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

IN THE MATTER OF Northwestern Energy's Application for Electric Supply Deferred Cost Account Balance and Projected Electric Supply Cost	))))	REGULATORY DIVISION DOCKET NO. D2010.5.50

MEMORANDUM

TO: Commissioners

FROM: Eric Eck, Will Rosquist, Scott Fabel, Mike Dalton, Kate Whitney

DATE: March 30, 2011

RE: Staff analysis and recommendations for final order

Procedural History

On June 7, 2010, NorthWestern Energy (NWE) filed its annual electric supply cost tracker application with the Montana Public Service Commission (PSC or Commission) requesting electric rates reflecting: 1) a zero balance in the electric supply deferred costs account for the 12 months ending June 30, 2010; and 2) the projected load, supply, and related electric costs for the 12-month tracker period July 1, 2010 through June 30, 2011. NWE also requested an interim rate increase.

The PSC issued a Notice of Application and Intervention Deadline on June 11, 2010. On June 29, 2010, the PSC issued Interim Order 7093 authorizing rates designed to recover an electricity supply revenue requirement of $254,818,346, plus the fixed cost of Colstrip Unit 4 (CU4) of $72,745,544 and the CU4 variable cost of service of $(5,528,024), for a total of $322,035,867. This resulted in an overall interim increase in jurisdictional electric supply revenues of $5,173,496.

On July 6, 2010, the PSC granted intervention to the Montana Consumer Counsel (MCC). On July 30, 2010, the PSC issued Procedural Order 7093a. The PSC issued a Notice of Public Hearing on December 15, 2010, establishing a January 19, 2011, hearing date. The hearing was held January 19-20, 2011, in Helena. NWE and MCC submitted post-hearing briefs.

Summary of Application and Testimony

Application

The application included a true-up of the actual electric supply costs and revenues for the July 2009 through June 2010 tracking period and NWE's projection of electric supply costs for the July 2010 through June 2011 tracking period. Regarding the true-up of supply costs for the 2009-10 tracker year, NWE reported the balance in its electric supply deferred cost account is an over-collection of $(201,344). NWE proposed to set the deferred cost rate to zero because the account balance is immaterial. Regarding 2010-11 electric supply costs, NWE requested a rate increase in order to recover its projected increased costs. According to NWE, the total effect of the requested increase on a typical residential customer's bill is an estimated increase of $3.47 per month.

NorthWestern Energy Prefiled Direct Testimony

David Fine

David Fine, NWE's Director of Energy Supply Planning, reported that during the 2009-10 tracking period, NWE: (1) executed a 20-year, 13 MW power purchase agreement with Turnbull Hydro, LLC (power deliveries to begin in May, 2011); (2) issued a competitive Request for Information (RFI) in August, 2009, for renewable resources with a preference for community renewable energy projects under § 69-3-2003, MCA; (3) managed the electric supply portfolio and implemented appropriate hedging criteria; (4) worked to expand and diversify its renewable resource portfolio with particular attention on possible biomass resources; (5) managed the qualifying facility (QF) queue and entered into one short-term QF contract in 2009; (6) satisfied the renewable energy standards under §69-3-2004, MCA in 2009; (7) comprehensively assessed the remaining electric demand side management (DSM) potential in its Montana electric service territory, which informed the DSM acquisition plan in NWE's 2009 electric supply procurement plan; and (8) initiated, facilitated and supported the wind integration working group that is analyzing appropriate wind integration requirements for NWE's system.

Fine reported that NWE's existing third-party regulation services contracts will expire at the end of 2010. He said NWE's Mill Creek Generating Station (MCGS) will supply regulation services after that and will be the basis for regulation costs in 2011. Fine stated that the 2010-11 tracker cost estimates include third-party regulation service costs through the remainder of calendar year 2010, and that beginning January 1, 2011 no regulation costs are included in the tracker cost estimates.

Frank Bennett

Frank Bennett, a NWE electric and natural gas specialist, addressed the status and updated the costs of the 2009-10 tracking period, and projected costs for the June 2011 tracker period.

Regarding the 2009-10 tracker period, Bennett explained that NWE treated the CU4 variable cost of service and price stability contracts in the same manner as in the previous annual tracker. He said the CU4 variable cost of service includes fuel costs, Puget Sound Energy (Puget) revenue credits, and incremental property taxes. He added that the price stability contract benefits are being returned to ratepayers over a two-year period and are shown in equal monthly amounts over the tracker period as directed in Order 6925f in Docket D2008.6.69, and that the CU4 cost of service related to property taxes is further adjusted as directed by the Commission in the 2009 property tax tracker case (Docket D2009.12.155). According to Bennett, NWE also removed wind regulation costs associated with its supply contracts with United Materials of Great Falls in accordance with previous Commission direction.

Bennett updated 2009-10 tracking period forecasted costs with 10 months of actual numbers and 2 months of estimated costs. He said the July 2010 market-based supply deferred account balance is a forecasted under-collection of $6,371,828 and the June 2010 CU4 deferred account balance is a forecasted over-collection of $6,653,168. The combined result is an over-collection of $201,340.

Bennett explained that four basic cost components made up the electric supply portfolio for the 12-month tracker period July 2009 through June 2010: Electric Supply, Transmission Services, Administrative Expenses, and CU4. Electric Supply includes the following cost elements:

- A 325 megawatt (MW) peak and 175 MW off-peak contract with PPL Montana, LLC that is supplied 7 days per week, 24 hours per day, irrespective of the operating performance of any specific electric generating facility. This contract expires June 30, 2014.

- Approximately 100 MW of unit-contingent QF energy that comes from contracts entered into prior to 1999. Only a portion of the costs of these contracts is included in the electric supply portfolio.

- Approximately 135 MW of unit-contingent energy from the Judith Gap Energy, LLC wind turbine facility. This contract expires December 31, 2026.

- Approximately 111 MW of unit-contingent energy from two prior Montana Generation, LLC contracts were assumed into the rate-based CU4 asset in January 2009.

- Approximately 50 MW of dispatchable energy from Basin Creek Equity Partners, LLC. This contract will expire July 1, 2026, unless extended for a 5-year term in accordance with the contract.

- Approximately 6 MW of unit-contingent energy that comes from Tiber Montana, LLC. This contract expires June 1, 2024.

- Approximately 50 MW of Sunday and North American Electric Reliability Council (NERC) Holiday firm energy from JP Morgan Ventures secured through the November 2006 pilot auction. This contract expired June 30, 2010.

- Approximately 25 MW of off-peak firm energy from Powerex Corp. secured through the November 2006 pilot auction. This contract expired June 30, 2010.

- Short, medium, and long-term market power purchases and sales with various suppliers. During the 2009-10 tracking period, the net non-base transaction purchase requirement was 1,795,535 MWh or 28 percent of the annual supply.

- Expenses related to wind integration and other wind costs incurred to fully incorporate the wind supply contracts into the portfolio and to meet balancing authority area minimum operating reserve requirements for wind integration that are independent of the transmission and distribution system integration charges.

- System imbalance adjustments and operating reserves.

- DSM program implementation costs and transmission and distribution lost revenue included as expenses directly involved with DSM programs and projects.

Transmission Services-related costs are associated with moving electricity off system through point-to-point transmission service in order to balance or optimize resources, as well as other ancillary services required for system integrity and reliability. Regulation and Frequency Response Service is an ancillary service currently provided by NWE’s Transmission Business Unit and represents $6,897,433 of the $7,667,096 stated transmission cost. Costs of the transmission facilities utilized to transmit and distribute energy to electric supply customers are included in delivery rates and as such, no additional revenue is collected for these costs in the tracker.

Administrative Expenses contains incremental administrative and general costs above those recovered in the last general rate case filing of $2,131,237 or 0.78 percent of total electric supply expenses are also included in electric supply costs. These costs include outside legal, scheduling, software, broker costs and other incremental expenses directly related to the electric supply (such as outside consultants to assist with or review procurement activities). Administrative expenses do not contain any expenses for internal company personnel.

Bennett said the CU4 category includes the costs and credits that were approved for inclusion under Order 6925f in Docket No. D2008.6.69.

Bennett summarized the 12-month electric supply tracker period ending June 2010 by explaining that the market-based supply under-collection deferred account balance of $6,371,828 as of June 2010 is the July 2010 beginning balance. July 2010 through June 2011 information is based on forecasted numbers and includes the electric supply base contracts. Beginning in January 2011, NWE set regulation costs to zero because the MCGS cost of service will not be reflected in rates until the Commission authorizes it. In addition, he noted the revenue credit from the Puget contract is eliminated when that contract expires at the end of 2010.

Beginning January 2011, when the Puget contract terminates, forecasted generation from CU4 increases from 111 MW to 222 MW. The CU4 variable cost rate reflects increased fuel costs related to this increase in generation.

Bennett said NWE forecasted a 1.25 percent decrease in its total electric supply requirement and a 0.25 percent increase in loads for the 2010-11 tracker period compared to the prior tracker period. NWE estimated that market transactions will account for 23 percent of total delivered supply in the 2010-11 tracker period.

Cheryl Hansen

Cheryl Hansen, a senior analyst in NWE's Regulatory Affairs Department, addressed in her testimony and exhibits the derivation of the 2010-11 billing statistics, the derivation of deferred supply rates resulting from the over/under collection reflected in the 2009-10 tracker, and the derivation of electric supply rates for the forecasted 2010-11 tracker period.

William Thomas

William Thomas, NWE's Manager of Regulatory Support Services, addressed NWE's universal system benefits (USB) and electric supply DSM programs, savings, costs and estimated lost transmission and distribution revenue due to programmatic energy savings.

Total DSM savings include both USB and energy supply DSM program savings. However, since USB programs are funded by a separate charge, Thomas did not include USB expenses in his electric supply DSM budget and expense figures. Thomas' Table 1 (below) shows NWE's annual DSM targets, reported actual savings, budgets and actual expenses for the 2004-05 through 2009-10 tracker years. Thomas explained that the reported program results represent the capability of the installed measures to produce energy savings for a full year.

Table 1. DSM targets, savings, budget and expenses

Tracking year	Target DSM savings (aMW)	Reported DSM savings (aMW)			Electric Supply DSM Budget	Electric Supply Actual Expenses
		USB	DSM	Total		
2004-05	2.60	2.04	0.22	2.26	$1,457,888	$320,389
2005-06	3.70	1.33	2.08	3.41	$2,097,734	$1,596,076
2006-07	5.00	0.36	3.04	3.40	$3,232,080	$2,497,359
2007-08	5.00	0.82	4.55	5.37	$3,631,683	$3,688,745
2008-09	5.00	1.11	5.58	6.69	$4,917,141	$5,504,111
2009-10	5.00	1.16	5.77	6.93	$6,625,192	$7,930,022
2010-11	6.00	-	-	-	$9,148,219	

Table 2 summarizes a portion of Thomas's testimony and exhibits (Ex. NWE-4 (WMT-1) & (WMT-2)) for the 2009-10 tracker year and shows expenses and reported energy savings for each electric supply DSM program. Thomas derived reported energy savings using two approaches. First, NWE requires project-specific engineering calculations from participants in programs such as E+ Commercial Lighting and Business Partners programs. Second, for programs that don't require participants to provide engineering calculations, such as residential lighting, Thomas relied on average measure savings. Reported savings represent the energy savings that would occur if all energy savings measures were in place for 12 months.

Table 2. 2009-10 tracker period electric supply DSM savings

	2009-10 Electric Supply DSM*		
		Annualized Energy Savings	
Programs	**Expenses**	**kWh**	**aMW**
General DSM expenses	622,084	-	-
E+ Business Partners/Irrigation	1,595,515	2,017,330	0.23
E+ Commercial Lighting	2,936,056	13,096,199	1.49
E+ Residential Lighting	1,753,582	19,028,585	2.17
NW Energy Efficiency Alliance	926,826	15,516,074	1.77
E+ New Homes / 80 Plus	21,698	226,574	0.03
E+ Residential Electric Savings	49,073	18,953	0.00
E+ Electric Motor Rebate	14,436	5,280	0.00
Energy Star 80 Plus Program	-	591,318	0.07
Demand Response Program	10,751	-	-
Totals	**7,930,022**	**50,500,314**	**5.76**

*These data are taken from Ex. NWE-4 (WMT-1) & (WMT-2). Annualized energy savings reflect 9 months (July-March) of actual reported savings and 3 months (April-June) of estimated savings. DSM Program expenses reflect 10 months (July-April) of actual reported expenses and 2 months (May-June) of estimated expenses.

Thomas summarized the following components of NWE's electric supply DSM programs:

E+ Lighting: NWE contracts with KEMA, an energy consulting firm, to implement lighting programs for commercial and residential customers. Through KEMA, NWE offers cash rebates for ENERGY STAR-rated compact fluorescent lights (CFLs) and indoor and outdoor fixtures. Other CFL promotions include CFL giveaways during audits, buying down the CFL retail price at retail stores, and hosting promotional events on lighting efficiency. Thomas stated that, in the 2009-10 tracker period, 437,745 CFLs were distributed to 34,544 residential customers and 635 commercial customers completed 17,580 lighting projects. NWE provided $215,508 in direct rebates to customers who participated in lighting programs in 2009-10.

E+ Business Partners: NWE contracts with the National Center for Appropriate Technology (NCAT) to market this program to architect and engineering firms and trade/industry associations, contact candidate businesses with good DSM potential, survey and assess buildings and facilities, provide technical assistance for building owners and assist customers with forms, contracts and other paperwork. In the 2009-10 tracker period NCAT made 2,145 contacts, 772 site visits, and prepared 512 proposals for customers. Customers submitted 39 of these proposals to NWE for approval. In addition to NCAT's marketing, NWE DSM staff directly contacted industrial supply customers, which resulted in 8 completed projects. Thomas said there are another 20 projects in development in the large commercial/industrial sector.

Northwest Energy Efficiency Alliance: NWE contributes to NEEA, a non-profit organization that encourages market transformation (the development and adoption of energy efficient products and services) in Montana, Idaho, Oregon and Washington. NEEA's market transformation efforts target the residential, commercial, industrial and agricultural sectors. In the 2009-10 tracker period NWE reported 1.8 aMW of energy savings from NEEA activities.

E+ New Homes: This program offers a variety of rebates for individual energy efficiency measures in new homes. KEMA administers the rebate portion of the program and also collects data and maintains program records. NWE contracts with NCAT to provide builder/owner education, technical assistance, marketing, and outreach. NWE blends USB and supply funds to promote ENERGY STAR building standards for new homes. NWE uses USB funds to market the program and educate architects, contractors, and customers. NWE uses electric supply funds to provide cash incentives. Thomas stated that, separately, NEEA funds some of the infrastructure development of ENERGY STAR Northwest activities. In the 2009-10 tracker period, two new electrically heated homes were certified and two new natural gas heated homes installed at least 50% ENERGY STAR lighting.

E+ Residential Savings Program: This program, contracted by NWE to KEMA, provides incentives for customers to install insulation, switch electric space or water heat to natural gas and install energy saving devices like programmable thermostats, low-flow showerheads, faucet aerators and water heater pipe insulation in existing homes.

E+ Electric Motor Rebate Program: NWE contracts with KEMA to offer cash rebates for purchases of premium efficiency electric motors. Prescriptive rebates are offered for motors rated between 1 and 200 horsepower. Larger motors can qualify with individual, application-specific calculations performed by NWE. Thomas stated that NWE modified the program in 2009 to include rebates for motor rewinding that adheres to NEEA-developed procedures designed to avoid efficiency losses. Thomas said three electric motor service centers in NWE's service territory perform this service. Despite this modification, NWE only processed three motor rebates in the 2009-10 tracker period. Thomas reported that NWE is eliminating this program. In the upcoming tracker period, NWE will incorporate the National Electrical Manufacturers Association (NEMA) premium efficiency motors and qualified motor rewinds into a new Commercial Electric Rebate Program.

Green Blocks Pilot Program: In 2008, NWE partnered with the City of Missoula on a pilot residential DSM program that combined elements of the E+ Audit, Lighting and Residential Savings programs. The City of Missoula provided marketing, outreach, recruiting and selection of up to 100 program participants. The City of Missoula secured funds through the 2009 American Recovery and Reinvestment Act (ARRA), and will use some of those funds to partner with NWE in 2010-11 to conduct a second round of Green Blocks, which should expand the program to 300 additional residential dwellings. The City of Missoula and NWE will share costs on an approximate 50/50 basis. In the upcoming period, NWE will conduct an expansion of the Green Blocks pilot program in the City of Helena, with a target of 100 homes. In the Helena program, there are no ARRA funds available. NWE will provide 100% of the funding and the City of Helena will be responsible for recruiting and soliciting interest in the program.

Bozeman Building Blocks: In 2009, NWE introduced a pilot program aimed at the Bozeman downtown business district that will provide a commercial energy audit conducted by NCAT at no direct cost to building owners and/or occupants of commercial buildings along a three block strip in the main downtown area. At the time Thomas filed his testimony, NCAT had completed all of the audits, was compiling reports and data, and planned to submit an interim report to NWE later in the year. NWE will consider expansion of the Bozeman Building Blocks program following its review of NCAT's results.

Thomas said NWE's staff and contractors held many training seminars throughout the year to increase awareness of energy efficiency opportunities in buildings and facilities. NWE blends USB and supply funds to cover the cost of these seminars. Thomas said NWE also promotes energy efficiency throughout its service territory through media events, appearances, meetings, speaking engagements, booth sponsorships, trade fairs and shows, conferences and other special events. He explained that NWE maintains networks of retailers, distributors, and other trade allies and provides a steady stream of information about its energy efficiency programs through print, radio, television, literature, and personal contact. Thomas provided as an exhibit NWE's 2009 USB/DSM Communications Plan, which details the techniques, locations, forms of media and schedule of activities designed to support DSM programs, attract customer participation, and acquire cost-effective DSM resources.

Thomas reported that NWE hired NEXANT, Inc., with The CADMUS Group, Inc. as subcontractor, to perform a comprehensive assessment of DSM potential on NWE's system. He said the results of the assessment have been incorporated into NWE's resource planning process and NWE's 2009 Electric Resource Procurement Plan contains a detailed discussion of the assessment's findings. The DSM assessment identified just over 84 aMW of achievable cost effective DSM potential in NWE's Montana electrical service territory, and NWE has increased its annual DSM acquisition goal from 5.0 aMW to 6.0 aMW. Thomas reported that NWE is taking several steps to achieve this goal. First, NWE has hired two additional professional staff to implement DSM programs. NWE has also issued a Request for Proposal (RFP) for additional outside service providers to develop commercial DSM projects, similar to the work now being performed by NCAT. Finally, NWE is developing a new commercial DSM program that will offer prescriptive rebates for various cost-effective DSM measures that were identified in the NEXANT/CADMUS Assessment.

According to Thomas, NWE estimates its DSM program costs for the 2010-11 tracker year will total $9,148,219. Thomas calculated NWE's electric DSM lost revenues for the 2009-10 tracker year to be $3,555,817. (Ex. NWE-4 (WMT-3)) NWE's calculation included $649,709 of CU4-related lost fixed cost revenues in the 2009-10 tracker year.

Montana Consumer Counsel

Dr. John Wilson

Dr. John Wilson, an economist, recommended reductions to NWE's proposed electric supply cost recovery.

Wilson observed that NWE estimated $649,709 of CU4-related lost fixed cost revenues in the 2009-10 period and $1,267,268 for the 2010-11 forecasted period, due to successful DSM programs. However, he noted that NWE did not claim that it collected less than the PSC-authorized cost of service revenue requirement of $72,745,544 for CU4, which was determined in Order 6925f, Docket D2008.6.69. Wilson asserted that NWE has consistently recovered more than the authorized fixed cost revenue requirement for CU4 in each year since the plant has been in rate base.

Wilson acknowledged that the PSC has implemented a mechanism to allow NWE to calculate and include in rates revenues it claims it would have received absent DSM activities; however, Wilson stated he does not believe that NWE based its cost recovery calculations on the authorized revenue requirements for CU4. Wilson argued that NWE has consistently collected more than the PSC's allowed CU4 fixed cost requirement because NWE: (1) used a low historic projected sales volume (the 2007 test year sales volume) to convert the PSC-authorized $72.7 million revenue requirement into a price per kwh, (2) assumed that this converted price per kwh was authorized in Order 6925f, and (3) applied this converted price per kwh to its larger actual sales volumes, thus leading to a larger CU4 revenue total than the $72.7 million that was actually authorized in Order 6925f.

Wilson contended that two fallacies underlie NWE's lost revenue claim for CU4. First, he said NWE's actual CU4 revenue in each tracker year has exceeded the PSC-determined CU4 revenue amount, and since ratepayers have already paid more than the authorized fixed cost of service, it would be inappropriate to provide additional CU4 revenue. Second, Wilson stated that, although CU4 was added to rate base in January 2009, NWE based its CU4 rates on lower 2007 test year sales volumes rather than using actual 2008 or projected 2009 sales, which he claimed NWE knew would produce revenues exceeding the CU4 fixed cost total allowed by the PSC. According to Wilson, Order 6925f did not authorize rates based on 2007 sales and NWE's intent to do so was not addressed in Docket D2008.6.69.

Wilson disagreed with NWE's contention that the company appropriately used 2007 test year sales as the basis of its CU4 rates because the CU4 fixed costs authorized by the PSC were based on a CU4 2007 test period. According to Wilson, in Docket D2008.6.69, the PSC authorized fixed-cost revenues that were based on the plant's market value and not related to CU4's 2007 fixed costs.

Wilson recommended the PSC make two adjustments to 2009-10 tracker revenue in order to properly reflect the CU4 fixed cost revenue requirement. First, to correct the over-collection Wilson contended occurred in the 2009-10 tracker year because CU4 fixed cost recovery rates were based on 2007 test year sales, he recommended a revenue reduction of $1,992,967. His proposed reduction is the result of reducing the average CU4 fixed cost recovery rate in the tracker to the level it would have been had it been based on expected 2008-09 sales.

Second, Wilson recommended that the calculation of CU4 revenues lost due to DSM also should be based on expected 2008-09 sales, not 2007 test year sales. He stated that this approach reduces total CU4-related lost revenues in tracker year 2009-10 to $631,903 from $649,709. Additionally, total CU4-related lost revenues estimated for tracker year 2010-11 decline to $278,584 from $1,267,268. Of this amount, $34,732 reflects the use of expected 2008-09 sales instead of 2007 test year sales to develop CU4 rates, and $953,953 results from zeroing out the continuing DSM lost sales balance due to the interim rate increase that became effective July 2010 in Docket D2009.9.129. He also recommended reducing NWE's estimated non-CU4 lost revenues for the forecasted tracker year 2010-11 from $3,612,263 as proposed by NWE to $742,567 as a result of the Docket D2009.9.129 interim rate increase.

<u>NorthWestern Energy Prefiled Rebuttal Testimony</u>

<u>Patrick Corcoran</u>

Patrick Corcoran, NWE's Vice President of Government and Regulatory Affairs, disputed Wilson's recommended adjustments to CU4 fixed costs, especially Wilson's recommendation to reduce NWE's 2009-10 tracker year revenue by $1,992,967. Corcoran stated that adjustments to the CU4 fixed cost revenue requirement are not part of annual electric supply tracker filings, which appropriately address 2009-10 actual electricity supply costs in this docket, not the CU4 fixed cost of service. In addition, he cited two parts of PSC Order 6925f as support for NWE's position that it correctly established rates to recover CU4 fixed costs pursuant to PSC direction: (1) Finding of Fact #257, in which the Commission accepted NWE's CU4 cost of service and revenue requirement as reflected in two NWE exhibits in that case; and (2) Ordering Clause #6, which directed NWE to file tariffs to take effect January 1, 2009, that reflected the rate-basing of CU4. He stated that NWE complied with the PSC order and with revenue requirement practices when it submitted a PSC-accepted CU4 revenue requirement implementing the rate-basing of CU4 as part of its December 2008 monthly electric supply tracking filing, with tariffed rates that took effect in January 2009. Corcoran argued that the CU4 compliance material in the filing was clearly set out and discussed separately and apart from the regular monthly tracking filing material.

Corcoran asserted that if MCC had any concerns with NWE's Order 6925f compliance filing, it should have been addressed at that time. Corcoran maintained that it is untimely and inappropriate for MCC to challenge NWE's compliance filing 21 months later in this supply tracker docket and, accordingly, the PSC should disregard Wilson's testimony on this issue.

<u>William Thomas</u>

Thomas updated NWE's DSM energy savings and lost revenue calculations to reflect the actual, rather than the previous estimated, data from the last three months of the 2009-10 tracking period. According to Thomas, the updated 2009-10 DSM energy savings totals 8.33 aMW, which results in an increased DSM lost revenue calculation of $3,778,987. That increased amount includes the increase in the DSM lost revenues associated with CU4, from the previous $649,709 to the updated amount of $716,410.

In response to Wilson's testimony, Thomas stated that he used the correct fixed cost rate for CU4 to calculate CU4-related lost revenue. Thomas also disagreed with Wilson that DSM lost revenues for the forecasted period of 2010-11, other than those related to CU4, should be modified due to the MPSC approval of interim rates in Docket D2009.9.129. Thomas agreed that the rates will need to be reset, but said it is not necessary to do so at this time because the final order in D2009.9.129 will approve the final rates to be in effect going forward. He added that NWE is also not authorized to include forecast lost revenues in the tracker and, therefore, forecast lost revenues for 2010-11 are not yet included in electric supply rates. Thomas said NWE intends to propose including actual lost revenues for the 2010-11 tracker period, including a reset that reflects the final order in Docket D2009.9.129, in its 2011 tracker filing.

Staff analysis and recommendations

The PSC's objective in this proceeding is to determine, pursuant to § 69-8-210, MCA, whether NWE's actual and projected electric supply costs for the tracker period were prudently incurred.

The one contested issue in the docket is MCC's contention that the CU4 fixed cost component of the tracker rate was improperly calculated based on 2007 sales volumes and that rate should be adjusted to reflect 2008/2009 projected sales volumes, which would result in reducing NWE's cost recovery for the tracker period by $1,992,967. The CU4-related rate adjustment proposed by MCC, if approved, would also result in reducing NWE's recovery of DSM-related lost revenues in the amount of $17,806. MCC did not contest the reasonableness of other electric supply costs included in NWE's application.

Analysis of the CU4-related issue raised by MCC requires looking back to the Commission's consideration of and decision on NWE's application in Docket D2008.6.69. On November 13, 2008, the Commission approved NWE's application to place its interest in CU4 into rate base as an electricity supply resource in Docket D2008.6.69, Order 6925f. In Order 6925f at Finding of Fact # 257, the Commission accepted NWE's CU4 cost of service and revenue requirement as reflected in two exhibits submitted by NWE. At Findings of Fact #260 and #261, the Commission found reasonable NWE's proposal to recover its CU4 cost of service, including its fixed costs, in electric supply rates as part of the annual electric supply tracker. Order paragraph #6 of Order 6925f directed NWE "to file tariffs to implement the rate-basing of CU4 for service on an after January 1, 2009." NWE submitted its tariffs in compliance with Order 6925f on December 16, 2008, in Docket D2008.7.75, which was the 2008/2009 monthly electric supply tracker docket. In accordance with the usual Commission procedure, Commission staff reviewed the tariffs for compliance with Order 6925f, approved them as filed on December 17, 2008, and returned the approved tariffs to NWE on December 28, 2008.

Scope of Supply Tracker

In NWE's view, the CU4 fixed costs and the rates that were established to recover them are outside the scope of an electricity supply tracker proceeding. According to NWE, the statutory basis for this proceeding is found at § 69-8-201, MCA, which requires the PSC to provide a mechanism that allows NWE to recover its prudently incurred electricity supply costs. Section 69-8-103(8), MCA, defines "electricity supply costs" as:

> ... the actual costs incurred in providing electricity supply service through power purchase agreements, demand-side management, and energy efficiency programs, including but not limited to:
>
> (a) capacity costs;
> (b) energy costs;
> (c) fuel costs;
> (d) ancillary service costs;
> (e) transmission costs, including congestion and losses;
> (f) planning and administrative costs;
> (g) any other costs directly related to the purchase of electricity and the management and provision of power purchase agreements.

NWE argues that Colstrip 4-related fixed costs do not qualify as "electricity supply costs" defined by law and recoverable in the tracker, and that MCC's recommendation to adjust the Colstrip 4-related fixed cost rate elements requires the PSC to consider costs which are beyond the scope of the docket. (NWE Initial Br. at 2-3.) NWE further argues it did not request to adjust the CU4 fixed-cost rates in this tracker and inclusion of them would have been inappropriate and illegal. According to NWE, the fixed costs of CU4 and associated rates, are "generation assets cost of service." Section 69-8-103(13), MCA, defines that term as follows:

> "Generation assets cost of service" means a return on invested capital and all costs associated with the acquisition, construction, administration, operation and maintenance of a plant or equipment owned or leased by a public utility and used for the production of electricity.

NWE claims the PSC determined the CU4 generation asset cost of service in Docket D2008.6.69 when it accepted NWE's cost of service and revenue requirement and that adjustments to CU4 fixed costs are subjects for rate cases concerning CU4, not supply tracker cases. (Ex. NWE-6 at 3.) NWE argues that Order 6925f makes clear that the PSC intended the only CU4-related costs to be addressed in the tracker are the CU4 variable costs and cites as support a reference in Order 6925f to NWE witness Corcoran's testimony in that docket. In the testimony, Corcoran explained NWE's proposal, subsequently approved by the PSC, for an "all-in" electric supply rate that included a CU4 fixed cost component that was to be "subject to adjustment only as the result of a future Colstrip Unit 4 general rate filing." (NWE Reply Br. at 3.)

MCC, on the other hand, argues that it is proposing to adjust the CU4 fixed-cost rate in this proceeding, not the fixed costs and, because the CU4 fixed costs are a component of the electric supply tracker, the associated unit rate is an appropriate subject to be addressed in tracker proceedings. (MCC Reply Br. at 4-6.) MCC contends that NWE's December 2008 filing of CU4 fixed-cost compliance tariffs in a tracker docket rather than in Docket D2008.6.69, even if NWE separately discussed the CU4 components separately in the filing, made the CU4 fixed-cost rate a part of the monthly tracker and therefore subject to review in tracker proceedings. (MCC Reply Br. at 6-7.) MCC also claims it had no opportunity to object to or otherwise comment on NWE's December 2008 compliance filing. (MCC Reply Br. at 8.)

Staff analysis and recommendation: In Order 6925f, the PSC approved NWE's proposal to develop an all-in electric supply rate that included CU4 costs and clearly understood that NWE would recover its CU4 fixed and variable costs in the electric supply tracker. Therefore, it was reasonable and appropriate for NWE to file its December 2008 compliance tariffs in the electric supply tracker docket. The Commission's consideration and approval of NWE's proposal in Docket D2008.6.69 to recover its CU4 costs in the tracker included the discussion and understanding that the amounts in the CU4 fixed-cost component of the tracker would be fixed and subject to adjustment only as a result of a future CU4 revenue requirement filing. (Ex. NWE-1, p. 24, Docket D2008.6.69) In contrast to the treatment of the CU4 fixed-cost section of the tracker, the CU4 monthly fuel costs and revenue credits in the CU4 variable-cost component of the tracker are tracked on an annual basis and change when the forecasted costs are updated in the annual tracker filing.

MCC's claim that there was no opportunity for MCC to object to the December 2008 CU4 initial tariff filing that NWE made in the then-current electric supply tracker docket lacks merit. While MCC correctly observed that PSC staff approved the compliance tariffs on December 17, 2008, the day after they were submitted for review, the approved tariffs were not effective until January 1, 2009 (and they were not mailed to NWE until December 28, 2008). MCC could have filed a timely objection that might have delayed or prevented the implementation of the CU4 fixed-cost rate at any time between December 16 and January 1. Moreover, MCC could have asked the Commission to reconsider its approval (through staff action) of the CU4 fixed cost rate implementation if it disagreed with that implementation.

Even assuming that MCC did not respond to NWE's December 2008, CU4 initial tariff filing because it believed that review would occur in annual tracker filings (see MCC Reply Br. at 8), the proper case in which to raise the issue would have been Consolidated Docket Nos. D2008.5.45/D2009.5.62. In that case MCC witness Wilson filed testimony on September 18, 2009, about nine months after NWE's CU4 initial tariff filing. However, in that case Wilson did not contest the CU4 fixed cost rate. Rather, he questioned whether allowing NWE to recover CU4-related DSM lost revenues was reasonable in light of the fact that NWE was already recovering more than the approved CU4 fixed cost revenue requirement because 2008/2009 sales volumes were higher than the 2007 sales volumes NWE used to derive the fixed cost rate. (Ex. MCC-1, pp 7-10.) The Stipulation between NWE and MCC in Consolidated Docket Nos. D2008.5.45/D2009.5.62 provides additional evidence that MCC did not contest the CU4 fixed cost rate in that case. The Stipulation identified three contested issues, none pertaining to the CU4 fixed cost rate. (Stipulation p. 2.)

Staff agrees with NWE that CU4 fixed costs and the associated unit rate are outside the scope of this docket. The PSC decided in Docket D2008.6.69 to consider the fixed costs of CU4, and set fixed cost rate elements, in general rate cases, not in annual electric tracker filings. In addition, any concerns MCC had regarding the derivation and implementation of CU4 fixed cost rates could have and should have been raised much earlier. Adjusting the CU4 fixed cost rate in this case, given the Commission's prior decisions in D2008.6.69, D2008.7.75, and D2008.5.45/D2009.5.62 would be untimely and retroactive rate making.

2007 sales as basis for CU4 fixed-cost rate

In this proceeding, MCC recommends reducing NWE's 2009/2010 electric supply tracker revenue by nearly $2 million because, MCC argues, NWE improperly used projected 2007 sales volumes to derive its CU4 rates, which has resulted in NWE collecting revenues that exceeded the PSC-authorized CU4 fixed-cost revenue requirement. (MCC Response Br. at 3.)

MCC witness Wilson arrived at his proposed revenue reduction amount by using NWE's expected 2008/2009 sales and the CU4 fixed costs authorized by the Commission in Docket D2008.6.69 to develop an alternative CU4 fixed-cost rate. He multiplied this fixed-cost rate by 2009/2010 electric tracker sales to derive his adjusted CU4 fixed-cost revenue for the 2009/2010 tracker period, which is approximately $2 million less than what current CU4 fixed-cost rates produced for the 2009/2010 tracker period. (Ex. MCC-1, pp. 11-16.)

MCC contends that NWE improperly used 2007 sales volumes to derive the CU4 fixed-cost rates because 2007 is far removed from late 2008 when Order 6925f was issued and CU4 rates were developed, Order 6925f did not explicitly authorize the use of 2007 sales volumes, and the majority of PSC-authorized CU4 fixed costs are not related to a test year. (MCC Response Br., at 3-4.)

NWE counters that it was appropriate for NWE to base its CU4 fixed-cost rates on 2007 sales in order to comply with the "matching principle" of utility regulation. NWE argues it presented 2007 test year CU4 costs in its Docket 2008.6.69 filing as required by PSC filing requirements and those 2007 costs were matched with loads from the same test year to derive the CU4 rates. (NWE Initial Br. at 6.) NWE further contends that the CU4 compliance material that was included in NWE's December 2008 electric supply tracker monthly filing (and provided to MCC at the time) clearly set out and separately discussed the new CU4 fixed- and variable-cost components that were being added to the electric supply tracker pursuant to Order 6925f. (Ex. NWE-6., p. 3.) NWE disputes MCC's claim that it did not have an opportunity to comment on the compliance filing and argues that MCC could have timely objected to the CU4 fixed-cost rates then, but did not do so. (NWE Reply Br. at 4.)

Staff analysis and recommendation: MCC correctly points out that Order 6925f did not provide specific instructions as to how NWE should derive the rates needed to implement the CU4 revenue requirement. (MCC Response Br. at 2.) However, staff agrees with NWE that, in this case, it was proper to use the CU4 2007 sales volumes as the basis for deriving the CU4 fixed-cost rates. The PSC-accepted revenue requirement in Docket D2008.6.69 was based on a 2007 test year, which was appropriate given the June 2008 date of NWE's application in that docket, the PSC's rules requiring use of an historic test period (ARM 38.5.106), and the fact that CU4, unlike other preapproved resources, was an existing resource with actual historic costs. Following issuance of Order 6925f, PSC staff reviewed and processed the compliance filing as usual and approved the compliance tariffs on December 17, 2008.

When a test year is used, compliance rates properly reflect test year revenues and sales. To use 2008/2009 sales, as MCC witness Wilson advocated in this case, would violate the test year matching principle. Obviously, 2009 sales were not known at any point during the pendency of Docket D2008.6.69. As to Wilson's concern that loads changed after the test year, that is always true with an historic test year because an historic test year is a snapshot of a utility's financial condition at a fixed point in time. The revenues, expenses, rate base, and customer loads will all have changed by the time the PSC ultimately determines rates. Staff finds nothing new or troubling about this reality.

The 2007 test year costs presented by NWE in Docket D2008.6.69 were properly matched with the loads that occurred over the same time period, consistent with the matching principle and usual Commission practice in rate cases. Compliance rates were subsequently derived on this basis. While loads have changed from 2007 to 2009, NWE claimed certain CU4 fixed cost components have also changed, growing by $3 million from 2007 to 2009. (Tr. at 266.) If NWE's costs have increased by that amount and if CU4 rates were adjusted as MCC proposes, except to reflect changes in both loads and costs in updating to 2009, rates would increase by $1 million. But, as already discussed, pursuant to Order 6925f rate cases, not annual tracker filings, are the proper forum for assessing CU4 fixed costs of service.

Staff overall recommendations

Staff recommends that the PSC reject MCC's proposed adjustment because it violates the matching principle, because fixed costs of CU4 are beyond the scope of annual electric tracker filings, and because MCC's proposal constitutes untimely retroactive ratemaking, given prior PSC decisions in multiple dockets.

Staff's recommendation to reject MCC's proposed adjustment to the CU4 fixed cost of service rate element, if accepted by the PSC, renders moot MCC's proposed adjustment to NWE's CU4-related lost revenues, which is a function of the CU4 fixed cost of service rate.

Staff recommends the Commission find that NWE's 2009/2010 electricity supply costs were prudently incurred.

Finally, to mitigate the potential for confusion in future preapproval applications, staff recommends the Commission direct NWE to include testimony and work papers that explicitly develop proposed tariff rates and illustrate customer bill impacts.