

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

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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)	

POST-HEARING BRIEF OF THE MONTANA CONSUMER COUNSEL

I. INTRODUCTION AND BACKGROUND

NorthWestern Energy (NWE, or the Company), submitted its annual electric default supply tracker filing on May 31, 2013.¹ The Montana Public Service Commission (“Commission”) entered Interim Order No. 7283 on June 18, 2013, approving implementation on an interim basis of a Deferred Supply Rate designed to refund the over-collection for Electricity Supply Costs of \$(3,477,111), to refund the over-collection for CU4 variable costs/credits of (\$1,868,066), and to recover the under-collection for DGGS variable costs/credits of \$4,598,342, reduced by (\$1,419,172).

¹ As required in tracker proceedings, NWE’s Application requested approval of rates to reflect rate treatment for the following: 1) amortization of a net over-collection of \$746,835 in the Electricity Supply Deferred Costs Account Balance (Deferred Account Balance) for the 12 months ending June 30, 2013; and 2) projected load, supply, and related electric costs for the 12-month tracker period July 1, 2013 through June 30, 2014. For the typical residential customer, the Company projected a net increase of \$0.03 per month, or \$0.36 per year, a 0.04% percent increase, in supply related costs.

The Commission consolidated the 2013 and 2014 Trackers on May 6, 2014, *Notice of Commission Action*, Docket No. D2013.5.33 (May 12, 2014). NWE filed its 2013-2014 Electricity Supply Tracker on May 29, 2014.² The Commission entered Interim Order No. 7283a on June 18, 2014, approving implementation of NWE's proposed rates for service on an interim basis.

II. SUMMARY

The Montana Consumer Counsel (MCC) identified the following issues in relation to NWE's consolidated annual electric trackers (2012 – 2014):

- Whether the Commission should disallow expenses attributed to LRAM in this proceeding?
- Whether the Commission should disallow costs incurred as a result of NWE's hedging program?
- Whether the Commission should disallow costs related to the CU4 outage and credit ratepayers with any outage related labor reductions or other cost savings?

With the filing of the Stipulation in Docket No. D2014.7.58 in which the Company agreed that it will “not make any new purchases of fixed price, firm power, for purposes of hedging the costs of purchased power, without first seeking

² In the combined docket, NWE's requested change in electric supply rates would reflect: 1) Amortization of a net under-collection of \$32,044,199 in the Electric Supply Deferred Costs Account Balance (Deferred Account Balance) for the 12 months ending June 30, 2014; and 2) projected load, supply, and related electric costs for the 12-month period ending June 30, 2015. For the typical residential customer, the Company projected a net increase of \$5.03 per month or \$60.36 per year.

and obtaining the approval of the Commission to make such purchases” the issue of hedging has been effectively resolved.³

With the Commission’s Order 7375a in D2014.6.53 the question regarding ongoing costs related to LRAM has also been resolved.

Regarding CU4, MCC witness Dr. John W. Wilson generally observed that despite the fact that CU4 is the highest cost source of power on the NWE system, the Company is not entitled to recovery of full CU4 plant and operating costs plus the costs of replacement service. Exhibit MCC-1, Direct Testimony of Dr. John Wilson, p. 15.⁴ Dr. Wilson recommended disallowing replacement power costs between \$8.2 million to \$11.135 million as not prudent as measured by NWE’s actions related to the CU4 outage in 2014. *Id.*

MCC requests disallowance of \$8.2 – \$11.135 million in replacement power costs while CU4 was out of service.

III. ARGUMENT

“[...] the best way to insure successful contracting is for risk to be borne by the party best able to control it [...]”⁵ the Company’s expert witness on contracts and insurance testified. In this docket the Company does precisely the opposite: it asks its ratepayers, the party least able to control the risk, to bear all losses related to the CU4 outage although they were the only party not involved in any way in

³ See Stipulation filed in D2014.7.58.

⁴ Dr. Wilson observed:

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

⁵ Exhibit NWE 37, Direct Testimony of Fred Lyon, Exh. FL-2 p. 3 of 11; TR. p. 106:20-24.

the negotiations regarding risk allocation or replacement power costs. The Commission must reject the Company's attempt to treat its ratepayers as default insurers and payers of all liability, regardless of fault of third parties, and disallow the Company's request for \$8.2 million in expenses related to the outage.

Section 69-3-201, MCA requires that every charge made by any public utility shall be **reasonable and just**. Both of these elements must be satisfied: rates must be reasonable, and in addition, they must be just. This analysis means that the rates charged to a Company's ratepayers must be considered with a view to equity. As between all the parties that should bear the cost of the outage at CU4, the one party that caused the outage, Siemens, has not paid a single penny for the costs related to the outage. The ratepayers, the party least able to control the risks associated with the outage, are asked to pay for it all. To experience a CU4 outage that is caused by the engineer hired by PPL, and then to ask ratepayers to continue paying CU4 costs plus additional costs for replacement power, makes the ratepayers pay for the highest source of power in NWE's portfolio plus replacement power costs when a third party caused the plant outage. The Company's cost recovery should be capped at what total CU4 cost levels would have been (fixed costs plus fuel and operating costs) without an outage.

In addition to the reasonable and just requirement, expenses included in rates must be prudently incurred. Prudence is a regulatory standard that obligates the Commission to disallow costs and expenses that have been imprudently incurred, as the ratepayers of Montana have no choice about where they take their

business, and the only motivation NWE has to act prudently is to face disallowance when warranted. See e.g., *Re: Long Island Lighting Co.*, 71 PUR 4th 262, 266 (N.Y.P.S.C. 1985); accord *Wisconsin Public Service Corporation*, 86 PUR 4th 357, 377 (Wis. P.S.C. 1987)(utility management must use the same vigor to protect ratepayers as it does to protect shareholders).

A. NWE failed to vigorously protect its ratepayers

NWE's actions leading up to the outage at CU4 in 2014 failed to prudently assess and manage the risk associated with the plant in several ways. The MPC – PPL Ownership and Operation Agreement for Colstrip Units #3 and #4 (PPL contract) was originally entered into in 1981.⁶ In the original PPL contract, MPC was the owner and operator of CU4, and the parties to the agreement waived consequential damages arising out of operation and maintenance of the plant.⁷ NWE Response to MCC 019, Attachment, TR. p. 117. This was a benefit to MPC as the then-operator of the plant.

When NWE purchased its current interest in CU4, however, it knew that it was not the operator of CU4. The PPL contract did not make sense for NWE because it was not standing in the shoes of MPC as the operator of the plant. NWE knew, when it acquired its interest in CU4, it was outsourcing the operation of the plant to a third party. NWE knew that there were risks of long term ownership. NWE also knew that the contract between PPL and NWE, as the

⁶ See NWE Response to MCC 019, Attachment, pp. 1-3.

⁷ *Id.*, pp. 7-8, 25.

successors to the original contract between the owners of CU4, released the owner and operator of the plant from liability for consequential damages. NWE made no effort to renegotiate this contract, or to acquire outage insurance, or take any other steps to protect its ratepayers from the costs of outages at CU4 as a result of the operation of the plant.

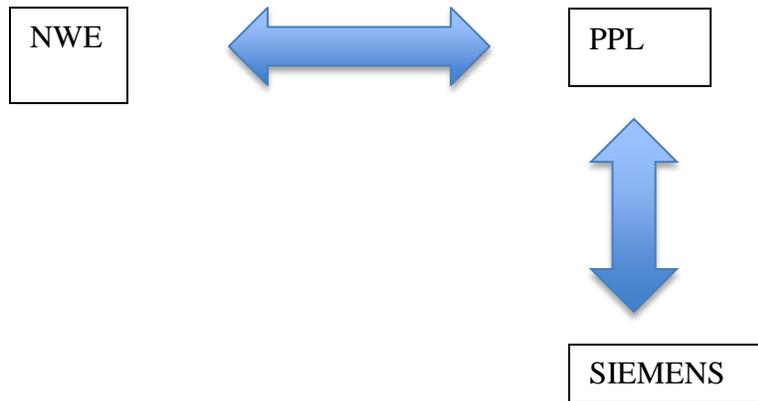
NWE bears the burden of ultimately demonstrating that the costs it wishes to pass on to its captive customers in Montana were prudently incurred. See, *Re: Central Vermont Public Service Corporation*, 83 PUR 4th 532, 566 (Vt.P.S.B. 1987). Although there is a presumption that management has acted prudently, NWE retains the burden of persuasion that its actions were in fact prudent. *Id.*, also *Re: Southern California Edison Company*, 116 PUR4th 365, 375 (Cal. PUC 1990).

Having succeeded to the MPC contracts without analyzing and reviewing the applicability of such contracts to NWE's present circumstances, NWE then failed to determine whether PPL as the operator of the plant or Siemens, the engineer responsible for the outage, bore any financial responsibility for costs associated with the outage. NWE outsourced operation and maintenance of CU4 to PPL.⁸ PPL hired Siemens to do maintenance work on CU4.⁹ NWE witnesses testified that Siemens, the party doing the work, was the party best able to control

⁸ TR. p. 111:16-24.

⁹ *Id.*, NWE Response to MEIC Data Request - 069, Attachment.

the work and associated risk.¹⁰ A simple diagram of the contractual relationships is:



There is no dispute that Siemens caused the outage at CU4. There is no dispute that NWE did not seek any recovery from either Siemens or PPL. There is no dispute that NWE did not read or review the Root Cause Analysis, prepared by Siemens to explain the cause of the outage and how it happened, prior to seeking full cost recovery from ratepayers. NWE did not present a witness or any testimony from the Company addressing the cause of the outage to explain or justify recovery of expenses related to the outage.

The parties involved, the parties most able to control the risk, released each other from liability contractually. Importantly, however, there remain key avenues of recovery that NWE did not seek including, for example, contractual remedies against PPL other than consequential damages, and remedies in tort against both PPL and Siemens.

¹⁰ TR. 111:20-24.

All parties agreed that Siemens caused the outage at CU4. Siemens did not pay a single dime for the costs that are associated with the outage and for which NWE seeks recovery from its ratepayers.¹¹ More significantly, NWE did not seek recovery from Siemens under any theory of liability.

If NWE were using the same vigor to protect ratepayers as it does to protect shareholders it would certainly have sought recourse against the party responsible for the outage. To adequately bring market forces to bear in determining the correct outcome in any given case, some Commissions apply the “capable executive” standard, meaning that the decision under review must be reasonable when viewed against the decision and courses of conduct of other corporations that make investment decisions of comparable size and complexity. See *Re: Northern Utilities, Inc.*, Docket No. 95-480 and 95-481, slip op. at 5 (Maine P.U.C. August 9, 1996); accord *Gulf States Utilities Co. v. La. Pub. Service Comm.*, 689 So.2d 1337, 1346 (La. 1997)(adopting objective reasonableness standard). To protect the ratepayers from becoming the default insurers for the utility, Commissions have required that management of a large construction project undertaken by a regulated utility should be no less rigorous or less oriented toward cost minimization than management of a large project in an unregulated industry. As the New York Commission recognized, this standard “provides the most fair and reasonable basis for evaluating the record in this case.” *Long Island Lighting Co.*, 71 PUR4th at 271.

¹¹ TR. p. 112:20-24.

Applying this standard is especially appropriate in the context of preapproval. Inclusion of other non-regulated industries for comparison prevents NWE from benefitting from imprudently incurred costs, which it has less incentive to avoid when functioning under the Commission's preapproval of costs to build in the first instance. When reviewing costs in the context of a preapproval docket, the Commission must be especially vigilant in its review and analysis of whether costs were prudently incurred. Management must be held to the same standard for protection of ratepayers that it uses to protect shareholders. *Re: Wisconsin Public Service Corp.*, 86 PUR4th 357, 377 (Wis. P.S.C. 1987).

Siemens and PPL both owe a duty of care to NWE. See, The Restatement (Second) Agency, §214, which provides for liability by a principal who has a duty to protect another from harm caused by its agent. The Restatement provides that a master or other principal who is under a duty to provide protection for or to have care used to protect others or their property and who confides the performance of such duty to a servant or other person is subject to liability to such others from harm caused to them by the failure of such agent to perform the duty. *Id.* The Montana Supreme Court has adopted Restatement (Second) Agency, § 214, as an appropriate statement of the law in Montana. *Paull v. Park County*, 2009 MT 321 ¶ 37, 352 Mont. 465, 218 P.3d 1198 (Mont. 2009). There were reasonable theories of liability for NWE to pursue to seek recovery from parties responsible for the outage, rather than simply turning to its ratepayers as a first line of payment. The Commission should disallow costs associated with the outage because NWE did

not vigorously protect its ratepayers and did not act prudently in seeking other remedies.

NWE is not a party to the contract between PPL and Siemens.¹² As a result, NWE was not barred under that contract from seeking recovery from Siemens for causing the outage and imposing millions of dollars of costs on NWE ratepayers in tort, or any other non-contractual theory of recovery. *Id.* See *Jim's Excavating Service v. HKM Associates*, 265 Mont. 494, 504 (the established law in Montana is that there is no requirement for privity in contract to bring an action in tort). In *Jim's Excavating Service*, the Montana Supreme Court affirmed a jury verdict finding an engineer liable for damages caused as a result of negligent design and supervision of a water pipeline project in Lockwood, Montana. The Court found that the excavating service was allowed to seek economic damages against the engineer for delay even though the engineering firm had been retained by the Water Users Association and there was no privity of contract between the excavator suffering damages and the engineering company that caused the damage. *Id.*, 265 Mont. at 503. Given this clear precedent in Montana, NWE was obligated to protect its ratepayers and seek compensation from Siemens as the party responsible for the outage rather than turning to its ratepayers first.

NWE's expert on contract damages testified the contractual relationships between the parties do not bar NWE from seeking recovery from PPL for damages

¹² NWE Response to MEIC-069, Attachment.

that are not characterized as “consequential.”¹³ While the PPL contract bars recovery as against PPL only for consequential damages, not all damages incurred related to the outage are consequential. Significantly, NWE witness Mr. Goetz testified that characterizing damages as “direct” or “consequential” is “not totally a bright line.” TR. p. 299:18-19. It is reasonable to expect NWE, if it were vigorously defending its ratepayers, to challenge the costs related to CU4 and to seek recovery for outage costs from all responsible parties. Its failure to do so should result in a disallowance at least of the replacement power costs it incurred while CU4 was off line.

Without question, damages that were itemized that are not consequential damages should be disallowed. Response to MCC-117 sets out damages that are not barred by the contract.¹⁴ When asked whether these damages were direct or consequential damages, NWE’s witness Mr. Goetz testified that “I don’t know if I have an opinion on that.” Since NWE’s own expert witness with years of litigation experience in damages was not able to offer an opinion as to whether these itemized damages were direct or consequential, it was reasonable and prudent, and just, for NWE to seek recovery for these damages. The NWE – PPL contract does not bar recovery for such damages under contract, and NWE had tort causes of action against both PPL and Siemens.

¹³ TR. p. 298:16 – 299:19, also NWE Response to MCC 019, p. 23. ¶ 20.

¹⁴ NWE totaled these costs as \$632,000 and noted that they are considered capital costs, which would be included in the “next general rate case.” Response to MCC-117. The Commission should at a minimum disallow NWE’s recovery for these costs either now or in any future rate case.

NWE's failure to assess and analyze an appropriate course of action against parties responsible for the outage was not prudent, and costs incurred as a result of the outage should not be passed on the NWE's ratepayers as the sole and default insurer.

NWE characterizes the MCC's advocacy as "asking NWE to sue someone." NWE has a duty to its ratepayers to protect their interests in the same manner they protect their shareholders' interest. NWE cannot treat its ratepayers as a first line of insurance, or as its default obligors anytime costs are incurred. Here, NWE did not even assess the cause of the outage prior to asking its ratepayers to bear all costs associated with it. No one from NWE bothered to even read the Root Cause Analysis before coming to the Commission and seeking recovery from its ratepayers. This was not prudent, and costs incurred as a result of the outage should be disallowed.

B. NWE failed to manage and assess risk

MCC witness Dr. Wilson raised the question of whether the Company's failure to assess and analyze risk by looking into replacement power insurance was prudent. NWE's applies an *ex post facto* response that replacement power insurance would not have been cost effective.¹⁵ The analysis of whether management acted prudently is viewed under the circumstances at the time the decision was made; not with hindsight. See, *New England Power Co.*, 31 FERC ¶

¹⁵ Here, as in the DGGS outage, NWE argues that its inquiry into the costs of replacement power insurance after the fact justify its failure to assess and manage risk prior to the outage. This argument flies in the face of the prudence standard and should be rejected.

61,047, *reh. denied*, 32 FERC ¶ 61,112 (1985). NWE asks this Commission to apply a legal standard to its actions that it rejects under any other circumstance: hindsight. Management's actions are never reviewed for prudence under later acquired knowledge.

NWE witness Lyon testified that independent power operators will get outage insurance, or at least assess the need for it, because it's a "condition of their loan covenants"; "they typically will not devote the resources to the operation and maintenance of a plant that an investor-owned utility would"; and the price protection associated with outage insurance is built into the pricing associated with the PPA. TR. p. 132-133. Lyon testified in response to questions that NWE's ownership in CU4 has the same risk profile as an investor owned utility. TR. p. 134 – 135. PPL operates and maintains CU4, NWE does not. Given the similar risk profile of outsourcing operation of the plant to a third party, NWE should have managed the risk associated with outsourcing the operation appropriately. At least one such approach would have been to assess outage insurance. NWE did not even consider outage insurance, though it had the same risk as an investor owned utility in that it was not the operator of its own plant.

Prior to seeking recovery of costs related to the CU4 outage from its ratepayers, the following had occurred:

- NWE, knowing that it outsourced maintenance and operation of the plant to a third party, did not assess this as a risk factor, in spite of its own expert's testimony that it is in fact a risk factor to be assessed

and guarded against. NWE simply turned to its ratepayers for recovery of all expenses that it, not its ratepayers, had the power to manage and mitigate.

- NWE knew that the “CU4 generating plant was taken out of service for overhaul by its operator, PPLM, from May 5, through June 7, 2013, during which time the rotor was taken out for inspection and what was apparently expected to be routine maintenance. The plant was eventually returned to service on June 27, 2013 but major problems were encountered almost immediately thereafter. According to the “Root Cause Analysis” performed for PPLM after the outage by outside consultants, initial “core melting” began prior to June 29 and continued thereafter until severe core failure occurred on July 1, 2013. (See response to MCC-015, Attachment 4)”¹⁶
- NWE knew, six months prior to filing its Application seeking recovery for costs related to the outage, that the extended forced outage event for CU4 “was caused in part or in whole by the work performed on the generator during the May/June, 2013 planned overhaul.” (See response to MEIC-045).¹⁷

¹⁶ Pre-filed Testimony of John Wilson, p. 5-6, citations in original.

¹⁷ *Id.*, p. 6:5-7.

- NWE identified “unanticipated costs associated with the ownership and operation of Colstrip Unit 4” as a risk of rate basing CU4.¹⁸
- NWE did not present any witnesses in this docket who had read or reviewed the Root Cause Analysis prior to NWE seeking recovery of costs associated with the CU4 outage from NWE ratepayers.¹⁹

Rather than using the information provided in the Root Cause Analysis to determine whether the parties who were responsible for maintaining and operating CU4 could be a source of recovery for NWE, NWE came first to its ratepayers. In doing so, NWE failed to explain what justified the amount of its request, saying only that such an explanation would require “*scores of assumptions and interpretations regarding what might have happened absent the outage.*”²⁰

NWE’s failure to assess and mitigate the risks associated with the outage and the sources of recovery for costs incurred related to the outage is not prudent, and the outage costs of replacement power should be disallowed.

MCC recommends disallowing these costs as the actions the Company took prior to seeking compensation from its ratepayers were neither reasonable nor prudent, nor were they equitable to the ratepayers. The Company did not look to other sources of recovery which are available and from whom recovery should be sought and in a market environment, would be sought. The Company did not

¹⁸ See TR. p. 71:lines 5-15.

¹⁹ TR. p. 71: 19-25, 72-73:9. Kevin Markovich testified that he knew the Root Cause Analysis had been performed, but did not review it prior to submitting a request for recovery of costs from ratepayers. Looking into the cause of the outage was “not within my area.” TR. 72:8.

²⁰ Pre-filed Direct Testimony of Markovich, *supra*.

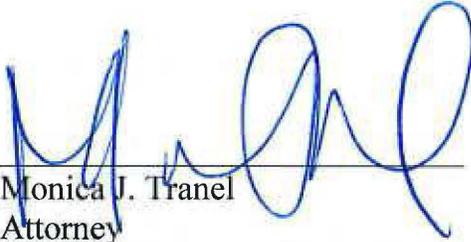
prudently assess the impacts of outsourcing its management of the facility, and did not look into risk management options that it should have done.

IV. CONCLUSION

The MCC requests disallowance of \$8.2 – \$11.135 million in replacement power costs while CU4 was out of service.

DATED this 18th day of December, 2015.

By: _____


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