

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

* * * * *

IN THE MATTER OF NorthWestern)	REGULATORY DIVISION
Energy's 2012-2013 Electricity Supply)	
Tracker)	DOCKET NO. D2013.5.33
)	
IN THE MATTER OF NorthWestern)	DOCKET NO. D2014.5.46
Energy's 2013-2014 Electricity Supply)	
Tracker)	

Pre-Filed Direct Testimony
of
George L. Donkin
on Behalf
of
The Montana Consumer Counsel

May 8, 2015

J. W. Wilson & Associates, Inc.

Economic Counsel

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1 **I. QUALIFICATIONS OF WITNESS AND INTRODUCTION**

2 **Q. PLEASE STATE YOUR NAME, OCCUPATION, AND BUSINESS**
3 **ADDRESS.**

4 A. My name is George L. Donkin. I am an economist employed by J.W.
5 Wilson & Associates, Inc. (JWWA). My business address is 1601 North
6 Kent Street, Arlington, VA, 22209.

7 **Q. ON WHOSE BEHALF ARE YOU APPEARING IN THIS**
8 **PROCEEDING?**

9 A. My appearance in this case is on behalf of the Montana Consumer Counsel
10 (MCC).

11 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL AND**
12 **PROFESSIONAL BACKGROUND?**

13 A. I hold B.A. and M.A. degrees in economics from the University of
14 Maryland, where my major fields of study were economic theory, industrial
15 organization, and antitrust economics. I am a consulting economist
16 specializing in energy economics and public policy toward business. I have
17 more than forty years of experience in energy-related and public utility
18 work, both as a consultant and as a staff economist at the Federal Power
19 Commission, the predecessor of the Federal Energy Regulatory

1 Commission (FERC). Since 1974, I have been employed as a consulting
2 economist representing various clients, including federal agencies, state
3 regulatory commissions, state consumer advocate offices, public and
4 private utility companies, industrial firms, natural gas producers, gas
5 pipelines, gas distribution companies, gas marketers, and non-profit
6 organizations. My professional work has pertained to a wide range of
7 issues concerning the natural gas and petroleum industries, public utility
8 regulation, energy policy, antitrust issues, and economic research and
9 analysis. A special focus of my professional work has been the study of
10 energy markets generally, with a particular focus on the analysis of price
11 formation in both the regulated and unregulated sectors of the natural gas
12 industry. For more than the past decade a significant part of my work has
13 involved the analysis of how firms in the energy industries can use hedging
14 strategies to assist in mitigating energy supply price volatility.

1 **Q. HAVE YOU PREVIOUSLY PRESENTED EXPERT TESTIMONY IN**
2 **PROCEEDINGS INVOLVING THE NATURAL GAS AND**
3 **ELECTRIC UTILITY INDUSTRIES?**

4 A. Yes. I have presented expert testimony on natural gas and electric utility
5 industry topics in nearly two hundred proceedings before numerous state
6 and federal courts, before the FERC, and before various state public utility
7 commissions. I have also testified as a natural gas expert in arbitration
8 proceedings in Louisiana, New Mexico and Texas, before a Mediator in
9 Ohio, and in Federal tax and bankruptcy courts.

10 **Q. HAVE YOU PREVIOUSLY PRESENTED EXPERT TESTIMONY**
11 **BEFORE THE MONTANA PUBLIC SERVICE COMMISSION?**

12 A. Yes. I have presented expert testimony before this Commission in
13 numerous proceedings, many of which involved NorthWestern Energy
14 (NWE, or the Company), or its predecessor, the Montana Power Company
15 (MPC).

1 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS CASE?**

2 A. The MCC has asked me to review the Company's May 31, 2013 and May
3 29, 2014 annual electricity supply tracker filings, with a particular focus on
4 NorthWestern's electricity supply cost hedging activities.

5 **Q. DID YOU PREVIOUSLY PERFORM A SIMILAR REVIEW OF THE**
6 **ELECTRICITY SUPPLY COST HEDGING ACTIVITIES THAT**
7 **WERE ADDRESSED IN NORTHWESTERN'S MAY 31, 2012,**
8 **ANNUAL ELECTRICITY SUPPLY TRACKER FILING, IN**
9 **DOCKET D2012.5.49?**

10 A. Yes, I did.

11 **Q. DID YOU PRESENT TESTIMONY AND EXHIBITS ADDRESSING**
12 **NORTHWESTERN'S ELECTRICITY SUPPLY COST HEDGING**
13 **ACTIVITIES IN DOCKET D2012.5.49?**

14 A. I did.

1 **II. DOCKET D2012.5.49**

2 **Q. PLEASE SUMMARIZE THE OPINIONS, CONCLUSIONS, AND**
3 **RECOMMENDATIONS YOU PRESENTED IN YOUR TESTIMONY**
4 **IN DOCKET NO. D2012.5.49.**

5 A. My testimony in that case included the following opinions and conclusions:

- 6 • Much of NorthWestern's total annual electricity supply requirement
7 is purchased at fixed prices under medium-term and long-term
8 supply requirements. In the 2011-2012 electricity supply tracker
9 period, fixed-price supplies represented 62.4% of the Company's
10 total annual electricity supply requirement.
- 11 • NorthWestern also owns rate-based electric generation resources,
12 with full cost recovery in rates. At that time, these resources were
13 represented by Colstrip Unit 4 and the Dave Gates Generating
14 Station (DGGS). Because much of the total cost of service of these
15 resources is fixed (78.4% for Colstrip Unit 4, and 73.0% for DGGS
16 in the 2011-2012 supply tracker period), the power supply costs
17 from these resources is expected to be more stable over time than
18 power supply costs that are purchased at short-term energy market
19 prices. At that time Colstrip Unit 4 and DGGS represented 22.9% of
20 NorthWestern's total annual electricity supply requirements.

- 1 • The rest of NorthWestern’s electricity supply is purchased at market
2 index prices. In NorthWestern’s 2011-2012 supply tracker period,
3 purchases at index prices represented 14.7% of the Company’s total
4 annual electricity supplies.
- 5 • In an effort to hedge against electric supply price volatility,
6 NorthWestern uses a combination of physical, fixed-price forward
7 purchases at the Mid-Columbia trading hub, coupled with physical,
8 index-priced or physical, spot market sales, also taking place at Mid-
9 Columbia.
- 10 • NorthWestern’s off-system Mid-Columbia electricity supply cost
11 hedges are very similar to its natural gas price swaps deals, which
12 through March of 2013 had produced \$80.9 million of gas price
13 hedging losses for the Company’s natural gas ratepayers.
- 14 • My exhibit ___ (GLD-1), which was based on Mr. Bennett’s Exhibit
15 ___ (FVB-2)12_13, Pages 3 and 4, showed that NorthWestern was
16 forecasting off-system electricity supply cost hedging losses of
17 \$14,932,708 for July 2012 – June 2013.
- 18 • NorthWestern’s off-system electricity supply cost hedging deals are
19 made with counterparties that expect the fixed prices they will be
20 paid will exceed the short-term electricity power supply market

1 prices they will pay in the future when settlements are made on the
2 applicable hedging transactions. Accordingly, the counterparties to
3 these transactions have a significant incentive to “beat the market” in
4 their hedging deals with NorthWestern, and that incentive appears to
5 be greater than NorthWestern’s.

- 6 • Unlike its counterparties, NorthWestern does not seek to realize
7 gains from its off-system hedging contracts; the hedges are used
8 only to promote greater price stability, with the specific recognition
9 that the end result may produce greater costs than would obtain had
10 its supplies been purchased at prevailing market prices. Under these
11 circumstances, NorthWestern appeared to be more likely to be the
12 loser over time in its hedging deals with counter parties.

- 13 • The counterparties in NorthWestern’s hedging transactions are
14 financially sophisticated firms. The list includes large international
15 financial firms like Citigroup, Barclay’s Bank, Morgan Stanley, and
16 Merrill Lynch, and large energy marketers, like BP Energy, Shell
17 Energy, and Cargill Power Markets. The counterparties are both
18 better positioned to prevail in their hedges with NorthWestern, and
19 they have a greater incentive to prevail in their hedges with
20 NorthWestern. They have a greater incentive to prevail in their
21 hedges with NorthWestern because they are putting their own money

1 at risk, with hedging gains and hedging losses flowing straight
2 through to the bottom line on their income statements. This is not the
3 case with NorthWestern. NorthWestern's hedging losses or gains
4 flow straight through to its ratepayers in its electric supply cost
5 tracker filings.

6 **Q. DID NORTHWESTERN PROVIDE A CALCULATION OF ITS**
7 **ACTUAL AND PROJECTED LOSSES FROM JULY 2011**
8 **THROUGH JUNE 2014 FROM ITS OFF-SYSTEM ELECTRICITY**
9 **SUPPLY COST HEDGING DEALS IN DOCKET D2012.5.49?**

10 A. Yes. NorthWestern witness Markovich confirmed at hearing that those
11 hedging losses amount to \$47 million, less a relatively small amount in
12 comparison with total hedging losses, for the discount to index.

13 **Q. DID YOU MAKE A RECOMMENDATION TO THE COMMISSION**
14 **IN DOCKET D2012.5.49 REGARDING NORTHWESTERN'S OFF-**
15 **SYSTEM ELECTRICITY SUPPLY COST HEDGING ACTIVITIES?**

16 A. Yes. I recommended that the Commission direct NorthWestern to terminate
17 its off-system fixed-price electricity supply cost hedging activities.

18 **Q. DID THE COMMISSION ADOPT THAT RECOMMENDATION?**

19 A. No.

1 **Q. DID THE COMMISSION STATE THAT A NEED EXISTS FOR A**
2 **REVIEW OF NORTHWESTERN’S FIXED PRICE HEDGING**
3 **STRATEGY?**

4 A. Yes. In Order No. 7219h, at ¶89, the Commission made the following
5 statements:

6 “However, MCC’s advocacy in this docket has made clear the need
7 for a review of NorthWestern’s fixed price hedging strategy. The
8 Commission is persuaded that NorthWestern transacts with less
9 incentive to avoid hedging losses than its hedging counterparties.
10 The Commission will open a docket within 90 days of this Order to
11 investigate possible mechanisms to better align the goals of rate
12 stability and risk mitigation with the goal of providing service at the
13 lowest long-term total cost. In the meantime, the prudence of
14 hedging losses will continue to be a potential issue in annual
15 electricity tracker dockets.”

16 **Q. DID THE COMMISSION SUBSEQUENTLY ESTABLISH A**
17 **DOCKET TO INVESTIGATE ELECTRICITY SUPPLY COST**
18 **HEDGING STRATEGIES AND ACTIVITIES?**

19 A. Yes. On January 24, 2014, in Docket N2014.1.11, the Commission issued
20 its *Notice of Investigation and Request for Comments* (Notice and Request)
21 regarding NorthWestern’s electricity supply cost hedging strategies and
22 activities. In response to the Commission’s Notice and Request, the MCC

1 filed a Motion to Stay Proceedings (Motion to Stay) in which the MCC
2 noted the following:

3 • [...]if NorthWestern's purchase of PPL's hydroelectric resources is
4 approved, the Company will need to acquire very little new, on
5 system electricity supplies for several years into the future. [Motion
6 to Stay p. 3];

7 • in calendar years 2014 and 2015, with the purchase of PPL's
8 hydroelectric supplies, NorthWestern would experience significant
9 electric supply surpluses (24.0 percent in 2014 and 19.2 percent in
10 2015), and its contracted supplies at index/market prices would
11 decline from nearly 20 percent during the twelve months ended June
12 30, 2014, to 13.3 percent and 12.2 percent in calendar years 2014
13 and 2015, respectively. (Motion to Stay pp. 3-4);

14 • with or without the purchase of PPL's hydroelectric supplies, after
15 calendar year 2015 NorthWestern's supplies at index/market prices
16 currently under contract will decline to only 4.7 percent in 2016, to
17 only 3.8 percent in 2017, and to less than 3.0 percent from 2018
18 through 2024. Under this scenario (i.e., Commission approval of
19 NorthWestern's purchase of PPL's hydroelectric supplies), the
20 Company's total electric supply portfolio would be subject to very

1 little supply price volatility, and there would be very little impact on
2 its total electric supply costs whether or not it continues to use off
3 system hedging transactions to reduce its exposure to future price
4 volatility under future purchases of on system supplies at
5 index/market prices. (Motion to Stay p. 4.)

6 And finally the MCC concluded:

- 7 • If the Commission approves the Hydro purchase, there is very little,
8 if any, need for off system supply price hedging transactions in the
9 foreseeable future. (Motion to Stay p. 4.)

10 **Q. HAS THE COMMISSION ACTED ON THE MCC'S MOTION IN**
11 **DOCKET N2014.1.11?**

12 A. No.

III. DOCKETS D2013.5.33 AND D2014.5.46

1
2 **Q. YOU MENTIONED PREVIOUSLY THAT IN DOCKET D2012.5.49,**
3 **NORTHWESTERN WAS FORECASTING \$14.9 MILLION OF OFF-**
4 **SYSTEM HEDGING LOSSES FOR THE TRACKER PERIOD JULY**
5 **2012 – JUNE 2013. HOW DOES THAT \$14.9 MILLION FORECAST**
6 **COMPARE WITH THE COMPANY’S ACTUAL OFF-SYSTEM**
7 **HEDGING LOSSES IN THAT SAME PERIOD OF TIME?**

8 A. Exhibit ___ (GLD-1) presents a summary of NorthWestern’s actual losses
9 from off-system electricity supply cost hedges during tracker periods
10 2011/2012, 2012/2013, and 2013/2014, respectively. As shown there,
11 during July 2012 through June 2013, NorthWestern experienced actual off-
12 system electricity supply cost hedging losses of \$20,205,071; that is nearly
13 \$5.3 million greater than the hedging loss forecast for July 2012 through
14 June 2013 that was presented by the Company in Docket D2012.5.49.

15 **Q. WHAT WAS NORTHWESTERN’S ACTUAL OFF-SYSTEM**
16 **ELECTRICITY SUPPLY COST HEDGING LOSS FOR TRACKER**
17 **PERIOD 2013/2014?**

18 A. Exhibit ___ (GLD-1) shows that NorthWestern experienced actual off-
19 system electricity supply cost hedging losses of \$19,421,992 during tracker
20 period 2013/2014.

1 **Q. HOW DOES THAT FIGURE COMPARE WITH THE FORECAST**
2 **FOR OFF-SYSTEM HEDGING LOSSES FOR JULY 2013**
3 **THROUGH JUNE 2014 THAT WAS PRESENTED BY THE**
4 **COMPANY IN DOCKET D2013.5.33?**

5 A. The table at page FVB-18 of Mr. Bennett's prefiled direct testimony in
6 Docket D2013.5.33 presents the Company's forecast for July 2013 through
7 June 2014 of its off-system electricity supply cost hedges. It shows hedges
8 of 1,217,800 Mwh of purchases, at an average fixed price of \$42.20/Mwh,
9 and a total purchase cost of \$51,393,840, and 1,217,800 Mwh of sales at an
10 average index price of \$33.59/Mwh, for total sales revenue of \$40,910,792.
11 The net result from hedging in Mr. Bennett's forecast for the 2013/2014
12 tracker period is a loss of \$10,483,048; that is \$8,938,944 less than the
13 actual hedging losses experienced by NorthWestern in tracker period
14 2013/2014 of \$19,421,992. Stated another way, for tracker period
15 2013/2014, NorthWestern's actual hedging losses exceeded the Company's
16 forecasted hedging losses by 85.3%.

1 **Q. YOUR EXHIBIT ___ (GLD-1) ALSO SHOWS \$16.9 MILLION OF**
2 **ACTUAL OFF-SYSTEM ELECTRICITY SUPPLY COST HEDGING**
3 **LOSSES FOR NORTHWESTERN'S TRACKER PERIOD 2011/2012.**
4 **WHAT THEN IS THE TOTAL AMOUNT OF NORTHWESTERN'S**
5 **OFF-SYSTEM HEDGING LOSSES FOR THE THREE TRACKER**
6 **PERIODS SHOWN IN EXHIBIT ___ (GLD-1)?**

7 A. The total of the actual hedging losses for July 2011 through June 2014
8 shown in Exhibit ___ (GLD-1) is \$56,547,411. That figure is \$9.5 million
9 greater than the \$47 million of off-system hedging losses for July 2011
10 through June 2014 that Mr. Markovich presented in testimony in Docket
11 D2014.5.46.

12 **Q. IS NORTHWESTERN FORECASTING ADDITIONAL OFF-**
13 **SYSTEM ELECTRICITY SUPPLY COST HEDGING LOSSES FOR**
14 **JULY 2014 THROUGH JUNE 2015?**

15 A. Yes. My Exhibit ___ (GLD-2) shows that NorthWestern is forecasting off-
16 system electricity supply cost hedging losses of \$6,475,063 for the July
17 2014/June 2015 tracker period.

1 **Q. PLEASE COMMENT ON NORTHWESTERN'S TOTAL**
2 **ELECTRICITY SUPPLY FORECAST FOR ITS TRACKER PERIOD**
3 **2014/2015.**

4 A. Mr. Bennett's Exhibit ___ (FVB-2)14-15, pp.1-3, presents the Company's
5 total Montana electricity supply forecast for July 2014 through June 2015. I
6 have compared that forecast with NorthWestern's actual total Montana
7 electricity supply portfolio for July 2013 through June? 2014. My
8 comparison is presented in Exhibit ___ (GLD-3).

9 **Q. UNDER THE HEADING "ON-SYSTEM FIXED PRICE**
10 **PURCHASES," EXHIBIT ___ (GLD-3) SHOWS SIGNIFICANT**
11 **SUPPLIES BEING PURCHASED FROM "PPL 7-YEAR**
12 **CONTRACT." HAS THAT CONTRACT BEEN TERMINATED?**

13 A. Yes. That is why "PPL 7-Year Contract" does not appear as a supply source
14 for July 2014 through June 2015 in Mr. Bennett's exhibit.

1 **Q. HAS THE PPL CONTRACT BEEN REPLACED BY A**
2 **SIGNIFICANT SUPPLY SOURCE THAT DOES NOT APPEAR IN**
3 **MR. BENNETT'S FORECAST OR IN YOUR EXHIBIT ___ (GLD-3)**
4 **FOR JULY 2014 THROUGH JUNE 2015?**

5 A. Yes. On September 26, 2014, the Commission approved the sale by PPL to
6 NorthWestern of 11 hydroelectric generating facilities and related assets in
7 Montana (Hydros, or the Hydros). At the time of NorthWestern's Docket
8 D2014.5.46 filing, the Hydros acquisition had not been approved. Hydros
9 was therefore not included as a supply source by Mr. Bennett in his exhibit
10 and testimony.

11 **Q. DOES MR. MARKOVICH ADDRESS THE HYDROS IN HIS**
12 **DIRECT TESTIMONY?**

13 A. Yes. At KJM-13 and KJM-14, Mr. Markovich states that if the Hydros
14 acquisition is approved, the electricity supply forecast for July 2014
15 through June 2015 will be updated to include the Hydros and the Company
16 will reevaluate its hedging strategy.

1 **Q. DOES THE ACQUISITION OF THE HYDROS AFFECT**
2 **NORTHWESTERN'S NEED FOR SHORT-TERM ELECTRICITY**
3 **SUPPLY PURCHASES AT INDEX PRICES.**

4 A. Yes. With the Hydros in the supply mix, NorthWestern will have very little
5 need in the near-term future to purchase electricity supplies at index prices.
6 The record evidence in the Hydro Case included NorthWestern's then
7 current projections of its future annual default supply load requirements, its
8 future annual available electricity supplies from existing on system supply
9 resources, i.e., Colstrip Unit 4, Spion Kop, Judith Gap, QF purchases, fixed
10 price purchases under existing agreements, and purchases at index/market
11 prices. That evidence demonstrates that with the Hydros in the supply
12 portfolio, the Company will need to acquire very little new, on-system
13 electricity supplies for several years into the future. Indeed, in calendar
14 years 2014 and 2015, with the purchase of the Hydros, NorthWestern
15 would experience significant electricity supply surpluses (24.0 percent in
16 2014 and 19.2 percent in 2015), and its contracted supplies at index/market
17 prices would decline from nearly 20 percent during the twelve months
18 ended June 30, 2014, to 13.3 percent and 12.2 percent in calendar years
19 2014 and 2015, respectively. Moreover, after calendar year 2015, with the
20 Hydros in the supply portfolio, NorthWestern's supplies at index/market
21 prices currently under contract will decline further, to only 4.7 percent in

1 2016, to only 3.8 percent in 2017, and to less than 3.0 percent from 2018
2 through 2024. This means that the Company's total electricity supply
3 portfolio would be subject to very little supply price volatility.

4 **IV. RECOMMENDATIONS**

5 **Q. IN DOCKET D2012.5.49, YOU RECOMMENDED THAT THE**
6 **COMMISSION DIRECT NORTHWESTERN TO TERMINATE ITS**
7 **OFF-SYSTEM ELECTRICITY SUPPLY COST HEDGING**
8 **STRATEGIES AND ACTIVITIES. IS THAT STILL YOUR**
9 **RECOMMENDATION IN THIS PROCEEDING?**

10 A. Yes, for the same reasons I gave in Docket D2012.5.49. Since then,
11 notwithstanding the Commission's expression of concern in ¶¶ 88-89 of
12 Order 7219h, NorthWestern's off-system electricity supply cost hedging
13 activity has increased. For example:

- 14 • Actual quantities hedged increased from 580,000 Mwh in
15 2011/2012, to 1,041,910 Mwh in 2012/2013, and to 1,390,839 Mwh
16 in 2013/2014; and
- 17 • Actual hedging losses paid by ratepayers increased from \$10.2
18 million in 2011/2012, to \$20.2 million in 2012/2013, and \$19.4
19 million in 2013/2014.

1 Simply stated, NorthWestern's off-system electricity supply cost hedging
2 strategies and activities have been extremely costly for the Company's
3 ratepayers.

4 In addition, now that the Hydros are in the Company's electricity supply
5 portfolio, there clearly is no need for NorthWestern to hedge in an effort to
6 mitigate electricity supply price volatility. The supply quantities at future
7 index prices are expected to be so low that if they are not hedged and an
8 unexpected upward spike in market prices were to occur, there would be
9 very little impact on total electricity supply costs.

10 **Q. DO YOU HAVE ADDITIONAL RECOMMENDATIONS FOR THE**
11 **COMMISSION'S CONSIDERATION IN THIS PROCEEDING?**

12 A. Yes. As I previously discussed, NorthWestern's electricity supply cost
13 forecast for July 2014 through June 2015 does not include the supply mix
14 and related cost impact of having added Hydros as a major source of
15 electricity supply. NorthWestern will make a new electricity supply tracker
16 filing at the end of May 2015. Presumably that filing will reflect the impact
17 on costs of having Hydros for a portion of the 2014/2015 tracker period,
18 and for the forecasted tracker period 2015/2016. If it does not, I recommend
19 that the Commission direct NorthWestern to submit a revised filing to
20 reflect having added the Hydros to the supply portfolio.

1 **Q. DO YOU HAVE ANY FURTHER RECOMMENDATIONS FOR THE**
2 **COMMISSION'S CONSIDERATION IN THIS PROCEEDING?**

3 A. I have one. As I previously discussed, with Hydros in the available supply
4 portfolio, NorthWestern has no need to enter into off-system electricity
5 supply cost hedging deals to mitigate electricity supply price volatility.
6 That fact was pointed out by the MCC in its March 20, 2014, Motion to
7 Stay in Docket N2014.1.11, more than 6 months before the Commission's
8 September 26, 2014 Final Order approving NorthWestern's acquisition of
9 the Hydros. NorthWestern announced having obtained final regulatory
10 approval from the FERC of its pending purchase of Hydros on October 30,
11 2014. Finally, on November 18, 2014, NorthWestern announced that it had
12 closed on the purchase of the Hydros. With the ownership of Hydros,
13 NorthWestern also should have known that new off-system electricity
14 supply cost hedging deals would not be needed. I therefore recommend that
15 the Commission disallow as imprudently incurred costs any net hedging
16 losses that may result from any new hedging deals entered into after
17 November 18, 2014.

1 **Q. DOES THIS COMPLETE YOUR PRE-FILED DIRECT**
2 **TESTIMONY?**

3 **A.** Yes, it does.

Exhibit No. ____ (GLD-1)

Consolidated Dockets

D2013.5.33

and

D2014.5.46

NorthWestern Energy

Pre-Filed Direct Testimony of

George Donkin

on behalf of the Montana Consumer Counsel

NWE's Actual Net Payments On Off-System Hedging Transactions
July 2011 Through June 2014

Line No.	Description	July 2011 - June 2012 Actual		July 2012 - June 2013 Actual		July 2013 - June 2014 Actual	
		MWh	\$ Amount Paid/(Received)	MWh	\$ Amount Paid/(Received)	MWh	\$ Amount Paid/(Received)
1	Competitive Solicitations at Fixed Prices	219,600	\$ 13,703,040	775,546	\$ 35,402,185	1,360,439	\$ 59,677,868
2	Term At Fixed Prices	360,400	\$ 13,377,220	266,364	\$ 8,315,084	30,400	\$ 1,231,900
3	Total Fixed-Price Purchases	580,000	\$ 27,080,260	1,041,910	\$ 43,717,269	1,390,839	\$ 60,909,768
4							
5	Competitive Solicitations At Index Prices	(219,600)	\$ (658,800)	(341,517)	\$ (4,298,302)	(341,810)	\$ (5,729,227)
6	Term At Index Prices - Sales	(360,325)	\$ (9,555,012)	(458,292)	\$ (10,599,896)	(1,039,206)	\$ (38,148,511)
7	Term At Index Prices - Purchases					-	\$ 2,389,852
8	Spot Purchases At Index Prices	3,600	\$ 53,900	400	\$ (2,032,604)	18,600	\$ 110
9	Spot Sales At Index Prices	-	\$ -	(242,400)	\$ (6,581,396)	-	\$ -
10	Total Transactions At Index Prices	(576,325)	\$ (10,159,912)	(1,041,809)	\$ (23,512,198)	(1,362,416)	\$ (41,487,776)
11							
12	Net Off-System Hedging Losses	3,675	\$ 16,920,348	101	\$ 20,205,071	28,423	\$ 19,421,992

Sources: (1) 2011-2012: NWE Response to Data Request MCC-081 Attachment in Docket D2012.5.49.
(2) 2012-2013: Exhibit__(FVB-1 Rev)12-13 Updated in Docket D2013.5.33.
(3) 2013-2014: Exhibit__(FVB-1)13-14 Updated in Docket D2014.5.46.

Exhibit No. ____ (GLD-2)

Consolidated Dockets

D2013.5.33

and

D2014.5.46

NorthWestern Energy

Pre-Filed Direct Testimony of

George Donkin

on behalf of the Montana Consumer Counsel

**NWE's Projected Net Off-System Hedging Loss
July 2014 - June 20115**

Line No.	Description	MWh	\$ Amount
1	Competitive Solicitations at Fixed Prices	906,300	\$ 43,250,700
2	Term At Fixed Prices	571,725	\$ 21,519,269
3	Total Fixed-Price Purchases	1,478,025	\$ 64,769,969
4			
5	Competitive Solicitations At Index Prices	(341,800)	\$ (12,928,507)
6	Term At Index Prices - Sales	(441,700)	\$ (18,044,207)
7	Spot Sales At Index Prices	(694,525)	\$ (27,322,192)
8	Total Transactions At Index Prices	(1,478,025)	\$ (58,294,906)
9			
10	Net Off-System Hedging Losses	-	\$ 6,475,063

Source: Exhibit__(FVB-2)14-15 in Docket D2014.5.46

Exhibit No. ____ (GLD-3)

Consolidated Dockets

D2013.5.33

and

D2014.5.46

NorthWestern Energy

Pre-Filed Direct Testimony of

George Donkin

on behalf of the Montana Consumer Counsel

NorthWestern Energy's Montana Electricity Supply
Actual Tracker Year 2013/2014 And Projected Tracker Year 2014/2015

Source	Tracker Year 2013/2014 (Actual)			Tracker Year 2014/2015 (Forecast)		
	\$	Mwh	\$/Mwh	\$	Mwh	\$/Mwh
Off System Transactions						
At Fixed Prices	\$ 60,909,768	1,390,839	\$ 43.79	\$ 64,769,969	1,478,025	\$ 43.82
At Index Prices	\$ (41,487,776)	(1,362,416)	\$ 30.45	\$ (58,294,906)	(1,478,025)	\$ 39.44
Total Off-System	\$ 19,421,992	28,423	N/A	\$ 6,475,063	-	N/A
Rate Based Assets						
Colstrip Unit 4	\$ 91,752,973	1,048,081	\$ 87.54	\$ 98,850,466	1,769,318	\$ 55.87
Dave Gates Generating Station	\$ 40,445,217	61,488	\$ 657.77	\$ 40,280,343	61,320	\$ 656.89
Spion Kop	\$ 6,239,085	139,116	\$ 44.85	\$ 8,731,588	135,752	\$ 64.32
Total Rate-Based Assets	\$ 138,437,275	1,248,685	\$ 110.87	\$ 147,862,398	1,966,390	\$ 75.19
On-System Fixed Price Purchases						
PPL 7 Year Contract	\$ 77,376,864	1,463,400	\$ 52.87	\$ -	-	\$ -
Judith Gap	\$ 15,240,182	502,944	\$ 30.30	\$ 14,982,361	471,885	\$ 31.75
Other Non-QF	\$ 2,604,371	48,857	\$ 53.31	\$ 3,942,993	77,482	\$ 50.89
Competitive Solicitations	\$ 13,268,540	235,600	\$ 56.32	\$ 13,268,540	245,600	\$ 54.03
QF Tier II	\$ 28,761,319	755,862	\$ 38.05	\$ 31,494,669	827,066	\$ 38.08
QF-1 Tariff Contracts	\$ 8,175,164	155,715	\$ 52.50	\$ 11,075,766	163,860	\$ 67.59
Term Fixed Price Purchases	\$ 509,724	102,087	\$ 4.99	\$ -	11,550	\$ -
Term Fixed Price Sales	\$ (408,304)	(34,772)	\$ 11.74	\$ -	(11,550)	\$ -
Base Fixed Price Purchases	\$ 145,527,860	3,229,693	\$ 45.06	\$ 74,764,330	1,785,893	\$ 41.86
On-System Purchases At Index Prices						
Base Index Price Purchases						
Competitive Solicitations	\$ 8,600,249	494,651	\$ 17.39	\$ 15,507,101	439,450	\$ 35.29
Term Index Price Purchases	\$ 19,425,731	536,688	\$ 36.20	\$ 42,601,926	1,055,600	\$ 40.36
Term Index Price Sales	\$ -	-		\$ -	-	
Spot Purchases	\$ 42,636,947	1,147,190	\$ 37.17	\$ 51,475,456	1,306,095	\$ 39.41
Spot Sales	\$ (1,902,925)	(62,249)	\$ 30.57	\$ (3,912,907)	(121,318)	\$ 32.25
Total On-System At Index Prices	\$ 68,760,002	2,116,280	\$ 32.49	\$ 105,671,576	2,679,827	\$ 39.43
Ancillary And Other						
Basin Creek	\$ 9,050,807	88,513	\$ 102.25	\$ 7,998,662	65,555	\$ 122.02
Operating Reserves	\$ 2,840,633	-	\$ -	\$ 2,698,080	-	\$ -
Wind Other Cost	\$ 1,777,819	-	\$ -	\$ 1,810,052	-	\$ -
Total Ancillary And Other	\$ 13,669,259	88,513	\$ 154.43	\$ 12,506,794	65,555	\$ 190.78
Total Montana Electricity Supply	\$ 385,816,389	6,711,594	\$ 57.49	\$ 347,280,160	6,497,665	\$ 53.45

Source: (1) Default Supply: Exhibit__(FVB-1)13-14 Updated and Exhibit__(FVB-2)14-15 in Docket D2014.5.46.

(2) CU4 Fixed and Variable Cost: Exhibit__(FVB-4)13-14 Updated and Exhibit__(FVB-5)14-15 in Docket D2014.5.46.

(3) DGGs Fixed and Variable Cost: Exhibit__(FVB-6)13-14 Updated and Exhibit__(FVB-7)14-15 in Docket D2014.5.46.

(4) Spion Kop Fixed and Variable Cost: Exhibit__(FVB-8)13-14 Updated and Exhibit__(FVB-9)14-15 in Docket D2014.5.46.

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

* * * * *

IN THE MATTER OF NorthWestern) REGULATORY DIVISION
Energy's 2012-2013 Electricity Supply)
Tracker) DOCKET NO. D2013.5.33

IN THE MATTER OF NorthWestern)
Energy's 2013-2014 Electricity Supply) DOCKET NO. D2014.5.46
Tracker)

Pre-Filed Direct Testimony
of
John W. Wilson
on Behalf
of
The Montana Consumer Counsel

May 8, 2015

J. W. Wilson & Associates, Inc.
Economic Counsel
1601 North Kent Street • Rosslyn Plaza C • Suite 1104 Arlington, VA 22209

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1

I. QUALIFICATIONS

2 **Q. PLEASE STATE YOUR NAME, OCCUPATION, AND ADDRESS.**

3 A. My name is John W. Wilson. I am President of J.W. Wilson & Associates,
4 Inc. Our offices are at 1601 North Kent Street, Suite 1104, Arlington,
5 Virginia, 22209.

6 **Q. PLEASE OUTLINE YOUR EDUCATIONAL BACKGROUND.**

7 A. I hold a B.S. degree with senior honors and a Masters Degree in Economics
8 from the University of Wisconsin. I have also received a Ph.D. in
9 Economics from Cornell University. My major fields of study were
10 industrial organization and public regulation of business, and my doctoral
11 dissertation was a study of utility pricing and regulation.

12 **Q. HOW HAVE YOU BEEN EMPLOYED SINCE THAT TIME?**

13 A. After completing my graduate education I was an assistant professor of
14 economics at the United States Military Academy, West Point, New York.
15 In that capacity, I taught courses in both economics and government.
16 While at West Point, I also served as an economic consultant to the
17 Antitrust Division of the United States Department of Justice.

1 After leaving West Point, I was employed by the Federal Power
2 Commission (now known as the Federal Energy Regulatory Commission or
3 “FERC”), first as a staff economist and then as Chief of the Commission's
4 Division of Economic Studies. In that capacity, I was involved in
5 regulatory matters involving most phases of federal regulation of electric
6 utilities and the natural gas industry. Since 1973 I have been employed as
7 an economic consultant by various clients, including federal, state,
8 provincial and local governments, private enterprise and nonprofit
9 organizations. This work has pertained to a wide range of issues
10 concerning public utility regulation, insurance rate regulation, antitrust
11 matters and economic and financial analysis. In 1975 I formed J.W.
12 Wilson & Associates, Inc., a Washington, D.C. corporation.

13 **Q. WOULD YOU PLEASE DESCRIBE SOME OF YOUR**
14 **ADDITIONAL PROFESSIONAL ACTIVITIES?**

15 A. I have authored a variety of articles and monographs, including a number of
16 studies dealing with utility regulation and economic policy. I have
17 consulted on regulatory, financial and competitive market matters with the
18 Federal Communications Commission (“FCC”), the National Academy of
19 Sciences, the Ford Foundation, the National Regulatory Research Institute
20 (“NRRI”), the Electric Power Research Institute (“EPRI”), the National

1 Association of Regulatory Utility Commissioners (“NARUC”), the Edison
2 Electric Institute (“EEI”), The American Public Power Association
3 (“APPA”), the National Rural Electric Cooperative Association
4 (“NRECA”), the U.S. Department of Justice Antitrust Division, the Federal
5 Trade Commission Bureau of Competition, the Commerce Department, the
6 Department of the Interior, the Department of Energy (“DOE”), the Small
7 Business Administration (“SBA”), the Department of Defense (“DOD”),
8 the Tennessee Valley Authority (“TVA”), the Internal Revenue Service
9 (“IRS”), the Federal Energy Administration (FEA”), and numerous state
10 and provincial agencies and legislative bodies in the United States and
11 Canada.

12 Previously, I was a member of the Economics Committee of the U.S. Water
13 Resources Council, the FPC Coordinating Representative for the Task
14 Force on Future Financial Requirements for the National Power Survey, the
15 Advisory Committee to the National Association of Insurance
16 Commissioners (NAIC) Task Force on Profitability and Investment
17 Income, and the NAIC's Advisory Committee on Nuclear Risks.

18 In addition, I have testified as an expert witness in state and federal court
19 proceedings dealing with many economic matters, including utility rates
20 and competition in the electric power industry and on other regulatory

1 matters before more than 50 Federal and State regulatory bodies throughout
2 the United States and Canada. I have also appeared on numerous occasions
3 as an expert witness at the invitation of U.S. Senate and Congressional
4 Committees dealing with antitrust and regulatory legislation. In addition, I
5 have been retained as an expert on regulatory matters by more than 25 State
6 and Federal regulatory agencies. I have also participated as a speaker,
7 panelist, or moderator in many professional conferences and programs
8 dealing with business regulation, financial issues, economic policy and
9 antitrust matters. I am a member of the American Economic Association
10 and an associate member of the American Bar Association and the ABA's
11 Antitrust, Insurance and Regulatory Law Sections.

12 **Q. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS**
13 **PROCEEDING?**

14 A. I am presenting testimony in this proceeding on behalf of the Montana
15 Consumer Counsel (MCC). I have been asked by the MCC to review and
16 address NorthWestern Energy's ("NWE" or "the Company") proposed
17 recovery of costs that are subject to this tracker proceeding, including
18 replacement power costs related to the Colstrip Unit 4 ("CU4") plant
19 outage that occurred on July 1, 2013 and the Company's claimed "lost
20 revenue" adjustment ("LRAM") related to transmission and distribution

1 (“T&D”) system fixed costs and the fixed costs of several generating
2 plants, including CU4.

3 **II. THE CU4 OUTAGE**

4 **Q. IS A SIGNIFICANT PART OF THE COMPENSATION THAT NWE**
5 **IS SEEKING IN THIS TRACKER CASE RELATED TO THE 2013**
6 **UNPLANNED OUTAGE OF CU4?**

7 **A.** Yes. The Company is requesting in this docket the authority to recover
8 between \$8 and \$11 million (depending on which of the Company’s
9 estimates is selected) of increased costs for the purchase of replacement
10 power related to that outage.

11 **Q. PLEASE BRIEFLY DESCRIBE THE 2013 CU4 OUTAGE.**

12 **A.** The CU4 generating plant was taken out of service for overhaul by its
13 operator, PPLM, from May 5, through June 7, 2013, during which time the
14 rotor was taken out for inspection and what was apparently expected to be
15 routine maintenance. The plant was eventually returned to service on June
16 27, 2013 but major problems were encountered almost immediately
17 thereafter. According to the “Root Cause Analysis” performed for PPLM
18 after the outage by outside consultants, initial “core melting” began prior to

1 June 29 and continued thereafter until severe core failure occurred on July
2 1, 2013. (See response to MCC-015, Attachment 4)

3 **Q. HOW WAS THE SEVERE CORE FAILURE THAT LED TO THE**
4 **EXTENDED FORCED OUTAGE OF CU4 CAUSED?**

5 A. According to NWE, the extended forced outage event for CU4 “was caused
6 in part or in whole by the work performed on the generator during the
7 May/June, 2013 planned overhaul.” (See response to MEIC-45).

8 **Q. WHO WAS RESPONSIBLE FOR THE WORK PERFORMED ON**
9 **THE GENERATOR DURING THE MAY/JUNE PLANNED**
10 **OVERHAUL?**

11 A. It is my understanding that PPLM, the plant operator, was responsible for
12 plant maintenance and that they hired Siemens, as a contractor, to perform
13 the overhaul work. (See response (a) to MEIC-64)

1 **Q. DOES NORTHWESTERN KNOW WHETHER PPLM, AS THE**
2 **OPERATOR OF CU4, BELIEVES THAT ANY OF THE WORK**
3 **PERFORMED ON THE GENERATOR DURING THE MAY/JUNE,**
4 **2013 OVERHAUL WAS DONE IMPROPERLY OR**
5 **NEGLIGENTLY?**

6 A. No. NWE states that it does not know whether PPL, as the operator of
7 CU4, believes that any of the work performed on the generator during the
8 May/June overhaul was done improperly or negligently. (See response to
9 part (a) of MEIC-061).

10 **Q. DOES NORTHWESTERN KNOW WHETHER PPL, AS THE**
11 **OPERATOR OF CU4, BELIEVES THAT ALL OF THE WORK**
12 **PERFORMED ON THE GENERATOR DURING THE MAY/JUNE,**
13 **2013 OVERHAUL WAS DONE IN ACCORDANCE WITH**
14 **INDUSTRY STANDARDS?**

15 A. No. NWE states that it does not know whether PPL, as the operator of
16 CU4, believes that any of the work performed on the generator during the
17 May/June overhaul was not done in accordance with industry standards.
18 (See response to part (b) of MEIC-061).

1 **Q. WOULD IT BE PRUDENT FOR A UTILITY, SUCH AS**
2 **NORTHWESTERN, TO DETERMINE WHETHER THE PLANT**
3 **OPERATOR BELIEVED THAT ANY OF THE OVERHAUL WORK**
4 **THAT CAUSED THE PLANT OUTAGE “IN PART OR IN WHOLE”**
5 **WAS DONE IMPROPERLY, NEGLIGENTLY OR NOT IN**
6 **ACCORDANCE WITH INDUSTRY STANDARDS PRIOR TO**
7 **SEEKING TO RECOVER THE REPLACEMENT POWER COSTS**
8 **FOR THE OUTAGE FROM ITS OWN RATEPAYERS?**

9 A. Yes; it would have been prudent for Northwestern to have first made that
10 determination.

11 **Q. HAS NORTHWESTERN CONDUCTED ITS OWN EVALUATION**
12 **TO MAKE ITS OWN DETERMINATION AS TO WHETHER ANY**
13 **OF THE WORK PERFORMED ON THE GENERATOR DURING**
14 **THE MAY/JUNE 2013 CU4 OVERHAUL WAS DONE**
15 **IMPROPERLY, NEGLIGENTLY OR NOT IN ACCORDANCE**
16 **WITH INDUSTRY STANDARDS?**

17 A. Apparently not. When asked for its own belief on this matter
18 NorthWestern responded: “NorthWestern believes that the cause of the
19 outage was most likely a result of equipment being damaged during work
20 completed on the generator during the May/June overhaul. The basis of

1 that conclusion is the evidence in the Root Cause Analysis (RCA).”
2 However, NorthWestern then went on to say that “Since the RCA did not
3 conclude that work was done improperly or negligently, NorthWestern does
4 not have any basis to conclude otherwise.” (See response to MEIC-060 (b))

5 **Q. DOES NORTHWESTERN KNOW IF ANY OF THE OTHER**
6 **OWNERS OF CU4 HAVE ATTEMPTED TO RECOVER**
7 **REPLACEMENT POWER COSTS FROM SIEMENS?**

8 A. No. NorthWestern states that it does not know if any other owners of CU4
9 have attempted to recover replacement power costs from Siemens. (See
10 response to MEIC-067.)

11 **Q. DOES NORTHWESTERN MAINTAIN INSURANCE COVERAGE**
12 **THAT WILL COMPENSATE THE COMPANY FOR THE COSTS**
13 **OF THE CU4 OUTAGE?**

14 A. I understand that there is property damage insurance that will pay for most
15 of the \$30 million repair cost of the plant. NorthWestern’s share of this

1 total is about \$4.5 million, of which there will be about \$589,000 of
2 deductible and unrecovered expense.¹

3 **Q. HOW WILL THIS REMAINING \$589,000 BE PAID FOR?**

4 A. Recovery of those costs is not being sought by NWE in this docket.
5 NorthWestern states that “if NorthWestern seeks recovery of these costs in
6 rates, they would be included in the next general rate case.” (See response
7 to MCC-117.)

8 **Q. DOES NORTHWESTERN HAVE INSURANCE COVERAGE FOR**
9 **REPLACEMENT POWER COSTS?**

10 A. No. NorthWestern states that it is now “in the process of investigating the
11 costs and benefits of obtaining outage insurance for Colstrip 4. Since this
12 evaluation is still under way, NorthWestern does not have any final
13 documents or correspondence to provide at this time.” (See response to
14 MEIC-39 (b)).

¹ NorthWestern originally reported this amount to be \$632,000. However, the Company later determined that it had made an error and corrected the amount to \$589,050. See response to MCC-117.

1 **Q WILL THE OUTCOME OF NWE'S ONGOING INSURANCE**
2 **EVALUATION ENABLE INSURANCE COST RECOVERY FOR**
3 **REPLACEMENT POWER COSTS IN THIS MATTER?**

4 A. No. Whatever the outcome of this evaluation, it will be too late for any
5 cost recovery in this case. In the recent case of the forced outage of DGGs,
6 which was affirmed by the District Court's decision in Cause No. DV-13-
7 399 in April, 2015, the Commission determined NWE's failure to evaluate
8 outage insurance prior to incurring an outage was imprudent.² (See
9 Montana Second Judicial District Court, Silver Bow County, Cause No.
10 DV-13-399, Draft Order at 4).

² NorthWestern's failure to evaluate outage insurance is compounded in this case by the Company's failure to explore and evaluate other recovery options besides passing replacement costs on to ratepayers as its first line of cost recovery.

1 **Q. CAN NORTHWESTERN RECOVER THESE REPLACEMENT**
2 **POWER COSTS FROM SEIMENS, THE PARTY WHOSE WORK**
3 **NWE BELIEVES CAUSED THE OUTAGE OR FROM PPLM, THE**
4 **PLANT OPERATOR, OR FROM THEIR INSURERS OR FROM**
5 **ANY OTHER PARTY?**

6 A. According to NorthWestern, “No determination has been made regarding
7 whether NorthWestern can pursue any actions to recover all or part of the
8 cost incurred by the outage.” (See response to MCC-057.)

9 **Q. SETTING ASIDE NORTHWESTERN’S NON-DETERMINATION**
10 **DOES THE COMPANY, NEVERTHELESS, HAVE A PLAN TO**
11 **RECOVER THESE REPLACEMENT POWER COSTS IN THIS**
12 **CASE?**

13 A. Yes. NorthWestern is attempting to recover these replacement power costs
14 from its Montana ratepayers in this case.

1 **Q. WOULD IT HAVE BEEN PRUDENT FOR NORTHWESTERN TO**
2 **DETERMINE WHETHER THE COMPANY COULD RECOVER**
3 **THESE REPLACEMENT POWER COSTS FROM SIEMENS, THE**
4 **PARTY WHOSE WORK NWE BELIEVES CAUSED THE OUTAGE**
5 **OR FROM PPLM, THE PLANT OPERATOR, OR FROM THEIR**
6 **INSURERS OR FROM ANY OTHER PARTY PRIOR TO SEEKING**
7 **TO RECOVER THESE COSTS FROM ITS MONTANA**
8 **RATEPAYERS?**

9 A. Yes. It would have been prudent for NorthWestern to have made that
10 determination.

11 **Q. WHAT IS THE AMOUNT OF CU4 REPLACEMENT POWER**
12 **COSTS THAT NWE IS SEEKING TO RECOVER FROM ITS**
13 **RATEPAYERS IN THIS TRACKER DOCKET?**

14 A. As I understand the Company's testimony on this matter, NWE has not
15 been able to accurately calculate these replacement power costs because it
16 is not able to accurately determine how CU4 would have performed if the
17 outage had not occurred nor what the exact purchased power procurements
18 would have been had the plant been operational.

1 **Q. HAS NORTHWESTERN NEVERTHELESS MADE ESTIMATES OF**
2 **WHAT PORTION OF THE PURCHASED POWER COSTS THAT**
3 **IT IS ATTEMPTING TO RECOVER IN THIS DOCKET ARE, IN**
4 **FACT, REPLACEMENT POWER COSTS FOR THE CU4 FORCED**
5 **OUTAGE?**

6 A. Yes. NWE has calculated several “estimates of what the actual power
7 replacement costs might have been.” These estimates range from \$8.243
8 million to \$9.736 million. Of these, NWE states that it believes that the
9 \$8.243 million amount is the most accurate estimate of what replacement
10 power costs were for the forced CU4 outage. (See response to MEIC-5.)
11 The calculation methodology follows an earlier estimate (\$11.135 million)
12 that was made by the Commission Staff.

13 **Q. IS THIS REPLACEMENT POWER COST GREATER THAN THE**
14 **COST OF OBTAINING POWER FROM CU4 WHEN THE PLANT**
15 **IS OPERATIONAL?**

16 A. While the replacement power was actually much less costly than the total
17 cost of equivalent service from CU4, the total CU4 cost recovery being
18 sought in this case by NWE is considerably greater because the very high
19 fixed costs of the CU4 plant (e.g., primarily depreciation, return and taxes)
20 continue unabated during the outage, in addition to replacement power

1 costs. Thus, during the outage, the sum of ongoing CU4 fixed costs (\$72.7
2 million on an annual basis) plus replacement purchased power costs (\$17 to
3 \$19 million for the outage period) exceeded CU4 fixed costs plus the
4 variable CU4 costs that would have been incurred but for the outage by an
5 estimated \$8.2 million to \$11.135 million.

6 **Q. IS CU4 NORMALLY A RELATIVELY LOW COST SOURCE OF**
7 **POWER FOR NWE?**

8 A. No. Overall, CU4 power costs in tracker year 2013/2014 were \$87.54 per
9 Mwh. This is, by far, the highest cost for any source of power on the
10 NorthWestern system, except for a small amount of power obtained at very
11 high cost from DGGs. Even in tracker year 2012-1013, when there was no
12 forced outage, CU4 was NWE's highest cost power source.

13 **Q. HAS NORTHWESTERN BEEN ABLE TO ACHIEVE ANY COST**
14 **SAVINGS AS A RESULT OF THE CU4 OUTAGE?**

15 A. Yes. NorthWestern was able to achieve significant labor cost savings at
16 CU4 during the outage period. As stated by the Company:

17 NorthWestern concurred with the decision to furlough 36 PPL
18 employees for 90 days (allowed per the labor bargaining agreement)
19 during the outage to reduce costs. This resulted in an approximately
20 \$800,000 reduction to expense. (Northwestern's share of the cost

1 savings would be 15% of \$800,000 or \$120,000.) See Response to
2 MCC-059.

3 **Q. IS NORTHWESTERN PASSING THIS LABOR COST SAVINGS**
4 **THROUGH IN RATE CREDITS TO IT CUSTOMERS TO HELP**
5 **OFFSET THE COSTS OF REPLACEMENT POWER?**

6 A. No. Even though NorthWestern is proposing to charge its customers for
7 the replacement power costs of the outage, the Company does not intend to
8 offset this rate increase with the savings that it expects to obtain and retain
9 for itself as a result of the outage. (See response to PSC-008.)

10 **Q. SHOULD THE COMPANY'S MONTANA RETAIL RATEPAYERS**
11 **BE REQUIRED TO PAY FOR THE ADDITIONAL**
12 **REPLACEMENT POWER COSTS THAT ARE ATTRIBUTABLE**
13 **TO THE FORCED OUTAGE?**

14 A. NorthWestern was granted prior approval by the Commission for the
15 recovery of CU4 fixed plant costs and the costs of its operation. This
16 approval was granted by the Commission despite CU4's relatively high
17 costs in comparison with competitive market alternatives. This prior
18 approval was granted with the expectation that it would protect ratepayers
19 against the risks of potentially higher market costs that might occur in the
20 future if markets became more costly. That has not happened. While the

1 prior approval that was granted may still make it reasonable to allow for the
2 recovery of replacement power costs up to the total cost of owning (and
3 paying the costs of operating) the CU4 plant, it does not seem reasonable to
4 now charge ratepayers a greater amount, including both full CU4 fixed
5 plant costs and the incremental costs of replacement power, due to a plant
6 outage for which ratepayers were not responsible.

7 **Q. ARE THERE FURTHER REASONS WHY THE COMMISSION**
8 **SHOULD WITHHOLD ITS APPROVAL OF NORTHWESTERN'S**
9 **RECOVERY OF REPLACEMENT POWER COST FROM ITS**
10 **RATEPAYERS AT THIS TIME?**

11 A. Yes. It is at least perplexing that NWE did not even bother to consider or
12 evaluate the merits of outage insurance for the plant. Especially since
13 encountering virtually the same problem with the DGGS outage, it seems
14 that prudent management would have at least looked into this.

15 Also, NorthWestern's apparent lack of any effort or interest in recovering
16 its replacement power costs, from other potentially responsible parties, is
17 even more perplexing. It would seem appropriate under the circumstances
18 here for the Commission to either deny cost recovery for replacement
19 power costs or, at least for the time being, treat this as a matter that requires
20 far more work by NWE before any reasonable claim might be made for a

1 partial cost recovery from ratepayers. This is underscored by
2 NorthWestern's intentions to retain for itself the labor cost savings
3 attributable to the outage rather than crediting ratepayers for these cost
4 savings.

5 **III. LOST REVENUES**

6 **Q. PLEASE DESCRIBE THE LOST REVENUES ISSUES THAT YOU**
7 **ARE ADDRESSING.**

8 A. As shown below, the amount of annual "lost revenue" compensation
9 claimed by NWE has grown substantially over time and now tops \$12.6
10 million for tracker year 2014/2015.

	<u>Year</u>	<u>Claimed Lost Revenues</u>
1		
2	2006/2007	\$ 1,687,576 ³
3	2007/2008	\$ 2,184,565 ³
4	2008/2009	\$ 1,337,669 ^{3,4}
5	2009/2010	\$ 3,320,802 ^{5,6}
6	2010/2011	\$ 2,647,371 ^{5,7}
7	2011/2012	\$ 4,330,864 ⁸
8	2012/2013	\$ 7,126,381
9	2013/2014	\$10,058,433
10	2014/2015	\$12,665,362

11 The claimed \$12.6 million of lost revenue compensation for tracker year
12 2014/2015 includes almost \$4 million of “lost revenues” for CU4 sales and
13 more than \$1.0 million for DGGS sales, even though the actual revenues
14 for each plant substantially exceeded the total test year authorized revenues
15 approved by the Commission.

³ See Attachment 3 – Updated Compliance Filing in D2012.5.49.

⁴ Lost revenues were reset Jan 1, 2008 due to newly established T&D rates.

⁵ See Exhibit_(WMT-3-Updated for 12+0), in D2013.5.33.

⁶ CU4 “lost revenues” increased from \$83,021 in 2008/2009 (first year) to \$635,362 in 2009/2010.

⁷ Lost revenues were reset again on Jan. 1, 2011 due to newly established T&D rates.

⁸ See Exhibit_(WMT-3), 12+0_Final in D2014.5.46.

1 **Q. WHAT ARE ANNUAL LOST REVENUES?**

2 A. Annual lost revenues are the difference between the actual amount of
3 revenues that NWE collects from its ratepayers in each year and the larger
4 amount of revenues that the Company estimates it would have collected but
5 for its efforts to promote energy conservation. NWE claims that it needs
6 compensation for these “lost revenues” in order to encourage the Company
7 to promote energy conservation.

8 **Q. ARE THESE DIFFERENCES BETWEEN ACTUAL ENERGY**
9 **SALES AND THE AMOUNT OF ENERGY SALES THAT THE**
10 **COMPANY ESTIMATES WOULD HAVE OCCURRED BUT FOR**
11 **NWE’S PROMOTION OF CONSERVATION THE RESULT OF**
12 **METERED MEASUREMENTS?**

13 A. No. They are estimates. However, NWE claims that its estimates are
14 “trued up” because it periodically hires a consultant to estimate whether its
15 own estimates have been accurate.

16 **Q. HOW MUCH HAS NWE’S CLAIMED LOST REVENUE**
17 **COMPENSATION GROWN IN RECENT YEARS?**

18 A. As shown above, in just the last three tracker years NWE’s claimed lost
19 revenues have grown from \$4.3 million to more than \$12.6 million per

1 year. This reflects a compound annual rate of lost revenue growth of 43
2 percent per year.

3 **Q. WHAT EXPLAINS THIS VERY HIGH GROWTH RATE FOR**
4 **CLAIMED LOST REVENUES?**

5 A. Two things. First, the Company's estimates of new lost revenues have been
6 robust in each recent year. Second, the Company assumes that the energy
7 sales which it estimates were lost due to its promotion of energy
8 conservation in any year will automatically carry forward, and repeat in
9 each subsequent year with a cumulative effect. Thus, if the Company
10 estimates that its conservation promotion induces 1,000 Mwh of energy
11 sales reductions in each year, lost revenues in the first year will be the
12 amount of revenues associated with 1,000 Mwh of estimated conservation;
13 lost revenues in year 2 will be the amount of revenues associated with
14 2,000 Mwh of estimated conservation (year 2 conservation plus a repetition
15 of year 1 conservation); lost revenues in year 3 will be the amount of
16 revenues associated with 3,000 Mwh of estimated conservation (year 3
17 conservation plus a repetition of year 2 conservation plus another repetition
18 of year 1 conservation); and so on in each subsequent year until lost sales

1 are zeroed out in a future general rate case.⁹ NWE's claimed annual lost
2 revenues have grown so much because the Company has elected not to file
3 a general rate case since its last rate case was filed in 2009.

4 **Q. WHAT PART OF THE ESTIMATED \$12,665,362 OF LOST**
5 **REVENUES IN THE 2014/2015 TRACKER YEAR REFLECTS**
6 **ESTIMATED NWE CONSERVATION IN THAT YEAR AND WHAT**
7 **PORTION REFLECTS THE REPETITION AND COMPOUNDING**
8 **OF ESTIMATED ENERGY CONSERVATION FROM PRIOR**
9 **YEARS?**

10 A. Only about 9 percent of the total relates to estimated conservation initiated
11 in the 2014/2015 tracker year. The other 91 percent is simply the assumed
12 repetition of estimated conservation from prior years. In fact, 45 percent of
13 the total is assumed re-repetition and re-re-repetition of estimated annual
14 conservation from tracker years 2011/2012 and earlier.

⁹ In compiling annual totals, NWE uses a half year convention for the current year, so, for example, in year 3 the total equals one-half of year 3 conservation plus all of years 1 and 2.

1 **Q. AS TIME PASSES DOES THE COMPANY'S ESTIMATION**
2 **METHODOLOGY RECOGNIZE THAT CONSERVATION THAT**
3 **WAS ESTIMATED TO HAVE BEEN INITIATED BY NWE'S**
4 **PROMOTION OF CONSERVATION IN EARLIER YEARS WILL**
5 **FALL OFF IN LATER YEARS EITHER DUE TO ATTRITION OR**
6 **THE FACT THAT, OVER TIME, CUSTOMERS WOULD HAVE**
7 **BEEN LIKELY TO ACHIEVE SOME ECONOMIC**
8 **CONSERVATION ON THEIR OWN WITHOUT NWE'S**
9 **PROMOTION?**

10 A. No. NWE's LRAM methodology assumes that each prior year's
11 conservation fully repeats itself in each subsequent year and that the
12 Company is entitled to full lost revenue compensation for the assumed
13 repetition of that estimated conservation in each year.

14 **Q. SHOULD THE COMMISSION APPROVE THE CONTINUATION**
15 **OF THIS CUMULATIVE COMPOUNDING APPROACH IN**
16 **AUTHORIZING NWE'S ASSESSMENT OF LRAM CHARGES TO**
17 **MONTANA RATEPAYERS?**

18 A. No. Although it is likely that there will be some repetition of conservation
19 initiatives in subsequent years and that some growth in accumulated lost
20 revenues may occur over time, savings from particular programs are also

1 likely to decrease and result in less certain estimated energy savings in later
2 years and savings that are less certainly linked exclusively to NWE's
3 conservation programs. This is particularly the case if it is recognized that
4 a direct causal connection to NWE's early promotional initiatives is not
5 highly likely for conservation that occurs years later when the associated
6 conservation practices have become commonplace and widely adopted.
7 Consumers become educated over time. They learn by observing the initial
8 experiences of others. As they understand the financial savings that are
9 possible, consumers are ultimately motivated to conserve by their own
10 economic interests. For example, a significant portion of NWE's claimed
11 lost revenues derives from the assumption that NWE should continue to be
12 compensated for shifts that have occurred over the years to more efficient
13 lighting even though such shifts have now generally happened nationwide,
14 encouraged by laws and initiatives that are not dependent on NWE's
15 programs to promote efficient lighting.

1 **Q. IN ADDITION TO T&D LOST REVENUES, IS THE COMPANY**
2 **PROPOSING TRACKER RATE ADDITIONS IN THIS CASE FOR**
3 **CU4 REVENUES THAT IT ESTIMATES HAVE BEEN LOST DUE**
4 **TO DEMAND SIDE MANAGEMENT (“DSM”) CONSERVATION**
5 **PROGRAMS?**

6 A. Yes. NWE is claiming \$3.2 million of CU4 lost revenues for tracker year
7 2013/2014 and another estimated \$3.9 million of CU4 lost revenues for
8 tracker year 2014/2015. These claims are up substantially from the
9 Company’s earlier estimates of \$649,709 of CU4 lost revenues in the
10 2009/2010 tracker year and \$1,267,268 of claimed CU4 lost revenues in the
11 2010-2011 tracker year. Over the last five years NWE claims that its
12 annual lost CU4 revenues have increased at a compound rate of 43 percent
13 per year.

1 **Q. DOES THE COMPANY CLAIM THAT, WITHOUT THESE “LOST**
2 **REVENUE” RATE ADDITIONS, CU4 REVENUES WOULD BE**
3 **LESS THAN THE COMMISSION’S ALLOWED CU4 COST OF**
4 **SERVICE BECAUSE OF CONSERVATION PROMOTION?**

5 A. No. The Company’s fixed cost of service revenue requirement of
6 \$72,745,544 for CU4 was determined by the Commission in Order 6925f in
7 Docket No. D2008.6.69 (as modified for property taxes in Order 7057b).¹⁰
8 NWE is not claiming that its promotion of energy conservation has resulted
9 in the collection of less than this Commission-approved cost of service
10 revenue requirement. In fact, it is the case that NWE has consistently
11 recovered substantially *more* than its authorized fixed cost revenue
12 requirement for CU4 in each year since the plant has been in rate base. For
13 example, while NWE is claiming \$3.245 million of lost revenues for CU4
14 in the 2013/2014 tracker year, the fact is that the Company actually
15 collected \$4.077 million *more* than its test year authorized revenues for
16 CU4 in that tracker year.

¹⁰ This revenue requirement determination is now seven years old. Depreciation and other changes have occurred since then. A general rate case is required to determine the full extent to which rates should be modified so as to correspond with current costs.

1 **Q. IS NWE SEEKING TO RECOVER “LOST REVENUES” IN**
2 **ADDITION TO REPLACEMENT POWER COSTS FOR THE**
3 **PERIOD OF THE UNPLANNED CU4 OUTAGE WHEN THE**
4 **PLANT WAS NOT RUNNING?**

5 A. Yes. In addition to the \$8 to \$11 million of increased purchased power
6 costs to replace CU4 power generation during the outage, NWE is also
7 seeking authority to charge ratepayers an additional \$1.637 million for
8 “lost” CU4 fixed cost revenues during the outage period when the plant was
9 out of service. This request is being made despite the fact that actual CU4
10 fixed cost revenues for the outage period already exceeded 100% of
11 authorized test year revenues by a wide margin.

12 **Q. IS THE STORY MUCH THE SAME FOR NWE’S OTHER LOST**
13 **REVENUE CLAIMS?**

14 A. Yes. In the case of DGGS, NWE is claiming \$775,684 of lost revenues for
15 tracker year 2013/2014 when, in fact, the Company’s actual DGGS
16 revenues in that tracker year exceeded test year authorized revenues by
17 \$693,000. Likewise, for the 2013/2014 tracker year the Company is
18 claiming \$5.949 million of lost revenues for T&D service when, in fact,
19 actual T&D revenues exceeded test year authorized revenues by \$18
20 million.

1 **Q. DO THESE REVENUE EXCESSES EXPLAIN, AT LEAST IN PART,**
2 **WHY NWE HAS NOT FILED AN ELECTRIC GENERAL RATE**
3 **CASE SINCE 2009?**

4 A. It is reasonable to conclude that the Company's earnings above its
5 previously determined revenue requirement have been compounded further
6 by NWE's persistently rising claims for additional lost revenue
7 compensation even though its actual revenues consistently exceeded the
8 test year authorized amounts. Under these circumstances and practices it is
9 not hard to see why NWE has not been motivated to file for more frequent
10 general rate case reviews. With a general rate case to rebalance the
11 Company's overall revenue requirements and costs on a properly matched
12 basis, lost revenues would be zeroed out and the current pyramid of
13 compounded annual lost revenues, that has continued to grow for multiple
14 years, would disappear.

15 **Q. DO LOST REVENUE ADJUSTMENTS NECESSARILY RESULT IN**
16 **REVENUES THAT EXCEED COSTS OVER TIME?**

17 A. The matching or balancing of this growth of revenues and costs requires a
18 general rate case to determine if any rate changes are reasonable. While
19 sales growth over time will tend to increase fixed cost revenue collections
20 to levels exceeding test year amounts, it is also the case that service area

1 expansion and customer growth will tend to increase fixed T&D costs.
2 However, while a utility's overall investments in T&D assets generally
3 grow over time to serve new customers and growing loads, generation and
4 production assets are typically specific units of property that depreciate
5 over time. Therefore, fixed cost revenue increases above test year levels
6 for generation plants like CU4, brought about by LRAM rate adjustments,
7 are most likely to result in excessive charges to ratepayers.

8 **Q. THEN, WHY IS THE COMPANY PROPOSING RATE ADDITIONS**
9 **IN THE TRACKER FOR "LOST" CU4 REVENUES DUE TO DSM**
10 **CONSERVATION?**

11 A. The Company's argument is that without DSM conservation, retail kwh
12 sales would have been even larger than they were, resulting in even larger
13 CU4 revenue increments above the Commission's determined CU4 fixed
14 cost of service. So as not to dampen NWE's enthusiasm for its DSM
15 conservation efforts, the Company is asking the Commission to add back
16 this "lost" surplus revenue as additional allowed tracker revenue, even
17 though it is in excess of the Commission-determined CU4 fixed cost of
18 service.

1 **Q. IS THERE A RESPONSE TO THIS ARGUMENT?**

2 A. Yes. First there is no evidence that such increased compensation would in
3 any way improve energy conservation efforts or results in Montana.
4 Second, since the Company's actual CU4 revenue in each tracker year has
5 exceeded the Commission-determined CU4 revenue requirement and
6 ratepayers have already paid more than the Commission's determined CU4
7 fixed cost of service, providing for further additional CU4 revenue in the
8 tracker would be fundamentally inconsistent with the establishment of just
9 and reasonable rates.

10 **IV. CONCLUSION**

11 **Q. PLEASE SUMMARIZE YOUR TESTIMONY.**

12 A. NWE is requesting authorization to charge its ratepayers between \$8
13 million and \$11 million of additional replacement power costs for the 2013
14 CU4 unplanned outage in this proceeding. This request is being made
15 despite the fact that the Company:

16 (1) believes that the outage was caused in part or in whole by
17 maintenance work being performed on the generator by Siemens

1 under PPLM's supervision and direction during the May/June
2 planned overhaul of the plant;

3 (2) does not know whether PPLM, the plant operator responsible for
4 plant maintenance and for hiring and supervising Siemens'
5 overhaul work, believes that any of the overhaul work that
6 caused the plant outage was done improperly, negligently or not
7 in accordance with industry standards;

8 (3) has made no determination whether it can pursue any actions to
9 recover all or part of the costs incurred by the outage from
10 Siemens, PPLM, their insurers, or from any other party;

11 (4) does not know if any of the other owners of CU4 have attempted
12 to recover replacement power costs from Siemens;

13 (5) is just now in the process of investigating the costs and benefits
14 of obtaining outage insurance for Colstrip 4; and

15 (6) is not going to credit ratepayers with the labor cost savings that
16 were realized because of the plant outage.

17 Under these circumstances the Commission should either deny cost
18 recovery for the CU4 replacement power costs or, at least for the time

1 being, treat these costs as a matter that requires far more work by NWE
2 before any reasonable claim might be made for a partial cost recovery from
3 ratepayers.

4 **Q. WHAT ARE YOUR CONCLUSIONS REGARDING THE LOST**
5 **REVENUE RECOVERY CLAIMS THAT NWE IS MAKING IN**
6 **THIS CASE?**

7 A. The amount of annual “lost revenue” compensation claimed by NWE has
8 grown enormously over time to more than \$10 million in tracker year
9 2013/2014 and more than \$12.6 million projected for tracker year
10 2014/2015. In just the last three tracker years NWE’s claimed lost
11 revenues have grown from \$4.3 million to more than \$12.6 million per
12 year, reflecting a compound annual rate of lost revenue growth of 43
13 percent per year.

14 A substantial portion of current year lost revenues is now accounted for by
15 the assumed repetition of estimated conservation that occurred in prior
16 years. For example, only 9 percent of the estimated DSM conservation in
17 tracker year 2014/2015 was initiated in that year – the rest being the
18 assumed repetition of conservation from previous years.

1 Also, a substantial part of claimed lost revenues is associated with
2 generation facilities, such as CU4, which have, in fact, already recovered
3 substantially more than their full authorized test year revenue requirement.
4 NWE's position is that the company is nonetheless entitled to this
5 additional LRAM revenue recovery because, without DSM, kwh sales
6 would have been even larger than they actually were, resulting in even
7 larger CU4 revenue increments above the Commission's determined test
8 year cost of service revenue requirement. NWE is even asking the
9 Commission to approve CU4 "lost revenue" charges to ratepayers of more
10 than \$1.6 million for the period during which CU4 was out of service and
11 ratepayers were paying NWE for replacement power costs.

12 **Q. WHAT IS YOUR RECOMMENDATION REGARDING CLAIMED**
13 **LOST REVENUES.**

14 A. My recommendation is that the Commission should attempt to avoid, as
15 much as possible, all single issue out-of-test-year rate adjustments and,
16 instead, base NWE's rate and revenue adjustments on balanced and
17 comprehensive revenue and cost of service reviews in reasonably frequent
18 general rate cases. If any out-of-test-year revenue adjustments are to be
19 retained, they should be limited to traditional fuel and purchased power
20 costs.

1 **Q. DOES THIS COMPLETE YOUR DIRECT TESTIMONY IN THIS**
2 **CASE?**

3 **A. Yes, it does.**