as needed, in the short-term market (twelve months and less). Net short-term transactions are projected to be 28 percent (1,706,560 MWh) of the total resources necessary to meet load.. The reliance on short-term purchases results in a fairly high degree of exposure to market volatility risk.

16. The 2004/2005 projection includes approximately $1.7 million of Demand Side Management (DSM) program costs and corresponding lost revenues. Also included in Administrative Expenses are labor costs related to the DSM Project Coordinator and $820,000 of Montana Consumer Counsel (MCC) and Public Service Commission (PSC) funding fees that were not included in prior tracking filings.

17. The projected unit cost of electricity during the 2004/2005 tracking period is $41.06 (including losses), an increase of approximately 9 percent over the energy rate in the 2003/2004 tracking period. In addition, there is a $.14 per MWh cost to cover the net under collection from the 2002/2003 and 2003/2004 tracking periods, making a projected total supply-related unit cost of $41.20 per MWh. This rate is a projection of costs over the next twelve months given existing market conditions. NWE will attempt to optimize market opportunities in order to mitigate costs throughout the year and cost estimates will be updated in subsequent monthly trackers. NWE files a strategy report with each monthly tracker to provide insight into market conditions and procurement activity. In July, 2003, NWE projected the upcoming twelve-month cost to be $40.52 per MWh, while the actual cost for the twelve-month tracking period was $37.56 per MWh.

Commission Analysis and Discussion

Electric Supply Deferred Cost Account Balance:

18. The Commission notes that since the last case the Company has reevaluated its position on the appropriate treatment of the July 2002 revenues. In this filing the Company has concluded that a full month of July 2002 supply revenues should be included in this adjustment.

NWE proposed that the $5,692,977 of deferred costs in this interim calculation be reduced by the 2003/2004 tracking period over collection of $4,954,810. This provides a final balance for the deferred cost account of $738,167. NWE, in its D2003.6.77 filing failed to include the last half of June 2002's revenues for July 2002 billed revenue and only included 11 ½ months of billed revenues. NWE corrected its oversight in this filing and adjusted July 2002 revenues to reflect the entire billed revenues for July 2002 and provide a proper match of actual revenue and expense. The July 2002 treatment is now consistent with the tracking methodology employed in all months of the electrical tracker and is consistent with the tracking methodology used in NWE's gas tracker.

New Default Supply Resources:

19. NWE proposed in this filing the inclusion of two new power purchase agreements. The agreements pertain to the Thompson River Co-Gen project (TR) and Tiber Montana hydro project (Tiber). TR is a 16 MW thermal generation facility located near Thompson Falls, Montana. The facility will burn coal, with up to 30 percent of the input energy coming from wood waste from an adjacent lumber mill. Construction began in December 2002 and commercial operation is anticipated for mid-year 2004. TR is a base-load, fixed price energy resource, similar to QFs or other unit-contingent contracts. This plant is anticipated to provide approximately 100,000 MWh of energy per year. The contract with TR is for a term of ten years with a price of $40 per MWh with **no escalation during the term**. The projected annual cost under the TR contract is approximately $4 million. If the unit does not perform, no payment is required.

20. Tiber is a 7.5 MW hydro generation facility located approximately 90 miles north of Great Falls in Chester, Montana at an existing dam on the Marias River. The average annual output from this "run-of-river" hydro facility is estimated at 4 MW. The Bureau of Reclamation (BOR) regulates the river stage to meet downstream demands. Construction began in December 2002, with commercial operation commencing in June 2004. NWE agreed to a seasonal supply structure in which NWE would accept energy from the resource from November through April each year. During the other six months of each calendar year, Tiber will sell the net output to another utility. Tiber is anticipated to provide approximately 23,900 MWh of energy under the seasonal agreement. The contract with Tiber is for a term of twenty years with an average price

of $35.54 per MWh. The projected average annual cost under the Tiber contract is approximately $850,000.

21. In this Docket the Commission will consider whether NWE acted reasonably and according to industry accepted procurement practices in the acquisition of purchased power agreements with TR and Tiber. For purposes of this Order when these projects begin commercial operation, costs may be included in the monthly electric tracker filings.

Recovery of DSM Program Costs and Lost Transmission/Distribution Revenues:

22. NWE included in its filing $1.7 million of Demand Side Management (DSM) program costs and corresponding lost revenues. Also included in the Administrative Expenses are labor costs related to the DSM Project Coordinator. Approximately six months of preparatory work is needed to prepare for introduction of the first DSM programs. Program design is underway and will continue through the third and fourth quarters of 2004. Introduction of residential and commercial energy efficient lighting programs will occur in January 2005. Subsequent programs for other end-uses, building thermal envelopes, and site-specific proposals will be offered in third and fourth quarters of 2005. The Commission grants an interim increase for DSM funding costs of $1,457,888.

23. NWE proposed to include DSM Program Cost Tracking and Lost Revenue Recovery in NWE's annual default supply tracking mechanism to recover the costs related to implementation and operation of DSM programs for Default Supply customers. This annual filing will reflect changes to the Default Supply Rate required as a result of DSM program activity.

24. The primary goal of this proposal to implement this as part of the annual tracking mechanism is to ensure NWE's default supply, transmission and distribution businesses are made financially whole as a result of its DSM expenditures and avoid disincentives to investment in DSM resources that are important to the overall Default Supply Portfolio. Cost-effective DSM is included in the Default Supply Plan to reduce the overall cost and risk of obtaining power for NWE Default Supply customers. The DSM tracking proposal is set forth in detail in the testimony of William Thomas, beginning at page 9.

25. In Docket No. D2001.10.144, Order No. 6382d, the PSC found that NWE should consider demand-side and supply-side resources on an equivalent basis when procuring resources to serve default supply loads and managing the total cost of providing default service.

Unless directed otherwise by the Legislature, or modified by the Commission, it is the Commission's policy that energy efficiency and conservation resources are resources that NWE should consider along with more traditional supply-side resources when evaluating alternative default portfolio resources.

26. In Order No. 6382d the PSC went on to say NWE should conduct further analysis of the available, cost-effective, demand-side resources in its service area. The Commission encourages NWE to communicate with interested persons and affected stakeholders during its analysis. Prudently incurred costs related to procuring demand-side resources are fully recoverable in rates. The Commission will evaluate the prudence with which the Company procures demand-side resources, including resources acquired through sub-contractors, consistent with evaluations of supply-side resources. The Commission is open to exploring with the Company and interested persons innovative ways of addressing cost recovery issues related to demand-side resource investments and expenses.

27. In this Docket, NWE has responded to Order No. 6382d. The Commission has supported the acquisition of cost-effective demand-side resources by utilities for many years. Pursuit of these resources should not have an impact on the financial status of NWE. Use of the proposed tracking procedure may be a reasonable method of removing financial disincentives to NWE's full and active pursuit of cost-effective DSM in its service area. However, it is premature to reach that conclusion in this interim order. The Commission denies an interim increase of $273,196 for lost transmission and distribution revenues (T&D revenues). The Commission will allow an opportunity for interested persons to intervene on this matter and evaluate the proposed mechanism.

Monthly Tracker:

28. NWE requested that the Company be allowed to continue using a monthly tracker. The monthly tracker is a 12 month rolling average tracker. The Commission approves NWE's request to continue the monthly electric default supply tracker. The monthly tracker adjustments remain subject to an annual review and approval (or disallowance) by the Commission.

Inclusion of PSC and MCC funding fees in the annual Electric Default Supply Tracker:

29. NWE proposed to include PSC and MCC fees based on electric default supply revenues. When NWE filed its last general rate case (Docket No. D2000.8.113), the cost of service for the PSC and MCC funding fees was based on test year 1999 Transmission and Distribution revenue only. The Electric Supply Buy-back contract rates did include recovery of the PSC and MCC fees until their expiration on June 30, 2002. Electric Default Supply rates since that time have not included recovery of the PSC and MCC fees. NWE has been and will continue to pay these fees based on total revenue, including supply.

Customers Returning to Default Supply

30. Customers returning to Default Supply around July 1, 2004 have a forecasted additional load of 200,554 MWh and an incremental supply expense estimated at $2,770,791. The Commission has carefully considered the comments on the treatment of these expenses (see paragraph 7, above), and for interim purposes has determined that those incremental supply expenses should be included in rates for all customers. NWE shall track the usage of returning customers described in Finding of Fact No. 3, and any incremental supply costs associated with those returning loads, from July 1, 2004 until a Final Order is issued in this Docket. The correct and proper treatment of these expenses on a final basis will be determined from a review of the record in this docket and an analysis of the law as applied to that record.

Conclusions of Law

1. NorthWestern Energy provides electric service within the State of Montana and as such is a "public utility" within the meaning of § 69-3-101, MCA.

2. The Montana Public Service Commission properly exercises jurisdiction over NorthWestern Energy's Montana rates, service and operations pursuant to Title 69, Chapter 3, MCA.

3. The Commission may, in its discretion, make temporary approvals of requests pending a hearing or final decision. § 69-3-304, MCA.

4. The rate levels and spread approved in this Order are a reasonable means of providing interim relief to NorthWestern Energy. The rebate provisions of § 69-3-304, MCA, protect ratepayers until there is a final Order in this Docket.

Order

1. NorthWestern Energy shall implement, on an interim basis, rates designed to increase annual jurisdictional electric supply revenues from $221,659,631 to $227,896,712 an increase of $6,237,081 over present rates. The revenue increase includes the net under collection of $738,167 for the tracking period from July 2002 through June 2004, excludes the $273,196 allowance for lost T&D revenues and includes the incremental costs of the customers returning to default supply.

2. NorthWestern Energy's request to continue the use of a monthly electric tracker is approved on an interim basis by the Commission.

3. Staff will consider the merits of consolidating this docket and Docket No. D2003.6.77 under a single procedural schedule.

4. NWE's request to recover PSC and MCC fees on a prospective basis from August 1, 2004 through June 30, 2005 is approved.

5. NorthWestern Energy shall adhere to and abide by all Findings of Fact in this Interim Order. All rate schedules shall comply with all Commission determinations set forth in this Interim Order.

6. NorthWestern Energy must file tariffs in compliance with the Findings of Fact in this Interim Order.

7. Nothing in this Order precludes the Commission from adopting in its Final Order a revenue requirement different from that contained in this Interim Order.

8. Any interest associated with a refund that may result from the revenue requirement determined in a Final Order in this Docket will be computed at 10.75 percent, the last approved cost of equity approved in Docket No. D2000.8.113, Order No. 6271c.

9. Interim approval of any matters in this proceeding should not be viewed as final endorsement by the Commission of any issues, calculations, or methodologies approved in this Order.

10. This Order is effective for service rendered on and after August 1, 2004.

DONE IN OPEN SESSION at Helena, Montana on this 20th day of July, 2004, by a vote of 3-2.

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BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

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BOB ROWE, Chairman (Concurring and Dissenting)*

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THOMAS J. SCHNEIDER, Vice Chairman

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MATT BRAINARD, Commissioner

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GREG JERGESON, Commissioner (Concurring and Dissenting)*

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JAY STOVALL, Commissioner

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.

* Chairman Rowe and Commissioner Jergeson dissent on the treatment of expenses caused by returning choice customers as described at paragraph 30. They concur with the balance of the order.