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

IN THE MATTER OF NorthWestern)	
Energy's Application for Approval to)	
Purchase and Operate PPL Montana's)	REGULATORY DIVISION
Hydroelectric Facilities, for Approval of)	
Inclusion of Generation Asset and Cost of)	DOCKET NO. D2013.12.85
Service in Electricity Supply Rates, for)	
Approval of Issuance of Securities to)	
Complete the Purchase, and for Related)	
Relief)	

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I. INTRODUCTION

NorthWestern Energy (“NorthWestern”) seeks to acquire the Hydros from PPL Montana (“PPLM”) for the benefit of its customers, both the present generation as well as for multiple, future generations. NorthWestern needs new resources. The Hydros are the right resource at the right time for the right price. The Hydros provide dependable, predictable energy and are renewable and carbon free. They will enable NorthWestern to protect customers from market volatility, and greater risks and costs. The Hydros are the lowest-priced, least-risk long-term resource available. They will provide long-term rate stability for generations to come.

In its December 2011 Electricity Supply Resource Procurement Plan (“2011 Plan”), NorthWestern recognized a pressing need to replace expiring contracts with PPLM. During 2012, NorthWestern learned of the potential opportunity to purchase PPLM’s hydroelectric facilities in Montana. Hydroelectric generation is unique in that it provides predictable baseload power with no air emissions or fuel cost risk. After months of analysis, comprehensive due diligence, consideration, and negotiations, NorthWestern entered into a Purchase and Sale Agreement (“Agreement”) to acquire PPLM’s Montana hydroelectric facilities (the “Hydros”) for \$900 million, subject to satisfactory regulatory approvals. NorthWestern cannot consummate the purchase of the Hydros without certain regulatory approvals. NorthWestern has received all necessary regulatory approvals except the Montana Public Service Commission’s (“Commission”) approval of the Hydros as an electricity supply resource, the Commission’s approval to issue securities to finance the purchase, and the Federal Energy Regulatory

Commission's ("FERC") Section 204 approval to issue securities to finance the purchase. FERC will act on NorthWestern's Section 204 application only after it reviews the financial coverage ratio produced by the Commission's decision.

Stochastic modeling of various electricity supply resource portfolios demonstrates that including the Hydros provides the lowest long-term cost and lowest risk alternative for providing service to NorthWestern's electric supply customers. Over the long-term, on a risk-adjusted basis, the Hydros will cost \$332 million less than the second-best alternative and \$376 million less than market purchases. The Commission's approval will enable NorthWestern to serve its customers with the least cost, least risk resource for generations to come. Without the Commission's approval, however, NorthWestern's customers will face a higher cost, riskier future, significantly vulnerable to market forces.

II. APPROVAL OF THE HYDROS IS IN THE PUBLIC INTEREST BECAUSE THE BENEFITS OF THE HYDROS CLEARLY OUTWEIGH ANY RISKS.

In 2007, the Legislature recognized the failure of Montana's foray into electric industry restructuring and passed House Bill 25, the Electric Utility Industry Generation Reintegration Act ("Act"). 2007 Mont. Laws 491. The Act's sponsor, Alan Olson, stated during public comment on July 17, 2014, "the intention behind House Bill 25, was to go back and give . . . NorthWestern Energy customers . . . a fully vertically integrated utility to take the consumers out of the market risk." *July 17 – 18 Public Comment Tr.* 5:8-12.

NorthWestern may apply to the Commission for approval of the Hydros as an electricity supply resource that is not yet procured. § 69-8-421(1), MCA (2013). On December 20, 2013,

NorthWestern filed an Application for Approval to Purchase and Operate PPL Montana's Hydroelectric Facilities, for Approval of Inclusion of Generation Asset Cost of Service in Electricity Supply Rates, for Approval of Issuance of Securities to Complete the Purchase, and for Related Relief ("Application"). To approve NorthWestern's Application, the Commission must find that approval is in the public interest and that procurement of the Hydros is consistent with certain statutes and regulations. § 69-8-421(6)(c), MCA (2013).

The Commission has determined that approval of an application for approval of an electricity supply resource is in the public interest if the benefits to customers outweigh the risks to customers. *See In the Matter of the Application of NorthWestern Energy for Approval to Purchase and Operate the Spion Kop Wind Project, for Certification of the Spion Kop Wind Project as an Eligible Renewable Resource, and for Related Relief*, Docket No. D2011.5.41, Order No. 71591, ¶ 95 (February 16, 2012); *Application for Approval to Construct and Operate the Mill Creek Generating Station to Supply Regulation Service*, Docket No. D2008.8.95, Order No. 6943a, ¶ 211 (May 20, 2009); *In the Matter of an Application by NorthWestern Corporation for Approval of its Interest in Colstrip Unit 4 as an Electricity Supply Resource under Certain Terms and Conditions Including Certain Treatment of Net Operating Losses*, Docket No. D2008.6.69, Order No. 6925f, ¶ 217 (November 13, 2008).

A. NorthWestern needs to acquire energy and capacity to serve its public utility load.

In its 2011 Plan, NorthWestern identified a need to acquire additional resources to account for the termination of two contracts with PPLM and for projected load growth.

NorthWestern estimated that it needed 770,000 MWh in 2012, 2,450,000 MWh in 2015 after the

PPLM contracts expired, and that its need would grow to 3,760,000 MWh in 2031. 2011 Plan, p. 69. Doing nothing was not an option. NorthWestern took steps to meet its customers' needs. For example, NorthWestern entered into several contracts that total up to 350 MW in 2014, 150 MW in 2015, 75 MW in 2016, and 50 MW in 2017 for delivery during heavy load hours, and total up to 200 MW in 2014 and 50 MW in 2015 for delivery during light load hours. See 2013 Electricity Supply Resource Procurement Plan (Application Ex. 4), pp. 2--18-19.

As described above and in the Application, NorthWestern also entered into the Agreement to purchase the Hydros. Without Kerr, the Hydros will supply an estimated average 2,490,000 MWh each year. See Exhibit NWE-7 (Prefiled Direct Testimony of Joe Stimatz), p. 9. Based on historical generation, the Hydros will produce 56% of their total output or approximately 1,390,000 MWh in heavy load hours and 1,100,000 MWh in light load hours. See Response to Data Request PSC-001 (admitted into evidentiary record, July 8 Tr. 16:15-19). With the addition of the Hydros, NorthWestern will have acquired approximately 90% of its load-serving needs for the 20-year planning horizon. Application Ex. 4, p. 1--6.

B. The Hydros are the least cost, least risk long-term resource available.

Section 69-8-419(2), MCA (2013) establishes objectives for NorthWestern to pursue in providing electricity supply service. NorthWestern must strive to provide adequate and reliable electricity supply service at the lowest long-term total cost, § 69-8-419(2)(a), MCA (2013), and identify and cost-effectively manage and mitigate risks related to its obligation to provide electricity supply service, § 69-8-419(2)(c) (2013).

The Commission requires NorthWestern to incorporate computer modeling and rigorous analyses in its procurement and decision-making. ARM 38.5.8213(1). The Commission has indicated that NorthWestern should use probabilistic analysis to incorporate explicit assessments of uncertainty. *In the Matter of the Submission of NorthWestern Energy's Electricity Supply Resource Procurement Plan*, Docket No. N2004.1.15, Written Comments Identifying Concerns, ¶ 10 (August 17, 2004). The Commission has criticized NorthWestern for not modeling carbon stochastically. *In the Matter of NorthWestern Energy's December 2005 Electric Default Supply Procurement Plan*, Docket No. N2005.12.172, Written Comments Identifying Concerns, ¶¶ 96-99 (July 31, 2006). In Electricity Supply Resource Procurement Plans filed in 2004, 2005, 2007, 2010, and 2011, NorthWestern used GenTrader[®] both intrinsically and stochastically to model portfolios. For every plan, in its written comments, the Commission expressed concerns about the robustness and appropriateness of GenTrader[®] as a modeling tool. For its 2013 Electricity Supply Resource Procurement Plan, NorthWestern chose to use a more robust model, PowerSimm by Ascend Analytics, LLC. Application Ex. 4, p. 4 –12. NorthWestern evaluated the effect of the Hydros on the Electricity Supply Resource Portfolio using the same model. *Id.* The Commission's consultant, Evergreen Economics concluded that "the PowerSimm model is a reasonable tool for evaluating the costs and benefits of NWE's proposed purchase of the hydroelectric generating facilities compared to realistic, available alternatives based on the following criteria that reflect industry best practices: . . ." Evergreen Economics, *Review of NWE's Application to Purchase Hydroelectric Facilities – Final Assessment*, p. i (March 27, 2014) (admitted into evidentiary record – July 11 Tr. 228:15-20) ("Ex. PSC – 4").

1. NorthWestern employed stochastic modeling of portfolios to evaluate the benefits and risks.

PowerSimm is a sophisticated model that incorporates a unified simulation framework that reflects joint financial and physical uncertainty while maintaining validated, defined structural and covariate relationships between variables. Application Ex. 4, p. 6 – 3. Using inputs, stochastically simulated variables, and interrelationships, PowerSimm calculates a risk-adjusted net present value of portfolio costs for alternative portfolios.

a. Results

NorthWestern modeled six portfolios using PowerSimm:

Name	Description
Current	Current resources plus market purchases for additional needs
Current + CC	Current resources plus a GE 7FA.04 combined-cycle turbine, online in 2018 (239 MW)
Current + Hydro	Current resources plus the Hydros
Current + LMS 100 2018	Current resources plus LMS 100 combustion turbine, online in 2018 (97 MW)
Current + LMS 100 + Wind 2025	Current resources plus LMS 100 and 100 MW of new wind above RPS requirements, online in 2025
Current + CC + Wind 2025	Current resources plus GE7FA.04 (239 MW) and 100 MW new wind, online in 2025

In discussing the adequacy of modeling these six portfolios, Evergreen Economics concluded, “given the significant advantages that NWE found in both total NPV cost and risk premium for the hydros, relative to the alternative portfolios considered, it would be highly unlikely that evaluating additional portfolios would produce a better alternative than the hydros.” Ex. PSC – 4, p. 17. The chart below presents the risk-adjusted net present value of each of the portfolios

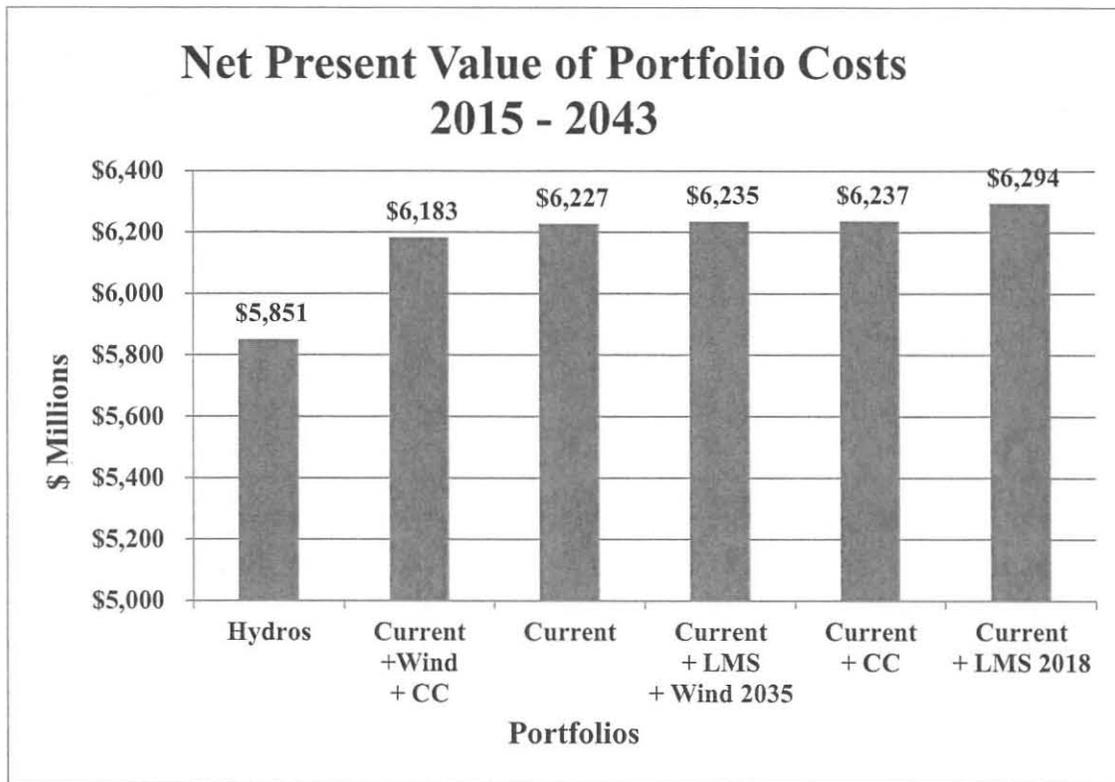


Exhibit NWE-3 (Prefiled Rebuttal Testimony of John Hines, as corrected), p. JDH-6. Clearly, the Hydros portfolio is the least cost alternative by a wide margin. The next best portfolio is \$372 million more expensive than the Hydros. Because PowerSimm includes risk in its portfolio cost, the results establish that the benefits to customers outweigh the risks to customers.

These values use the revenue requirement that NorthWestern requested in its Application, \$128,402,190. At hearing, NorthWestern reduced its requested revenue requirement to \$117,149,256. The Hydros offer even a lower cost and a greater advantage when the \$11,252,934 reduction in first year revenue requirement is considered.

b. The inputs are correct

The validity of any modeling depends on the validity of the inputs. The forecasted inputs for the PowerSimm modeling are forward prices, general economic assumptions, load growth, and carbon costs. Application Ex. 4, p. 6 – 21.

i. Commodity Prices

For commodity forward prices, PowerSimm started with current expectations of forward prices, market expectations of price volatility, fundamental market relationships, rate of mean reversion, and correlations of simulated prices through time. *Id.* Using these inputs, PowerSimm projected natural gas prices at AECO delivery, power prices at Mid-C, and coal prices for the Powder River Basin. *Id.* PowerSimm's mean natural gas price ranged from \$3.82/MMBtu in 2014 to \$7.08/MMBtu in 2033. No party contested the natural gas price forecast. Evergreen Economics commented on the PowerSimm natural gas forecast stating:

For the first 10 years of the planning horizon (2014-2024), the PowerSimm mean forecast is approximately equal to the 2013 Northwest Power and Conservation Council's (NPCC) medium case gas price scenario and the 2013 Energy Information Administration's (EIA) reference case gas price scenario. However, after 2024, the PowerSimm mean forecast falls below these comparison forecasts for each year after 2024.

We believe the generated price projection appears reasonable and is comparable to other sources of price forecasts in the industry. The fact that the NWE gas price forecast varies little from those developed by NPCC and EIA indicates that even with the uncertainty associated with future gas prices, there is a high degree of consensus in the expected value of future gas prices

Ex. PSC-4, p. 10.

PowerSimm's mean electricity prices for Montana delivery ranged from \$33.55/MWh to \$88.51/MWh for heavy load hours and from \$24.35 to \$70.24 for light load hours. From 2021 to 2033, these prices include a carbon adjustment accomplished by applying the annual carbon penalty to the implied marginal unit. Application Ex. 4, pp. 5 – 5 - 5 – 6. The flat market carbon adder ranged from \$13.52/MWh in 2021 to \$24.28/MWh in 2033. *Id.* at 5-7.

The Commission's own consultant recognized that the power price projections including carbon are reasonable. Evergreen Economics stated:

For the first two years of the planning period, NWE's electricity price forecast is approximately equal to the 2013 NPCC electricity price projection [based on delayed implementation of a federal CO2 tax]. NWE's price forecast then falls below the NPCC forecast from 2016 to 2021, at which point the carbon penalty enters into the NWE price forecast. The two forecasts are approximately equal for 2021. However, from 2021 to the end of the planning period, the NWE forecast is consistently below the NPPC forecast. A similar relationship exists between NWE's 2013 RPP forecast and NWE's 2011 RPP forecast. **NWE's forecast of electricity prices appears reasonable when compared with other, publicly available, forecasts.**

Ex. PSC-4, p. 11 (emphasis added).

ii. Carbon Cost

Given the conclusion that NorthWestern's price forecast is reasonable, the carbon cost should not be an issue. However, the Montana Consumer Counsel ("MCC"), and some members of the public expressed concern and confusion about the impact of carbon. Commissioners and Commission staff asked questions about the impact of including carbon on the acquisition price and rates. Because of these concerns, NorthWestern provides additional discussion. To be clear,

however, the revenue requirement and corresponding rates do not include any explicit cost for carbon.

The evaluation of carbon has been an issue in nearly every NorthWestern Electricity Supply Resource Procurement Plan. In the 2004 plan, NorthWestern did not explicitly incorporate environmental costs into its portfolio analysis. The Commission stated, “In its next planning cycle NWE should explicitly incorporate environmental costs into its portfolio analyses.” *In the Matter of the Submission of NorthWestern Energy’s Default Electricity Supply Resource Procurement Plan*, Docket No. N2004.1.15, Written Comments Identifying Concerns – Recommended Remedies, ¶ 6 (August 17, 2004). In the 2005 plan, NorthWestern developed two CO₂ cost scenarios—one with a levelized cost of \$10.60/ton for a resource with a 2013 on-line date and another with a cost of \$31.22/ton. The Commission stated, “Although NWE’s CO₂ tax risk evaluation represents an improvement over the 2003 DSP, ultimately it falls short in terms of adequately illuminating the cost-risk trade-offs surrounding long-term, base load supply options.” *In the Matter of NorthWestern Energy’s December 2005 Electric Default Supply Procurement Plan*, Docket No. N2005.12.172, Written Comments Identifying Concerns, ¶ 99 (July 31, 2006). In its 2007 Plan, NorthWestern calculated three CO₂ cost scenarios and included a market price adjustment for each of the scenarios. The market price adjustment ranged from \$0.00/MWh in as late as 2015 to \$35.62/MWh in 2027. The Commission stated, “NWE’s 2007 plan significantly improved the evaluation of portfolio risks related to future CO₂ costs. The PSC’s primary concern is whether NWE adequately captures the magnitude of possible impacts.” *In the Matter of NorthWestern Energy’s December 2007 Electric Default*

Supply Procurement Plan, Docket No. N2007.11.138, Written Comment Identifying Concerns, ¶ 96 (December 12, 2008). The Commission cited several publications that suggested NorthWestern’s levels were too low. *Id.*, ¶¶ 96-100. In its 2009 plan (filed June 30, 2010), NorthWestern incorporated the NPCC 6th Plan average carbon tax with two separate phase-in periods. The Commission did not comment on the analysis. In its 2011 plan, NorthWestern included a base case with a 2015 carbon price. The Commission made two comments regarding the effect of carbon regulation. The Commission stated, “The base case’s 2015 carbon price implementation date is increasingly unrealistic in light of the delays associated with such regulations as the Mercury and Air Toxics Standard and the various state Regional Haze Rules.” *In the Matter of NorthWestern Energy’s December 2011 Electricity Supply Resource Procurement Plan*, Docket No. N2011.12.96, Written Comments Identifying Concerns, ¶ 18 (September 28, 2012). The Commission also stated, “NorthWestern should also anticipate the effects of environmental regulations on the market in which it purchases, both as regards the withdrawal of generating capacity by coal plant owners and how cost-of-production increases could impact the market-wide price of electricity.” *Id.*, ¶ 19.

In analyzing the Hydros, NorthWestern has followed the Commission’s directions. NorthWestern has extended the implementation of any carbon cost to 2021. Additionally, NorthWestern has reduced the level of carbon from prior resource procurement plans.

Evergreen Economics commented separately on NorthWestern’s carbon forecast:

NWE’s modeling assumption that carbon taxation will occur in the United States by 2021, while not a foregone conclusion, may be increasingly likely. The Carbon Disclosure Project (CDP) recently released results from its annual

disclosure process in 2013, which find that most companies covered in its report expect some form of regulatory approach to addressing climate change in the future. Furthermore, “many major publicly traded companies operating or based in the United States have integrated an ‘internal carbon price’ as a core element in their ongoing business strategies”. The CDP report states that utility and energy companies in particular are the most likely to employ internal carbon pricing schemes for strategic decision-making. The CDP noted that prices for carbon penalties covered a wide range from US \$6-\$60 per metric ton of carbon and cited \$20 per ton as the average carbon price among utilities in North America.

The future cost of carbon emissions, an externality not currently taxed at the State or Federal level, has a positive and materially significant impact on the value of hydroelectric assets relative to generation assets that do emit carbon. NWE’s carbon price assumptions are in line with internal carbon pricing used by other investor-owned utilities (IOUs) for operational and planning purposes. While a national, regional or state carbon tax is not a foregone conclusion, NWE’s assumption that a carbon tax will be assessed beginning in 2021 may be reasonable.

Ex. PSC-4, p. 12.

John Hines testified that NorthWestern’s estimate of the impact of carbon is lower than the average of its peer utilities. July 8 Tr., 110:17-25. Gary Dorris testified, “I would say that with respect to planning choices for carbon, NorthWestern is unquestionably at the low end of the spectrum.” July 9 Tr., 29:18-20.

iii. Expenses and Investments

In addition to inputs for electricity, coal and natural gas prices, PowerSimm incorporated NorthWestern’s estimates of future operation and maintenance expenses (“O&M”) and future capital expenditures (“Capex”). NorthWestern determined these estimates through its extensive due diligence. Evergreen Economics suggested that a “probabilistic representation of [maintenance and refurbishment] costs would have provided a more realistic assessment of the

risk.” Ex. PSC-4, p. 6. Stochastic analysis of O&M and Capex is not a standard practice. *See* NWE Exhibit NWE-4 (Prefiled Rebuttal Testimony of Gary Dorris), p. 22:3-10.

NorthWestern estimated annual O&M to go from \$22 to \$30 million annually. No party specifically questioned this estimate. This estimate is comparable to historical O&M, when adjusted for elimination of the Kerr lease payment, and is higher than PPLM’s estimated O&M. *See* Response to Data Request PSC-001.¹

NorthWestern estimated annual Capex using PPLM’s specific 5-year plan through 2017, used \$8.5 million in 2018, and then escalated this amount at 2.5% going forward. John VanDaveer explained how NorthWestern reached this estimate. *See* Exhibit NWE-25 (Prefiled Additional Issues Testimony of John VanDaveer), pp. 6:8-7:15. Gary Wiseman, of CB&I confirmed this amount. HDR Engineering, Inc. (“HDR”) prepared an independent estimate of future Capex that was lower than NorthWestern’s estimate. *See* Exhibit NWE-29 (Prefiled Additional Issues Testimony of Rick Miller), pp. RM-7:21-9-3. HDR concluded that NorthWestern’s estimate was adequate. *Id.*, 9:6-10:2. Like the O&M, NorthWestern’s estimate of future Capex exceeds that of PPLM for the same period. *See* Response to Data Request PSC-001. Mr. Fred Szufnarowski of The Essex Partnership, another of the Commission’s consultants, testified that “we are not convinced there’s enough information to say with certainty one way or the other that [NorthWestern’s future Capex budget] is adequate or inadequate.” July10 Tr. 28:4-6. He also stated that after reviewing additional testimony, that he had more comfort with NorthWestern’s due diligence in certain areas. *Id.* 67:5-70:11.

¹ The PPLM information is in the June 2013 Confidential Information Memorandum (“*CIM*”). The *CIM* is protected material. This general statement does not reveal the actual confidential information.

Given the industry's standard practice, the convergence of the various estimates, and the thorough due diligence that led to them, there is no reason to suppose that using a probabilistic approach would add any more useful information or change the conclusions.

2. The MCC's focus on the short-term is improper.

The MCC suggested that the Commission approve the transaction only if it imposed certain conditions and reduced the revenue requirement. Although not explicitly stating so, the MCC implied that approval of the Application is not in the public interest. The MCC focused on rates that would be higher than projected market prices during the first eight years, the possibility that NorthWestern has overstated market prices due to the inclusion of carbon costs after 2021, and the possibility that NorthWestern has underestimated future Capex. None of the MCC's arguments in this area is well taken.

The statute requires NorthWestern to consider the long-term. § 69-8-419(2)(a), MCA (2013). As the Commission stated when faced with a similar argument, "The PSC is fully aware that approving NWE's rate-basing proposal means customers' rates will be somewhat higher for several years, but the PSC finds the initial cost is justified by the benefit to customers from the relative rate stability that rate-basing contributes to the supply portfolio, as well as the benefit to customers from lower rates in the long term." *In the Matter of an Application by NorthWestern Corporation for Approval of its Interest in Colstrip Unit 4 as an Electricity Supply Resource*, Docket No. D2008.6.69, Order No. 6925f, ¶ 224 (November 13, 2008). In another context, the Commission commented that a seven-year contract was not a long-term resource. Docket No. N2005.12.172, Written Comments Identifying Concerns, ¶ 85

The discussion in Section II.B.1.b above, regarding O&M and Capex, demonstrates that the MCC's speculative arguments do not have any validity. The MCC did not even acknowledge that NorthWestern's estimates are higher than those offered by PPLM.

C. Acquisition of Kerr subject to the subsequent FERC mandated transfer to the Confederated Salish and Kootenai Tribes ("CSKT") is in the public interest.

In its Application, NorthWestern requested, in part, that the Commission issue an order, "authorizing NorthWestern to make a final compliance filing in approximately December 2015 to reflect post-closing adjustments, the conveyance of the Kerr Project to CSKT, if it occurs, and the actual property tax expense for the Hydros."² Application, p. 9. During the hearing, public comment raised issues about the transfer of the Kerr Project to the CSKT. Commissioners questioned whether an order approving NorthWestern's acquisition of the Hydros also would include an implied approval of the future transfer of the Kerr Project to the CSKT and, if so, what evidence demonstrated that such a transfer would be in the public interest. While the Kerr Project creates a unique situation, the record demonstrates that approval of the transfer of the Kerr project is in the public interest. If the Commission were to place restrictions on the future transfer of the Kerr Project to CSKT, then the entire transaction may be at risk.

1. Kerr cannot be separated from the acquisition of the Hydros.

Acquisition of the Hydros without Kerr is in the public interest. However, as John Hines testified, PPLM was not willing to sell the Hydros without Kerr. July 8 Tr., 172:21-25. Bob Rowe indicated that NorthWestern would have preferred to acquire the Hydros without Kerr.

² The request regarding actual property taxes was modified during the hearing. NorthWestern describes this modification below.

July 17 Tr., 258:5-7. As the questions about the future Kerr transfer arose during the hearing, NorthWestern reached out to PPLM to explore the possibility of removing Kerr from the transaction between PPLM and NorthWestern; PPLM remained unwilling to amend the PSA to remove Kerr. July 17 Tr., 258:7-11. NorthWestern has addressed the short period for which it will own the Kerr Project by forgoing any return on its one-year investment of \$30 million.

2. The Kerr Project is burdened by the CSKT's option to purchase.

The Montana Power Company's ("MPC") initial license for the Kerr Project expired in 1980. In 1976, the MPC applied for renewal of the Kerr Project License. About one month later, the CSKT filed a competing application for a new license. FERC issued notice of the applications. The Flathead, Mission, and Jocko Valley Irrigation Districts (representing most owners of irrigable lands served by the Flathead Irrigation Project) (collectively, the "Districts") and the MCC intervened in the proceeding. FERC held hearings in Helena on July 11-13, 1984 and in Missoula on July 16-18, 1984. On March 29, 1985, the MPC, CSKT, the Districts, the MCC, and the Secretary of the Interior filed a proposed settlement in the license application proceedings. On July 17, 1985, FERC issued an order approving the settlement and issued a joint license for the Kerr Project to the MPC and the CSKT. *In re The Montana Power Company*, 32 FERC ¶ 61,070 (July 17, 1985). Among other provisions, the 1985 license provided that at any time between the 29th and 39th anniversaries of the Effective Date [as defined in the license], the CSKT could designate a date for transfer of the project to the CSKT. This provision granted the CSKT an unconditional right to acquire the project.

Subsequent license transferees have recognized the CSKT's right to acquire the project. FERC referenced the provisions in approving subsequent license transfers. "PPLM is qualified to hold the license and to operate the property under the license, and it has agreed to accept all the terms and conditions of the license, and to be bound by the license as if it were the original licensee." *Montana Power Company, Confederated Salish and Kootenai Tribes of the Flathead Reservation, and PP&L Montana, LLC*, 88 FERC ¶ 62,010 (July 7, 1999). "The transferee [NorthWestern] has agreed to accept all of the terms and conditions of the license, including conveyance of the license to the Tribes, and to be bound by the license as if it were the original licensee." *PPL Montana, LLC, NorthWestern Corporation*, 148 FERC ¶ 62,072 at 8 (July 24, 2014). In commenting about the concerns of Senator Jackson, Lake County, Flathead County, Flathead Business & Industry Association, Bayside Park & Marine Center, LLC, and Eagle Bend Yacht Harbor, FERC reiterated that the 1985 order issuing the license "set forth that Montana Power would hold and operate the project for the first 30 years of the term and that the Tribes would hold and operate the project for the balance of the term and any annual license term thereafter." *Id.* at 6.

3. FERC has preempted the Commission from barring the transfer of Kerr to the CSKT.

FERC has spoken and has granted the CSKT the right to the license beginning in 2015. Parties had the right to weigh in and contest FERC's decision in the competing licensing dockets in 1985. Irrigators and the MCC availed themselves of that opportunity and supported the settlement that FERC approved. The Federal Power Act has preempted state authority with respect to hydroelectric projects, with very limited exceptions related to distribution of water

used in irrigation or for municipal or other uses. *See California v. F.E.R.C.*, 495 U.S. 490, (1990); *First Iowa Hydro-Electric Cooperative v. FPC*, 328 U.S. 152 (1946). The transfer of a license does not impact the property rights that the exceptions are aimed at protecting. None of the exceptions would permit the Commission to interfere with FERC's regulation of licenses that it has granted.

III. NORTHWESTERN APPLIED INDUSTRY STANDARD PROCUREMENT PRACTICES TO REACH AN AGREEMENT TO ACQUIRE THE HYDROS

The Commission requires a utility to apply industry standard procurement practices to acquire electricity supply resources. ARM 38.5.8212(1). The Commission also recognizes that it "cannot prescribe in advance the precise industry standards a utility must apply since industry standards vary depending on context and circumstances." *Id.* NorthWestern applied industry standard procurement practices to procure an existing resource, the Hydros, from a seller that was interested in selling but under no compulsion to sell. Under such circumstances, industry practice is for the seller to identify and prequalify potential purchasers, to provide specific information subject to non-disclosure agreements, and to engage potential purchasers in bilateral negotiations. As described in the prefiled testimony of Brian Bird and of Ahmad Masud, that is exactly what occurred with this transaction. Gary Dorris testified that based on his experience, NorthWestern's process was consistent with how other entities would analyze a resource. July 9 Tr. 159:9-160:9.

A. NorthWestern could not acquire the Hydros through a competitive solicitation.

The Commission's administrative rules indicate that competitive solicitations are the preferred method for acquiring resources. ARM 38.5.8212(2). However, the Commission's rules recognize that competitive solicitations may not always be possible. "The rules accommodate situations in which a cost-effective opportunity resource might be lost due to the longer time frame needed for a competitive procurement process." Docket No. N2011.12.96, Written Comments, ¶ 23. PPLM, not NorthWestern, controlled the process by which PPLM would sell the Hydros. Therefore, a competitive solicitation run by NorthWestern was not possible.

1. NorthWestern thoroughly documented its exercise of judgment in evaluating and selecting the Hydros.

The Commission's rule recognizing that competitive solicitations are not always possible provides, "To the extent a utility does not use competitive solicitations to acquire electricity supply resources it should thoroughly document the exercise of its judgment in evaluating and selecting resource options" ARM 38.5.8212(3). The prefiled direct, supplemental, additional issues, and rebuttal testimony; the thousands of pages of responses to data requests; and the live testimony at the hearing thoroughly document NorthWestern's exercise of judgment.

In evaluating the price it could pay for the Hydros, NorthWestern considered all of the information available. NorthWestern considered Credit Suisse's estimate that the value of the Hydros was between \$750 million and \$1 billion on an unregulated basis and between \$800 million and \$1.25 billion on a regulated basis. *See* Exhibit NWE-13 (Prefiled Direct Testimony

of Ahmad Masud), p. AM-12. Credit Suisse formed its estimate based on sales of comparable hydroelectric facilities and portfolios (\$752 million to \$995 million), sales of utilities (\$789 million to \$1.268 billion), and discounted cash flow analyses (“DCF”) (\$770 million to \$1.01 billion). Exhibit NWE-13, AM Exhibit 1. NorthWestern considered its own DCF that indicated the value of the Hydros to an unregulated buyer would range from \$790 million to \$994 million. See Exhibit NWE-11, pp. BBB-17 – BBB-18 and Ex. __ (BBB-3). NorthWestern’s initial DCF value, after it eliminated overly conservative assumptions, was \$883 million, not the \$826 million has been quoted. *Id.*, p. BBB-18. NorthWestern considered that PPLM had rejected its previous offer of \$740 million for the Hydros and had indicated that it expected the value to be more than \$1 billion. July 11 Tr., 70:4-8. NorthWestern considered that it wanted to keep the rate impact to less than 10% of a customer’s total electric bill.

NorthWestern considered what its due diligence showed about the condition of the Hydros and its estimates for future O&M and future Capex. NorthWestern considered that the Hydros have had extensive renovation over the past 20 years. As described by John VanDaveer, more than 75% of the installed capacity is less than 20 years old. Ex. NWE- 26 (Prefiled Rebuttal Testimony of John VanDaveer), p. JCV-4 – JCV-5. Mr. VanDaveer identified units initially commissioned in 1995 and 2013; new turbines installed 2000-2001, 2007-2008, and 2011-2013; generators rewound in 2004-2005, 2009-2010, and 2009-2010; and a turbine and generator upgraded in 2013-2014. *Id.* As described above, NorthWestern checked its estimates against PPLM’s for reasonableness. NorthWestern considered that its Capex projections included amounts to invest in parts of the system that have not had extensive renovation. *Id.*

NorthWestern considered what its due diligence showed about the reliability and the output of the Hydros and considered how the output matched its needs.

After consideration of all these factors, NorthWestern determined that it could offer \$900 million for the Hydros, including \$30 million for Kerr that likely would be returned to NorthWestern upon conveyance to CSKT in one year.

2. NorthWestern evaluated the Hydros against market-based alternatives.

The Commission's administrative rules require, "A decision by a utility regarding the acquisition of an equity interest in an electricity generating plant or equipment or the construction of such a resource on its own should be thoroughly evaluated against available market-based alternatives." ARM 38.5.8212(4). NorthWestern performed this evaluation through its use of PowerSimm. As the results above demonstrate, acquisition of the Hydros provides a long-term savings of more than \$375 million over the market. NorthWestern also used PowerSimm to back cast the performance of the Hydros compared to market. *See* Exhibit NWE-4, p. GWD-15. The net present value of customer cost for the Hydros from 1999 to 2013 would have been nearly \$400 million less than the cost of the market. *Id.*

B. A willing seller, PPL Montana, and a willing buyer, NorthWestern, conducted demanding negotiations to reach a fair price with fair terms.

In addition to testing the rates against projected electricity market prices, NorthWestern entered into an agreement to purchase the Hydros at market value. Market value is the price that a willing buyer would pay a willing seller taking into consideration relevant facts. *DeVoe v. Department of Revenue*, 263 Mont. 100, 112, 866 P.2d 228, 236 (1993). In this transaction, a

willing buyer, NorthWestern, and a willing seller, PPLM, determined the price through negotiations. NorthWestern had to be cognizant of what it could pay and also of what PPLM may be expecting to receive. NorthWestern was aware that PPLM's confidential pre-tax net cash flow estimates over a 20-year period were greater than those projected by NorthWestern. NorthWestern was also aware that PPLM had rejected its earlier offer of \$740 million, and that market comparisons supported a purchase price as high as \$1.268 billion. The price of the Hydros to be placed into rate base, \$870 million, represents a negotiated market value.

Even after reaching an agreement on price in late July 2013, the parties negotiated the transaction's terms and condition over the following two months to reach an agreement. While no party to this proceeding challenged the reasonableness of the PSA's terms and conditions other than price, it is worth noting that multiple provisions of the Purchase and Sale Agreement (PSA) favor NorthWestern. The PSA includes customary representations and warranties and indemnifications, which benefit NorthWestern in the event of a PPLM breach. PPLM is also solely responsible for certain liabilities called "Excluded Liabilities." See PSA Section 2.1(d). Among the long list of "Excluded Liabilities" are "Retained Environmental Liabilities." PSA Section 2.1(d)(vi). These include PPLM's agreement to share the cost of demolishing the old powerhouse at the Rainbow Plant. See Definition of "Retained Environmental Liabilities." They also include a commitment by PPLM to pay all costs arising out of the release of oil from gearboxes at the Morony Plant on or about July 31, 2013 and the waste oil contaminated with PCB at the Holter Plant. *Id.* and Schedule 1.1(g). In addition, among the "Excluded Liabilities" are "Excluded Claims Liabilities." PSA Section 2.1(d)(vii). The definition of "Excluded Claims

Liabilities” includes certain pre-closing litigation liabilities. See Section 2.1(d), definition of “Excluded Claims Liabilities,” and Schedule 3.6(a).

IV. NORTHWESTERN’S REQUESTED REVENUE REQUIREMENT OF \$117,149,256 RESULTS IN JUST AND REASONABLE RATES.

To approve the Application, the Commission must find that procurement of the Hydros is consistent with § 69-3-201, MCA (2013). § 69-8-421(6)(c)(ii), MCA (2013). Charges for power must be reasonable and just. § 69-3-201, MCA (2013). Just and reasonable rates allow a utility to recover its prudently incurred expenses and earn a return on its invested capital such that it can attract capital. The rates proposed by NorthWestern are just and reasonable.

A. A 10% return on equity and an estimated 6.88% rate of return are just and reasonable

NorthWestern has requested a 10% return on equity and estimated that it will have a 6.88% rate of return. The MCC has suggested that the reasonable range for return on equity is 8% to 9%.

Both Brian Bird and Adrien McKenzie of FINCAP, Inc. (“FINCAP”) supported NorthWestern’s requested return on equity. Mr. Bird justified the 10% return on equity with recent Commission-authorized return on equity, including NorthWestern’s most recent electricity supply resource decision, the recent increase in interest rates, comparison to authorized return on equity for other electric utilities, and FINCAP’s range of reasonable returns. FINCAP’s range of reasonable returns on equity is 9.64% to 11.14% with a midpoint of 10.39%.

Adrien McKenzie testified that a 9% return on equity would be insufficient for NorthWestern to attract capital. Ex. NWE-34 (Prefiled Rebuttal Testimony of Adrien M.

McKenzie), pp. AMM-3 – AMM-7. NorthWestern competes with other utilities for capital. In the last three years there have been over 200 authorized returns on equity. Only 3 of them were in the range that Dr. Wilson has recommended in this docket. Mr. McKenzie also pointed out that during the pendency of this proceeding, FERC revised its method of setting return on equity and, under the new method, authorized a return on equity of 10.57%, substantially higher than Dr. Wilson's recommendation of 8.2% to 8.7% in that case. July 17 Tr. 70:6-71:14. Mr. McKenzie also testified that Montana's cost recovery mechanisms, such as trackers and approval of resources not yet acquired, do not reduce NorthWestern's risk compared to other utilities. *Id.* 71:15-73:8.

Based on all of the information and on the requirement for just and reasonable rates, the Commission should grant NorthWestern's request for a return on equity of 10%. With an adequate return on equity and a timely approval that permits financing, NorthWestern estimates the overall rate of return will be 6.88%. This will be the lowest overall rate of return for any regulated utility in Montana.

B. NorthWestern's concessions on cost of service, including depreciation and property taxes, are reasonable and benefit customers.

From the time that it filed the Application to the end of the hearing, NorthWestern agreed to or offered concessions that reduced the requested revenue requirement and protected customers from increased Capex from 2015 through 2020. NorthWestern has made concessions in the areas where it can. NorthWestern cannot accept any rate base value below its purchase price of \$870 million for the Hydros without Kerr. A lower rate base value would probably

require an immediate write down of asset values or recognition of a potential impairment. Either result is unacceptable.

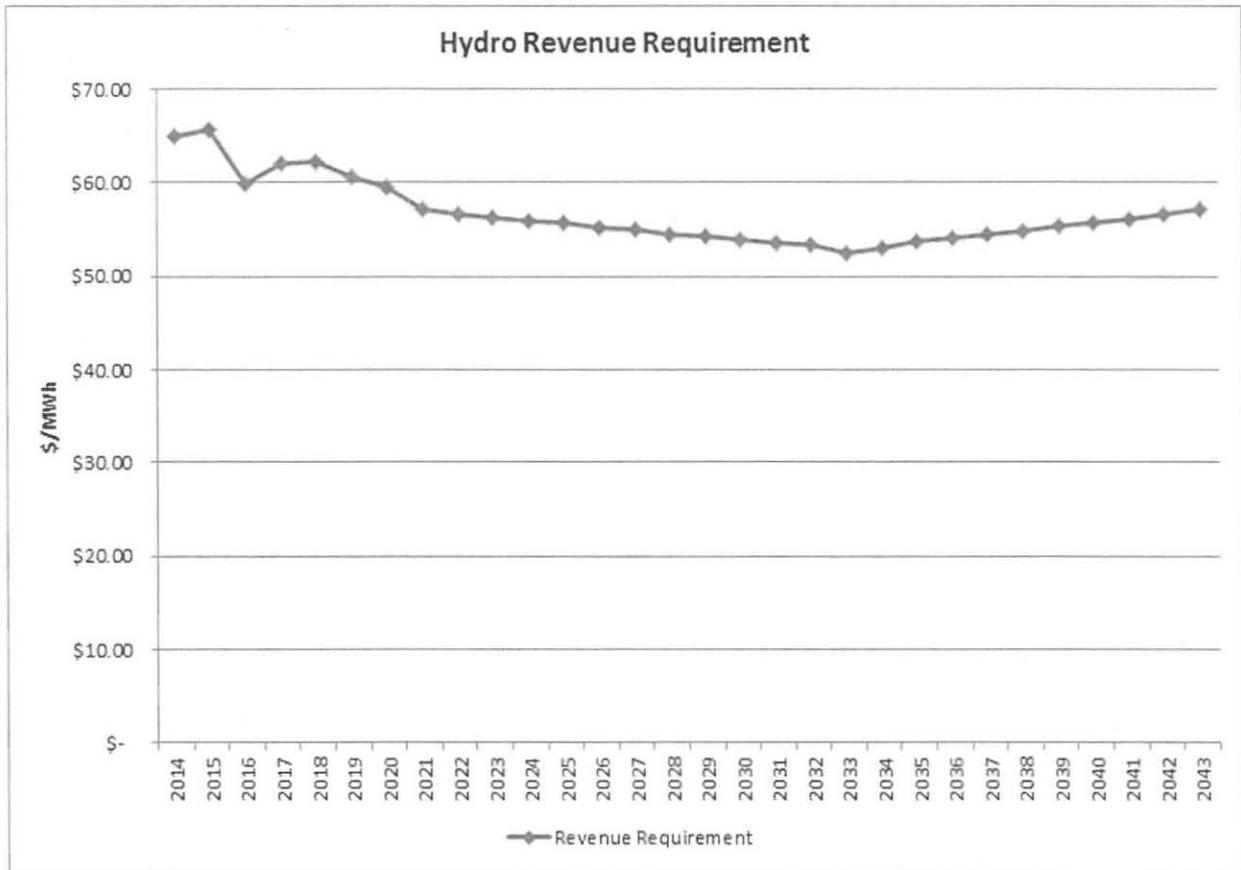
NorthWestern initially requested a revenue requirement of \$128,402,190. At hearing, NorthWestern reduced its request to \$117,149,256. NorthWestern offered this reduced revenue requirement by forgoing any return on its investment in the Kerr Project; extending the depreciation period on the rate-based Hydros to 50 years (producing a net present value benefit to customers of \$16.1 million, Hearing Request Provide #1); lowering its requested property taxes in the first year to the actual level paid by PPLM; reducing the estimated cost of debt to 4.00%; and by reducing related items whose calculation depends on total revenue. Additionally, NorthWestern offered to forgo any return on investment over \$58.1 million for the period 2015 to 2020 (except for an ability to request recovery due to extraordinary conditions).

C. The Hydros contribute to rate stability that NorthWestern's customers want.

When NorthWestern prepared its Application, an average monthly residential bill for 750 kWh was \$83.69. As of July 1, 2014, an average monthly residential bill is \$82.77. The projected average monthly bill on October 1, 2014 with the Hydros is \$87.43. The long-term rate stability that the Hydros will provide to NorthWestern's more than justifies this small rate increase.

During listening sessions, many NorthWestern customers commented that they wanted rate stability and that they would be willing to pay more for that stability. From the expiration of the PPL buyback contract in 2002 to 2009 when NorthWestern included Colstrip Unit 4 in ratebase, NorthWestern's customers saw their cost of electricity increase by 112.9%. Exhibit

NWE-3, p. JDH-7. This is a compound annual growth rate (“CAGR”) of 13.4%. *See* Response to Data Request PSC 315 (admitted into evidentiary record, July 8 Tr. 16:15-19). Since reintegration of supply began, NorthWestern’s customers have experienced a vastly reduced CAGR of 2.4% for electricity supply. *Id.* The Hydros’ projected revenue requirement is stable or declining. Exhibit NWE-3, p. JDH-20. The following chart illustrates the projected revenue requirement.



Id. This stable revenue requirement for a significant portion of NorthWestern’s customers’ needs will contribute to rate stability over the long-term. This is the legacy that NorthWestern

strongly believes best serves all of its customers, as it reduces market volatility risks and costs, and helps provide a stable economic foundation for all customers, for generations.

V. CONCLUSION³

On July 18, 2014, Chairman Gallagher asked NorthWestern's CEO, Bob Rowe, if this is the right thing for his six-year old grandson and his constituency. July 18 Tr. 19:18-21. Part of Mr. Rowe's answer was, "Absolutely." *Id.* 21:11. The evidence establishes that approval of the Application is in the public interest, that acquisition of the Hydros is consistent with the statutory objectives and the Commission's rules, and that the resulting rates are just and reasonable. In listening sessions around the state, NorthWestern's customers said they would gladly pay a little more for stable, predictable supply prices that will benefit future generations of Montanans. NorthWestern respectfully requests that the Commission approve the Application and grant the relief requested.

Respectfully submitted this 1st day of August, 2014.

NORTHWESTERN ENERGY

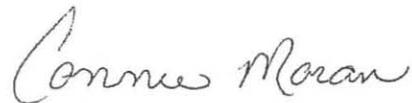
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³ During the hearing, some choice customers in Great Falls expressed concern that they might not be able to receive energy from PPLM if NorthWestern purchased the Hydros due to transmission constraints between Colstrip and Great Falls. On July 21, 2014, NorthWestern updated its response to PSC-353 to reflect that some transmission customers had withdrawn transmission service requests ("TSRs") and that there was available transmission capacity. On July 29, 2014, NorthWestern provided a second updated response to reflect that each potentially impacted customer in Great Falls that is currently served out of the Crooked Falls or Black Eagle substation has made a new TSR to designate the resource as PPL Montana's Colstrip facilities. The TSRs are being processed. This is no longer an issue.

CERTIFICATE OF SERVICE

I hereby certify that a copy of NorthWestern Energy's Initial Post-Hearing Brief in Docket No. D2013.12.85 will be hand delivered to the Montana Public Service Commission (PSC) and the Montana Consumer Counsel (MCC) on this day and e-filed electronically on the PSC website. It will be mailed to the most recent service list in this Docket and will also be emailed to the Counsel of Record.

Date: August 01, 2014

A handwritten signature in cursive script that reads "Connie Moran".

Connie Moran
Administrative Assistant
Regulatory Affairs

**Docket No D2013.12.85
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