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

IN THE MATTER OF NorthWestern Energy's 2012-2013 Electricity Supply Tracker	REGULATORY DIVISION
IN THE MATTER OF NorthWestern Energy's 2013-2014 Electricity Supply Tracker	Docket Nos. D2013.5.33, D2014.5.46

MONTANA ENVIRONMENTAL INFORMATION CENTER'S AND SIERRA CLUB'S RESPONSE BRIEF

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INTRODUCTION

This docket concerns whether NorthWestern Energy prudently incurred certain "electricity supply costs" associated with a nearly seven-month outage at Colstrip Unit 4 in 2013-2014. MCA § 69-8-210(1). NorthWestern concedes that the outage likely resulted from a combination of inadequate insulation on components of the Colstrip Unit 4 generator core and actions by Siemens—a third-party equipment vendor—that caused those inadequately lined components to contact each other and create shorting. As a result of these events, Colstrip Unit 4 generated no electricity from July 1, 2013 until January 23, 2014. Nonetheless, Colstrip's customers were required to pay $21 million in fixed costs for Colstrip Unit 4 while it was not operating during those months. Now, on top of those fixed costs, NorthWestern seeks to charge its customers more than $8 million for replacement power purchased during the outage.

Prior to the nearly seven-month outage, NorthWestern failed to take necessary steps to identify and mitigate the risks of an outage at Colstrip Unit 4. In fact, while NorthWestern represented to this Commission that the unit was "better than new" in 2008, since then, equipment failures and other events have left it out of service approximately 25% of the time. Despite Colstrip Unit 4's poor operating history, NorthWestern never sought to ensure contractual liability on the part of the equipment vendor (Siemens) or plant operator (Talen Montana) for negligent acts that may take the unit offline. And having waived the liability of those parties in the best position to prevent an extended outage, NorthWestern failed even to investigate whether insurance could effectively mitigate the risk to ratepayers of having to pay substantial replacement power costs in the event of an outage. In other words, NorthWestern's actions ensured that the only party that bore any risk from an extended outage of Colstrip Unit 4 was the party in the worst position to avoid such an event—the ratepayers.

Intervenors Montana Environmental Information Center and Sierra Club respectfully request that the Commission find that all of the replacement power costs attributable to the Colstrip Unit 4 outage were not "prudently incurred" under MCA § 69-8-210(1) and that NorthWestern did not identify and cost-effectively manage and mitigate the risks of an outage at Colstrip Unit 4 and the need to incur replacement power costs per MCA § 69-8-419(2)(a), (c). As a result, the Commission should deny NorthWestern's request for recovery of $8.2 million in replacement power costs. Furthermore, the Commission should order NorthWestern to reimburse customers for any replacement power costs they already have paid through the interim rate increase.

FACTUAL BACKGROUND

A. NorthWestern's Interest in Colstrip Unit 4

NorthWestern Energy is a 30 percent owner of Colstrip Unit 4, a 740-megawatt coal-fired generating unit in Colstrip, Montana. The unit was first put into service on December 15, 1985 with a "turbine generator" manufactured by Siemens/Westinghouse. NWE Resp. to MEIC-44a, Attachment at 5. NorthWestern acquired a leased interest in Colstrip Unit 4 from Montana Power Company in 2002, and gained control of its interest by purchasing the leases in 2007. *See* 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, Dkt. No. D2008.6.69, Order No. 6925f, ¶¶ 21-22, 38 (Nov. 13, 2008).

On June 27, 2008, NorthWestern filed with the Commission an application to include Unit 4 in its rate base. *Id.* at 2. At that time, NorthWestern employee Michael Barnes testified that Colstrip Unit 4 was operating "as good as, if not better than, new in recent years which is a

testament to maintaining the investment necessary to keep these plants in top condition." Dkt. No. D2008.6.69, Prefiled Rebuttal Testimony of Michael J. Barnes on Behalf of Northwestern Energy, MJB-2:1-3; *see also* Trans. 228:9-18. Notwithstanding this representation, the Commission identified risks associated with "cost uncertainties related to CU4, such as coal cost increases, a future carbon tax, potential market price decreases, or CU4 maintenance and operation costs that exceed NWE's estimates, will increase the cost to ratepayers of CU4 power over and above what NWE has projected." Dkt. No. D2008.6.69, Order No. 6925f, ¶ 227. Accordingly, the Commission approved including Colstrip Unit 4 in NorthWestern's rate base, but committed to "conduct[ing] rigorous examinations in annual supply trackers of the prudence of NWE's expenses related to CU4." *Id.*

B. 2014 Annual Supply Tracker

This docket presents the vehicle for the Commission's "rigorous examination[]" of greater-than-projected electricity supply costs from July 1, 2013 to June 30, 2014. *Id.*; *see* Dkt. Nos. D2013.5.33, D2014.5.46, NorthWestern Energy's Application for Interim and Final Electricity Supply Rate Adjustment, at 3 (May 29, 2014). NorthWestern projected that its proposed rate adjustment would increase the total bill of a typical residential customer using 750 kilowatt-hours per month by $60.36 per year, a 6.47% increase for supply-related costs. *Id.*, Cover Letter at 3. Of particular relevance, the 2014 tracker includes the costs for replacement power incurred due to the nearly seven-month forced outage of Colstrip Unit 4.

1. <u>The Root Cause Analysis of the Extended Outage at Colstrip Unit 4</u>

From May 5 to June 7, 2013, Colstrip Unit 4 was offline for planned maintenance conducted by Siemens. NWE Updated Resp. to MEIC-44a, Attachment; *see also* NWE Resp. to MEIC-9, Attachment – Protected, at 7-8 (pages 3-4 in the original document). Colstrip Unit 4

returned to service on June 27, but suffered a massive core failure on July 1. NWE Resp. to MCC-18, Attachment 1 – Public, at 42. The outage that began immediately following work performed by Siemens during a major unit overhaul stretched from July 1, 2013 until January 23, 2014.

The Root Cause Analysis completed on November 18, 2013 (but only disclosed in this proceeding on February 18, 2015) determined that "[t]he cause of the failure was most likely inadequate interlaminar insulation permitting shorting between laminations caused during the prior outage [i.e., the generator overhaul outage of May and June 2013] by rotor insertion, skid pan damage, or air gap baffle installation." NWE Resp. to MEIC-9, at 3 (public version). In other words, the insulation protecting the laminations within the generator core from coming into contact with each other was thin or nonexistent in places, likely from the time the Unit first went into service. Trans. 147:13 – 148:2. Thus, the most likely explanation of the outage is that Siemens forced the laminations together while reinstalling the rotor or other equipment following the routine overhaul, leading the inadequate interlaminar insulation to short, which triggered the meltdown that tripped the unit offline. Rebuttal Testimony of Ronald A. Halpern, RAH-7 to 9, RAH-11; *see also* NWE Resp. to MEIC-9, Attachment - Protected at 5, 45 (pages 1, 41 in the original document). As a result, NorthWestern incurred approximately $8.2 million in costs to purchase replacement power to supply to NorthWestern's customers during the outage.[1]

Ronald A. Halpern and Robert Ward prepared the Root Cause Analysis on behalf of Colstrip's operator, PPL Montana (now Talen Montana). *See* NWE Resp. to MEIC-9, Updated Attachment - Public. The analysis concluded that "PPL did everything according to standard

[1] Although NorthWestern failed in its tracker filing to provide any estimate of replacement power costs, the Company provided estimates in response to data requests ranging from approximately $8.2 to 9.7 million, and identified $8.2 million as the most reasonable estimate. NWE Resp. to MEIC-5 & Attachment 1.

industry practice … . Nothing they did or could have done, could have prevented this failure." *Id.* at 46. The Root Cause Analysis did not address whether Siemens could have prevented the failure, nor did it address NorthWestern's actions. Prior to hiring them for this proceeding, NorthWestern did not communicate with Mr. Halpern and Mr. Ward regarding the cause of the outage or Siemens' performance. *See* NWE Resp. to MEIC-48; Trans. 145:11-24, 163:16-22.

2. The Risks and Consequences of an Outage at Colstrip Unit 4

Many years before the Colstrip Unit 4 outage occurred, it was known within the electric power industry that there were problems with the kind of interlaminar insulation, Alkaphos, in use at the Unit 4 generator. *See* Trans. 189:7-17. NorthWestern witness Ronald Halpern noted that the kind of insulation on the Unit 4 generator "could vary in thickness and in spots be non-existent, and where bare, could result in possible shorting and damage to the core." Rebuttal Testimony of Ronald A. Halpern, RAH-8 to 9. Around the year 2000, Siemens began using a newer form of insulation that does not have the same incidence of non-existent or improperly thin coatings as Alkaphos. Trans. 189:1-6. In addition, prior to the Unit 4 outage, it was known in the electric power industry that "rotor-out" overhauls carry a risk of damaging generator components. Trans. 154:16-25.

Notwithstanding the risks posed by inadequate interlaminar insulation and rotor-out overhauls, along with other risks inherent in the operation and maintenance of a large electric generating unit such as Colstrip, NorthWestern's contract with PPL Montana, and PPL Montana's contract with Siemens, waived any cause of action against either party for consequential damages, including replacement power costs. Exh. JHG-1 at 7; Exh. JHG-2 at 3. The contract between all of the owners of Colstrip Units 3 and 4 and the operator, PPL Montana (now, Talen), releases the operator from all liability from claims of "any consequential

damages," including "loss of use" and "replacement power costs." Exhibit JHG-2 at 3. Similarly, PPL Montana's contract with Siemens expressly states that Siemens is not liable for any consequential damages, including the costs of replacement power. Exhibit JHG-1 at 7.

The 2013-2014 outage was the second extended forced outage at Colstrip Unit 4 costing ratepayers since the Commission approved the unit's inclusion in rate base in 2008. *See* Order No. 7350, Dissenting Opinion of Comm'r Travis Kavulla, at 1; NWE Resp. to MEIC-26, Attachment at 2, 4, 8; NWE Resp. to MEIC-28, Attachment at 1. In 2009, Colstrip Unit 4 experienced a five-month outage resulting from cracks in the turbine blades in a low-pressure turbine area of the Unit. *See* In the Matter of NorthWestern Energy's Application for Approval of Electric Supply Deferred Cost Account Balance and Projected Electric Supply Cost, Dkt. D2009.5.62, Application for Interim and Final Rate Adjustment, KJM-5 (May 29, 2009); *see also* Trans. 229:22-230:6; NWE Confidential Resp. to MEIC-26, Attachment at 8. NorthWestern's replacement power costs resulting from the 2009 outage were included and approved in the company's 2008-2009 tracker filing. *See* Dkt. D2008.5.45/ D2009.5.62, Order No. 6921c, at 23, 35-36.

The combined effect of these extended outages and other events at Colstrip Unit 4 is that Colstrip has been *unavailable* for electricity generation more than one-quarter of the time between 2009 and 2014. *See* NWE Resp. to MEIC-75(d). Over this time period, Colstrip Unit 4 has been available 12.5% *less time* than its sister unit, Colstrip Unit 3. *Id.* Indeed, compared to similar coal-fired units, Colstrip Unit 4's reliability is well below average; from 2009-2013, Colstrip Unit 4 had an equivalent availability factor[2] of 72.65%, while the average equivalent

[2] Equivalent availability factor ("EAF") is one measure of the reliability of a unit. The EAF measures the percentage of time during a given period when a unit was available to generate electricity. *See* Trans. 202: 1-12.

availability factor for similar coal-fired units was 82.81%. NWE Response to MEIC-75(c); Rebuttal Testimony of Michael Barnes at 8. During all of this time, whether Unit 4 was operating or not, NorthWestern customers have paid approximately $3 million each month in fixed costs for the Unit. Direct Testimony of David Schlissel at 5; NWE Resp. to MCC-24, Attachment 1, at 2.

All of these circumstances—inadequate interlaminar insulation, rotor-out maintenance activity, contractual liability waivers for the parties in control of operation and maintenance of the Unit, and Unit 4's outage history—add up to enormous risk on the shoulders of NorthWestern customers in the event of an outage. Yet NorthWestern never disclosed to the Commission the status of the interlaminar insulation or the waiver of PPL's and Siemens' liability when it rate-based Colstrip Unit 4 in 2009. Before the 2013-2014 outage, NorthWestern never considered obtaining insurance that would mitigate the risk of a forced outage. Trans. 218:14 - 219:6. And following the outage, NorthWestern sought ratepayer reimbursement without even considering whether it could recover replacement power costs from Siemens—which partially caused the extended outage. NWE Resp. to MEIC-79(b); *see also* NWE Resp. to MEIC-9, Attachment – Protected, at 5, 45.

3. Testimony of Intervenor Witnesses

In this proceeding, MEIC presented the expert testimony of Mr. David Schlissel, an engineer with over forty years of experience in electric utility proceedings. *See* Exhibit DAS-1. Mr. Schlissel testified that, prior to the 2013-2014 outage, NorthWestern had not evaluated obtaining outage insurance for Colstrip Unit 4. Direct Testimony of David Schlissel, at 17. Mr. Schlissel testified that in his opinion, NorthWestern should have at least considered the costs and benefits of obtaining outage insurance, because, without outage insurance, ratepayers would be

forced to pay both the fixed costs of the unit plus replacement power costs if an outage occurred. *Id.* at 19-20. Mr. Schlissel also noted that NorthWestern should have evaluated outage insurance because Colstrip Unit 4 had been out of service for significant periods of time as a result of forced outages prior to 2013. *Id.* at 18-19. Mr. Schlissel noted that NorthWestern was the only party with access to the information, particularly outage insurance quotes, necessary to evaluate outage insurance. *Id.* at 20.

MCC witness Dr. Wilson reached a similar conclusion, testifying that a prudent utility would have at least considered outage insurance for Colstrip Unit 4, but that NorthWestern had not done so prior to the 2013-2014 outage. Direct Testimony of Dr. John W. Wilson, at 10-11, 17.

Mr. Schlissel also testified that the Root Cause Analysis identified a combination of two factors—Siemens' actions during the generator overhaul and inadequate interlaminar insulation—as the most likely cause of the 2013-2014 outage at Colstrip Unit 4. Direct Testimony of David Schlissel, at 8-9. Mr. Schlissel noted that, at the time of his testimony, NorthWestern had not reached any conclusions about whether it had a cause of action against Siemens for having contributed to the outage and the need for replacement power. *Id.* at 15. Mr. Schlissel testified that "NorthWestern Energy should not be seeking to recover outage-related replacement power costs from its ratepayers without first seeking recovery of those costs from Siemens or, at a minimum, concluding an evaluation of whether an action against Siemens is warranted. If approved, the Company's application to recover these costs may force ratepayers to bear costs before NorthWestern has conducted a thorough assessment of whether Siemens is liable for the replacement power costs incurred during the Colstrip 4 outage." *Id.* at 16.

MCC witness Dr. Wilson reached a similar conclusion, testifying that NorthWestern did not know whether the plant operator, PPL Montana (now Talen Montana), believed that Siemens acted negligently during the generator overhaul and NorthWestern did not know whether other owners were attempting to recover replacement power costs from Siemens. Direct Testimony of Dr. John W. Wilson, at 7, 9. Furthermore, Dr. Wilson noted that at the time of his testimony, NorthWestern had not yet determined whether it could recover any replacement power costs from Siemens. *Id.* at 12. In light of the Root Cause Analysis identifying Siemens' maintenance activities as a component of the most likely cause of the outage, Dr. Wilson testified that NorthWestern should have evaluated whether it could recover replacement power costs from Siemens before attempting to recover such costs from ratepayers. *Id.* at 13, 17.

The Commission held a hearing on October 6-7, 2015. NorthWestern filed its opening post-hearing brief on November 24, 2015. Intervenors Montana Environmental Information Center and Sierra Club (collectively "MEIC") now file this response.

LEGAL STANDARDS

A. Electricity Supply Costs Are Recoverable Only if They Were Prudently Incurred and the Utility Complied With Other Statutes and Regulations.

In this tracker docket, NorthWestern Energy seeks to recover replacement power costs incurred during the Colstrip Unit 4 outage under a provision that authorizes recovery of "prudently incurred electricity supply costs subject to the provisions of 69-8-419, 69-8-420, and [C]ommission rules." MCA § 69-8-210(1). NorthWestern distorts Montana law by suggesting that whether electricity supply costs were "prudently incurred" rests primarily on the amount and price of the electricity procured. *See* NorthWestern Br. at 16-17, 23. NorthWestern's attempt to inappropriately narrow the Commission's inquiry has no basis in the law. First, NorthWestern repeatedly claims that if the requirements of MCA § 69-8-210(1) are met, the Commission must

provide for recovery of NorthWestern's electricity supply costs. *E.g.*, NWE Br. at 13. However, the statute expressly makes recovery of electricity supply costs contingent on the company's prudence and "subject to the provisions of 69-8-419, 69-8-420, and [C]ommission rules." MCA § 69-8-210(1). NorthWestern, then, can recover its electricity supply costs only if the Commission finds both that the company acted prudently and that it took appropriate steps to "provide adequate and reliable electricity supply service at the lowest long-term total cost" and to "identify and cost-effectively manage and mitigate risks related to its obligation to provide electricity supply service[.]" MCA § 69-8-419(2)(a), (c). Furthermore, the Commission may "disallow rate recovery for the costs that result from the failure of a public utility to reasonably manage, dispatch, operate, maintain, or administer electricity supply resources in a manner consistent with" these objectives. *Id.* § 69-8-421(9). Thus, electricity supply costs are recoverable only if the costs were "prudently incurred" and only if the requirements of "69-8-419, 69-8-420, and [C]ommission rules" are satisfied.

Second, NorthWestern's interpretation of the statute must be rejected because it would lead to absurd results. NorthWestern suggests that electricity supply costs can be "prudently incurred" without examining the utility's actions that led to the need for the electricity supplies in the first place. NorthWestern's argument would mean that electricity supply costs could be "prudently incurred" even if the utility's imprudence caused the need for the replacement power. For example, according to NorthWestern, if, hypothetically, its employees committed gross negligence that caused Colstrip Unit 4 to go offline, replacement power costs would be "prudently incurred" so long as NorthWestern purchased the appropriate amount of replacement power at a reasonable price. This self-serving argument leads to absurd results, and cannot be what the Montana legislature intended in enacting MCA § 69-8-210(1).

Accordingly, in determining whether NorthWestern is entitled to recover its electricity supply costs, the Commission evaluates whether NorthWestern's actions were prudent and whether NorthWestern complied with its statutory and regulatory electric supply obligations, MCA § 69-8-210(1), based on the "information and circumstances that were known or should have been known at the time by NWE's management," *In Re Nw. Energy*, Dkt. No. D2002.11.140, Order 6468C ¶ 44 (July 3, 2003). When approving the addition of Colstrip Unit 4 to the rate base, the Commission instructed NorthWestern that it would "conduct rigorous examinations in annual supply trackers of the prudence of NWE's expenses related to [Colstrip Unit 4]." Dkt. D2008.6.69, Order 6925f, ¶ 227 (Nov. 13, 2008).

B. The Applicant Bears the Burden of Proof in an Electricity Supply Tracker Docket.

As this Commission has observed, "NorthWestern bears the burden of showing that its electricity supply costs were prudently incurred." *In the Matter of Nw. Energy's 2011-2012 Elec. Supply Tracker*, Dkt. No. D2012.5.49, Order 7219H ¶ 102 (Oct. 22, 2013) ("A utility filing for an increase in rates and charges shall be prepared to … sustain the burden of proof of establishing that its proposed charges are just and reasonable." (citing ARM 38.5.182)); ARM 38.5.8213 (requiring modeling and analysis to meet the "burden of proof in prudence and cost recovery filings"); ARM 38.5.8220 (discussing how a utility may "satisfy its burden of proof."). "Nothing limits the Commission's ability to inquire into the manner in which NorthWestern has 'managed, dispatched, operated, or maintained any resource… as part of its overall resource portfolio.'" Dkt. D2012.5.49, Order 7219H ¶ 104 (quoting MCA § 69-8-421(9)).

Further, this proceeding is governed by the Montana Administrative Procedure Act, under which the parties are "bound by common law and statutory rules of evidence." MCA § 2-4-612(2). Therefore, each party in this proceeding "has the burden of persuasion as to each fact

the existence or nonexistence of which is essential to the claim for relief or defense the party is asserting." *In the Matter of Nw. Energy's Application for Qualifying Facility Tariff Adjustment*, Dkt. No. D2014.1.5, Order 7338B ¶ 34 (Apr. 14, 2015) (quoting MCA § 26-1-402).

To the extent there is a conflict between the burden of proof in proceedings before the Montana Public Service Commission and in proceedings before other state commissions or before FERC, the Montana standards control. However, there is no such conflict here. Placing the burden of proof upon the utility which applies to raise rates is consistent with the burden of proof in FERC proceedings. *See* 16 U.S.C. § 824d (2013) ("At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the public utility.").

This Commission should not adopt NorthWestern's proffered standard under which prudence of electricity supply costs is "presumed," NWE Br. at 15, because it flies in the face of the controlling standard in proceedings before this Commission. While NorthWestern claims it need not offer any evidence to demonstrate the prudency of its actions until "*after* an opposing party has made a prima facie showing of lack of prudence," *id.* (emphasis in original), the Commission's regulations provide that "a utility's periodic electricity supply cost tracking filings should include the information, analyses, and documentation recommended in [procurement planning] guidelines to support its request for cost recovery related to electricity supply cost additions or changes." ARM 38.5.8226(2). NorthWestern's suggestion that it can omit such evidence from its initial filings conflicts with this governing requirement.

As support for its position, NorthWestern relies primarily on *West Ohio Gas Company v. Pub. Util. Comm'n*, 294 U.S. 63, 72 (1935) and *Potomac Elec. Power Co. v. Pub. Serv. Comm'n*, 661 A.2d 131, 140 (D.C. Ct. App. 1995). Neither case supports NorthWestern's argument. The

District of Columbia Court of Appeals in *Potomac Electric* noted that it was an open question whether the presumption of "prudent outlay" discussed in *West Ohio Gas Company* applied beyond advertising or similar costs to other costs such as DSM program expenditures. *Potomac Elec. Power Co.*, 661 A.2d at 140. The *Potomac Electric* court declined to determine whether it was appropriate to extend such a presumption to the DSM costs at issue in that proceeding since the record evidence was "sufficient to overcome the *West Ohio Gas* presumption, if applied." *Id.* The *Potomac Electric* court held that

> We take this to mean that, at most, *West Ohio Gas* intended a so-called "bursting bubble" presumption that vanishes once opponents of the expenditure make a showing of improvidence. At that point, the burden of persuasion, not merely of producing rebuttal evidence, falls squarely on the utility to show that the costs for which it seeks recovery are reasonable.

Id. Accordingly, NorthWestern's proffered authority does not direct this Commission to apply any presumption as to the prudency of its electricity supply costs in a tracker proceeding where, as here, parties have raised a "serious doubt as to the prudence of an expenditure." *Id.* (quoting *Anaheim, Riverside v. FERC*, 669 F.2d 799, 809 (D.C. Cir. 1981)).

ARGUMENT

The replacement power costs incurred during the Colstrip Unit 4 outage were not prudently incurred and NorthWestern did not identify and mitigate the risk of incurring replacement power costs, for two reasons. First, NorthWestern failed to investigate outage insurance for Colstrip Unit 4 prior to the 2013-2014 outage. Second, prior to filing its application, NorthWestern failed to evaluate whether it could recover its replacement power costs from Siemens, the contractor who contributed to the outage, rather than from the ratepayers who did nothing to cause the outage. For each of these two reasons, the Commission should find

that NorthWestern may not recover as electricity supply costs the replacement power costs attributable to the 2013-2014 Colstrip Unit 4 outage.

In addition, NorthWestern's initial application contains no evidence regarding the amount of replacement power costs, much less any evidence that such costs were incurred prudently or in compliance with NorthWestern's duty to identify, manage, and mitigate risks. Perhaps most egregious was the fact that NorthWestern did not even mention in its application, let alone produce, the Root Cause Analysis, which contains the only evidence of the cause of the Colstrip Unit 4 outage. As a result, this proceeding was needlessly delayed and the Commission and the parties were required to commit resources to acquiring information from the company that should readily have been disclosed at the outset. The Commission should take appropriate action to enforce its rules that require NorthWestern to include essential information and analysis in its application, including by discounting NorthWestern's recovery in this proceeding.

I. NORTHWESTERN IMPRUDENTLY FAILED TO INVESTIGATE INSURANCE COVERAGE FOR REPLACEMENT POWER COSTS.

NorthWestern's failure to consider the option of obtaining outage insurance to mitigate its customers' risk of having to pay significant power costs in advance of the Colstrip Unit 4 extended outage was imprudent. As a preliminary matter, NorthWestern's brief fundamentally misrepresents the position taken by intervenors MEIC and MCC with respect to outage insurance in this proceeding. NorthWestern erroneously claims that the issue contested by intervenors is whether it was prudent for NorthWestern "not to have outage insurance for Colstrip Unit 4," NWE Br. at 18. On the contrary, intervenors have contended that NorthWestern should have *evaluated* outage insurance prior to the 2013-2014 outage. Direct Testimony of David Schlissel at 20 ("NorthWestern Energy's failure to even consider obtaining business interruption insurance was imprudent."); Direct Testimony of Dr. John Wilson at 17 ("It is at least perplexing that

NWE did not even bother to consider or evaluate the merits of outage insurance for the plant. Especially since encountering virtually the same problem with the DGGS outage, it seems that prudent management would have at least looked into this.”).[3]

In any event, NorthWestern argues that its omission was prudent for two primary reasons. First, NorthWestern claims that other regulated utilities similarly decline outage insurance. Second, NorthWestern’s argues based on its post hoc evaluation of the cost of outage insurance that such insurance would not have provided financial benefit to its customers. For the reasons that follow, both defenses fail.

A. NorthWestern’s Failure to Evaluate Outage Insurance Prior to the 2013-2014 Outage Was Imprudent.

To prudently manage a portfolio of supply resources and incur electric costs, a utility must “identify and cost-effectively manage and mitigate risks related to its obligation to provide electricity supply service.” MCA § 69-8-419. Here, effectively mitigating the risk to Colstrip’s customers required NorthWestern to, at a minimum, evaluate whether outage insurance could insulate its customers from potentially significant replacement power costs due to an extended outage of Colstrip Unit 4. NorthWestern’s failure even to consider such insurance in advance of the 2013-2014 outage was imprudent.

[3] As described below, the intervenors’ framing of this issue is consistent with the legal standards for prudence, whereas NorthWestern’s framing of the issues is legally unsupported. The intervenors ask the Commission to judge NorthWestern’s actions based on what was known, or should have been known, prior to the outage, and prior to the filing of NorthWestern’s application. By contrast, NorthWestern asks the Commission to disregard what NorthWestern did prior to the outage and prior to filing its application, and instead consider after-the-fact analyses to determine whether, in hindsight, NorthWestern’s decisions turned out to be good decisions. NorthWestern’s framing of the issues is inconsistent with the very prudence standard that NorthWestern advances, which “is used to avoid the application of hindsight in reviewing the reasonableness of a utility decision.” NWE Br. at 14.

NorthWestern claims that, "[t]he 2013 core failure at CU4 was a highly unusual occurrence," NWE Br. at 12, suggesting that as a result, it was prudent not to consider insurance for such a low-risk event. This suggestion ignores that outage insurance protects against forced outages with a broad range of causes—not just against an outage caused by the specific events that occurred here, a combination of rotor-out maintenance and inadequate interlaminar insulation. Moreover, the basic purpose of any kind of insurance is to protect against uncertain events, including events that have a low probability but may impose large costs if they do occur. Prudent homeowners consider home insurance, not because every homeowner faces a high risk that their home will be flooded or damaged in a storm, but because even though the risk is low, the consequences can be very high. And in perhaps the most relevant example, NorthWestern has endorsed a hedging strategy that resulted in significant net costs to customers based on the purported value of hedging in protecting customers from unforeseen price volatility. Trans. 69:19-70:5. Outage insurance carries the same value in mitigating risk to NorthWestern customers due to unpredictable forced outages.[4]

Moreover, the specific facts regarding Colstrip Unit 4 should have led NorthWestern to consider outage insurance prior to the 2013-2014 outage. Even if the core failure that occurred at Colstrip Unit 4 was unusual, the risk of such a failure was known or should have been known by NorthWestern. First, it was known in the industry as early as the year 2000 that the type of interlaminar insulation in use at Colstrip Unit 4—Alkophos—had problems. Trans. 189:7-17.

[4] Needless to say, NorthWestern's positions on hedging and outage insurance are hopelessly inconsistent. NorthWestern defended its hedging practices by claiming that there is value in protecting against future risks even if subsequent analyses show that the risk did not materialize, and the hedging lost money. Trans. 69:19 – 70:5. NorthWestern takes the exact opposite approach to outage insurance, discounting any value of using outage insurance to protect against future risks, and evaluating such insurance based solely on a hindsight analysis. *See* Rebuttal Testimony of Michael Barnes at 8-17; Exhibit MJB-2.

NorthWestern witness Ronald Halpern explained in his pre-filed rebuttal testimony that while Alkophos was "state-of-the-art technology" in 1985 when Unit 4 was placed into service, "[i]t was later determined that, depending on the application of the insulation, this form of insulation could vary in thickness and in spots be non-existent, and where bare, could result in possible shorting and damage to the core." Rebuttal Testimony of Ronald A. Halpern, RAH-8 to 9. Around 2000, Siemens began using a different type of insulation in place of Alkophos. Trans. 189:1-6.[5]

Mr. Halpern testified that, although Siemens had published the fact that Alkophos insulation may be inadequate, utilities likely were not aware that Alkophos no longer was state-of-the-art. Trans. 180:5-15. Here, however, NorthWestern only recently purchased its interest in Colstrip Unit 4, and around that time, represented to this Commission that the plant was "at least as good as when it was new, if not better." Dkt. D2008.6.69, NorthWestern Opposition to Mont. Consumer Counsel Mot. for Reconsideration of Order 6925f, at 3 (Dec. 2, 2008). Presumably, NorthWestern undertook some investigation before making such a claim, putting NorthWestern in the position of discovering Siemen's findings about the inadequacy of Alkophos insulation.

[5] Mr. Ward also acknowledged that the current interlaminar insulation used by Siemens has fewer bare spots (i.e., areas with no insulation coating) than the insulation on Colstrip Unit 4, called Alkaphos, Trans. 189: 22-25. Mr. Ward nonetheless claimed that the new type of insulation may not do any better job than Alkophos at preventing shorting, Trans. 190: 1-6, "[b]ecause the edge of the laminations is still a point where a contact can be made, regardless of insulation, where the slots are in the pore surfaces." Trans. 190: 8-10.

But the Root Cause Analysis specifically identified "inadequate interlaminar insulation permitting shorting between laminations," not contact on the edge of laminations which are never insulated, as the cause of the shorting. NWE Resp. to MEIC-9 – Public, at 1. Furthermore, shorting can occur because of contact at the edges with both Alkaphos and the newer form of insulation. If the risk of shorting from edge contact is equal, but the risk of shorting from contact between bare spots is lower, than the overall risk of shorting is lower for the newer form of insulation.

Second, NorthWestern knew or should have known that major, "rotor-out" overhauls carry a risk of damaging generator components. *Id.* 154:16-25. NorthWestern's witness Mr. Halpern testified as early as 2002 that rotor-out inspections can force laminations together. NWE Resp. to MEIC-89a, Attachment 2 at 12. Indeed, in 2002, Mr. Halpern specifically noted that during a rotor-out inspection, "there is a risk that the rotor will bump into the core during removal or reinstallation causing damage to the core laminations." *Id.* Even while the potential that such damage alone would cause core failure may be remote, this fact combined with Unit 4's inadequate insulation should have put NorthWestern on notice of the risk of such an outage.

Commission staff asked parties whether NorthWestern has met its burden of proof, "particularly with respect to the lack of a witness from the operator of the Colstrip facility, and the lack of an expert on interlaminar insulation." The Root Cause Analysis identified actions that Siemens took during the generator overhaul, in combination with inadequate interlaminar insulation, as the most likely cause of the outage. Given the critical importance of these two issues in this case, it is unclear why NorthWestern did not present a witness from the operator or Siemens who was present during the overhaul and has direct knowledge of what was done during the overhaul. Similarly, it is unclear why NorthWestern did not present a witness from Siemens or another company who is an expert in interlaminar insulation. However, NorthWestern could not meet its standard of proof to demonstrate it acted prudently even if it had proffered knowledgable witnesses on these issues, since the record demonstrates that NorthWestern should have been on notice of the risks posed by inadequate interlaminar insulation and rotor-out inspections.

Third, as discussed above, Colstrip Unit 4 experienced an extended outage due to equipment damage discovered during routine maintenance in 2009. *See* Trans. 229:22-230:6.

The turbine equipment that experienced problems in 2009 was part of the "turbine generator" package from Siemens when Unit 4 was first constructed. *See* NWE Updated Resp. to MEIC-44a, Attachment at 5 (referencing "turbine generator"). Although NorthWestern attempts to dismiss the 2009 turbine damage as irrelevant to the generator damage that caused the 2013 outage, NorthWestern's insurance underwriter identified the events associated with the 2009 outage as a "pretty significant part of [NorthWestern's] rating in regards to premium." NWE Resp. to MEIC-72c, Attachment at 2304714. In other words, an insurance company whose business it is to evaluate risk determined that the 2009 Colstrip Unit 4 outage indicated greater risk of future outages. Indeed, it is logical that damage to equipment that is the same age as the generator, with a common manufacturer, and a similar operation and maintenance history would give rise to questions about the risk of future damage to the generator itself. And while NorthWestern seeks to divorce the two events, the fact remains that Colstrip Unit 4—for whatever reason—has been available for electricity generation 12.5% *less* than Colstrip Unit 3. *See* NWE Resp. to MEIC-75(d).

Fourth, even if NorthWestern could not foresee the specific nature of the 2013-2014 outage in advance, it was aware of the risk to its customers if such an outage were to occur. Specifically, NorthWestern's position that it is precluded by its contract with PPL Montana and by PPL Montana's contract with Siemens from recovering replacement power costs from either of those parties meant that, if an extended outage did occur, it would be more likely that

customers would have to shoulder the full burden of replacement power costs.[6] In effect, NorthWestern shifted the risk of major outages away from the parties most able to prevent them, and onto ratepayers who are least able to prevent them.

All of these circumstances should have given NorthWestern "situational awareness" that would lead it to at least inquire about outage insurance in order to protect their ratepayers from a low risk, high consequence outage. *See In re NorthWestern Energy's 2011-2012 Electricity Supply Tracker*, Dkt. No. D2012.5.49, ¶ 35 (Oct. 22, 2013) (discussed *infra*). The circumstances around NorthWestern's purported inability to seek consequential damages from Siemens combined with Colstrip Unit 4's poor operating history make the outage at issue in this docket analogous to the 2012 outage at NorthWestern's Dave Gates Generating Station ("DGGS"). In evaluating NorthWestern's request for customer reimbursement for a 3-month outage at DGGS, this Commission found that the plant presented a special risk of forced outage due to its one-of-a-kind design and operation and the waiver of consequential damages in NorthWestern's purchase warranty for the plant. *See id.*, ¶¶ 24, 32-33, 35. In light of these circumstances, the Commission concluded that "NorthWestern's failure to evaluate the availability, price and terms of outage insurance prior to commencement of DGGS' commercial operation in January 2011 was imprudent." *Id.* ¶ 33.

Here, NorthWestern has not testified that outage insurance was unavailable. To the contrary, NorthWestern successfully obtained quotes for such insurance, albeit after the fact.

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[6] This is because NorthWestern's contract with the plant operator shields the operator from any liability for consequential damages, even if the operator acted negligently. Exhibit JHG-2 at p. 3. Similarly, the operator's maintenance contract with Siemens waived Siemens' liability to PPL (now Talen) for consequential damages, including replacement power costs. Exhibit JHG-1 at p. 7. As discussed below, MEIC disputes that the PPL-Siemens contract eliminates NorthWestern's ability to recover against Siemens under a tort theory of liability. However, NorthWestern's extreme interpretation of the effect of those contracts should have made it even more concerned about identifying and mitigating the risk to ratepayers of an extended outage.

Rebuttal Testimony of Michael J. Barnes, Exhibit MJB-1. NorthWestern's witness Mr. Lyon testified that NorthWestern could obtain outage insurance on its own, even if other owners of Colstrip Unit 4 do not. Trans. 123:20 – 124: 3.

Further, the testimony shows that other electric generating facilities do obtain outage insurance, including, as NorthWestern's witness Fred Lyon observed, independent power producers ("IPPs") that do not have the safety net of customer reimbursement for outage costs. Rebuttal Testimony of Fred Lyon, FL-14 to 15; *see* Trans 103-04. NorthWestern's customers deserve no less protection than IPP shareholders who bear the risk of significant outage costs.[7] NorthWestern's failure even to evaluate whether outage insurance was appropriate to mitigate those risks was imprudent.

B. NorthWestern's Claim That Outage Insurance is Generally Known Not to Be Cost Effective is Contradicted by its Own Witness's Testimony.

NorthWestern attempts to defend its failure even to consider, let alone analyze, outage insurance for Colstrip Unit 4 by stating that "NorthWestern knew that outage insurance was not cost-effective." NWE Br. at 19; *see also id.* at 12-13. NorthWestern relies primarily on the

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[7] This Commission's prudence reviews must provide the requisite incentive for the utilities it regulates to operate efficiently, in a manner protective of their customers' interests:

> Undoubtedly, employees and management at NorthWestern feel an ethical and professional commitment to efficiency, but there can be equally little doubt that there are almost no *financial* incentives that prod them toward that efficiency. There is only the distant prospect of a disallowance and, perhaps even more fanciful, an administrative rule that allows the Commission to reward the utility for "superior electricity supply service." Admin. R. Mont. 38.5.8227 (No such award has ever been given.). In this sense, NorthWestern is unlike any ordinary business when it comes to the electricity supply costs that are here at issue: It does not profit when it outperforms, it does not suffer when it underperforms.

In the Matter of Nw. Energy's 2011-2012 Elec. Supply Tracker, Dkt. No. D2012.5.49, Order No. 7219H, at 33 (Oct. 22, 2013) (Comm'r Kavulla, concurring)

testimony of Fred Lyon, who claimed that utilities "typically" do not obtain outage insurance "for fossil fuel plants." Rebuttal Testimony of Fred Lyon, at 14. The notion that outage insurance is not cost-effective for fossil fuel plants is contradicted by Mr. Lyon's own testimony and in any event is unsubstantiated.

Mr. Lyon contradicted his own claim by noting that "[i]ndependent power producers ("IPPs") are more likely to purchase [outage] insurance" than regulated utilities. *Id*. The reason for this difference is obvious: when regulated utilities believe that their money is not on the line, they are happy to have captive ratepayers function as their form of outage insurance, confident in the belief that regulatory commissions will force ratepayers to pay for any replacement power costs.

Mr. Lyon's subsequent attempts to support the claim that it would never be cost-effective for a regulated fossil fuel unit to obtain the outage insurance that is obtained for unregulated fossil fuel units, *see id.* at 14-15, are unconvincing. First, Mr. Lyon claimed that outage insurance might make sense for IPPs because they are more thinly capitalized than regulated utilities and because lenders may insist on such insurance. *Id.* But he ignores that regulated utilities are generally better capitalized because they are required to be and have a stable sources of funding from captive ratepayers. In the context of IPPs, lenders insist on outage insurance because there are no captive ratepayers to foot the bill. *See* Trans. 102-04. Far from showing that regulated utilities should not consider outage insurance, Mr. Lyon has merely shown that regulated utilities often do not seek outage insurance because they treat captive ratepayers themselves as the unwilling providers of outage insurance. When power companies do not have captive ratepayers and instead their own money is at stake if a unit goes offline, independent power producers apparently conclude that outage insurance can be cost-effective.

Second, Mr. Lyon suggested that independent power producers obtain outage insurance because they have less experience than utilities in operating power plants. Trans. 133:4-9, 134: 15-19. But NorthWestern does not operate Colstrip Unit 4; "PPL Montana, Inc., now Talen . . . is the operator of [] the Colstrip Project." NWE Br. at 9. If Mr. Lyon is suggesting that power companies that lack sufficient knowledge to operate a plant they own should obtain outage insurance, then NorthWestern should have obtained outage insurance. Moreover, Mr. Lyon admitted on cross-examination that this purported difference between IPPs and regulated utilities does not exist here, because the IPP is the operator of the plant and therefore has more experience with plant operations than the regulated utility, NorthWestern, which has less experience since it does not operate Colstrip Unit 4. *See* Trans. 134:20-135:4.

Finally, in response to MEIC's request that Mr. Lyon substantiate his claim that fossil-fuel plants do not obtain outage insurance, he conceded that he possesses no documents or evidence. Instead, his opinion was based on his participation "in numerous negotiations where this insurance was *occasionally* discussed, *general discussion* with project and risk managers about insurance options, and industry contacts with whom insurance options were *sometimes* discussed." NWE Resp. to MEIC-88(a) (emphasis added). In short, Mr. Lyon did little more than provide hearsay testimony that explains what other people have "occasionally" said about outage insurance.

For the company's part, NorthWestern employee Michael Barnes testified that "it's a long-held belief by me and a lot of my colleagues is, if you hold this over the long term, it doesn't ever pay because the premiums overwhelm any recovery that you'd otherwise get." Trans. 254. When millions of dollars of ratepayer money are at stake, a prudent utility does not make decisions based purely on a "belief." Instead, a prudent utility should make decisions

based on data and analyses. Under the Commission's regulations, this Commission should find that "occasional[]" discussions and NorthWestern's general "belief" do not satisfy the requirement to support its request for cost recovery with "information, analyses, and documentation." ARM 38.5.8226(2).

In sum, it was not prudent for NorthWestern to fail to consider the outage insurance that independent power producers find can be cost-effective.

C. NorthWestern's *Post-Hoc* Evaluation of the Costs and Financial Benefits of Outage Insurance Demonstrates That Outage Insurance Would Have Been Cost-Effective.

In defending its failure to consider outage insurance based on a post-hoc cost-benefit analysis, NorthWestern improperly tries to have its cake and eat it too. NorthWestern emphasizes that prudence is to be judged based on "what the utility knew at the time it had to act." NWE Br. at 14. NorthWestern concedes that at the time it had to act—i.e., before the 2013-2014 outage—it had not analyzed outage insurance for Colstrip Unit 4. NWE Resp. to MEIC-39(b); *see also* Rebuttal Testimony of Michael Barnes at 11 (outage insurance quotes were obtained in September 2014 and March 2015); NWE Resp. to MEIC-74 (Mr. Barnes first analyzed outage insurance using the quotes in September 2014). Yet NorthWestern claims that an analysis produced *after* the outage occurred can somehow be evidence of the prudence of actions it took *before* the outage. The Commission should reject this premise.

NorthWestern's reliance on its 2015 analysis of outage insurance violates its own argument that a "prudence determination is not to be made with the benefit of hindsight." NWE Br. at 14. But that is exactly what NorthWestern is asking the Commission to do: use hindsight to bless NorthWestern's decision in 2013 and prior years not to consider outage insurance. This

type of hindsight analysis is exactly what NorthWestern, the Commission, and the courts have said should not be done in a prudence analysis.

For the same reason, NorthWestern's observation that neither Mr. Schlissel nor Dr. Wilson had examined the "cost effectiveness of outage insurance" for Colstrip Unit 4 is irrelevant. *See* NWE Br. at 18. Both Mr. Schlissel and Dr. Wilson testified that NorthWestern was imprudent for not having analyzed outage insurance prior to the 2013-2014. Direct Testimony of David Schlissel at 20; Direct Testimony of Dr. John Wilson at 17. No after-the-fact analysis that Mr. Schlissel or Dr. Wilson could have done would have changed the fact that NorthWestern failed to do an analysis during the only time period that matters for this proceeding: prior to the July 2013 outage.

Even if the Commission were to consider NorthWestern's *post-hoc* analysis of outage insurance, that analysis demonstrates that ratepayers would have benefitted from outage insurance. NorthWestern's analysis inappropriately uses the years before Colstrip Unit 4 was placed into rate base. NorthWestern provided no rationale whatsoever in its testimony for why its analysis used the years 2002 to 2014. *See* Rebuttal Testimony of Michael J. Barnes, Exhibit MJB-2 at 1. The pertinent issue is whether NorthWestern should have considered outage insurance in order to protect ratepayers against the kind of costs that NorthWestern seeks to recover in this proceeding. Colstrip Unit 4 was not in rate base, and thus not subject to this Commission's oversight, until 2009. Therefore, the years before 2009 are irrelevant to this proceeding. When the proper time frame of 2009-2014 is used, Exhibit MJB-2 shows

unequivocally that outage insurance would have saved ratepayers $2,792,129.78. *See* Exhibit MJB-2 at 1.[8]

In short, NorthWestern's analysis shows the exact opposite of what NorthWestern claims. The analysis confirms that outage insurance would have been cost-effective, saving ratepayers approximately $2.8 million between 2009-2014. In addition, a consideration of NorthWestern's outage insurance and hedging practices in combination show that NorthWestern has dramatically misjudged risk: NorthWestern lost tens of millions of dollars by hedging against risks that never materialized; and NorthWestern lost millions of dollars by failing to identify and mitigate the risks of forced outages and replacement power costs that actually did materialize. To the extent that NorthWestern wishes its actions to be judged based on hindsight, hindsight shows that NorthWestern has come nowhere close to meeting the statutory requirement to "identify and cost-effectively manage and mitigate risks." MCA § 69-8-419(2)(a), (c).

II. NORTHWESTERN IMPRUDENTLY FAILED TO INVESTIGATE POTENTIAL CAUSES OF ACTION AGAINST SIEMENS TO RECOVER REPLACEMENT POWER COSTS.

NorthWestern's imprudence extends to its failure to evaluate whether any party other than ratepayers—and in particular Siemens—should be responsible for paying replacement power costs incurred because of the extended outage Siemens itself caused. NorthWestern acknowledges that in a prudence review, "the [Commission] must look to what [NorthWestern] knew or should reasonably have known at the time." NWE Br. at 14 (brackets in the original). NorthWestern provided no evidence that, at or before the time that NorthWestern filed its application seeking to recover replacement power costs from ratepayers, NorthWestern had

[8] From 2009-2014, NorthWestern would have paid $7,219,777.06 in insurance premiums, but received $10,011,906.84 in insurance payouts, for a net savings of $2,792,129.78. *See* Exhibit MJB-2 at 1.

conducted any investigation into whether it could recover replacement power costs from Siemens.

NorthWestern creates a straw man in claiming that Intervenors argue that it was imprudent for the company "not to sue Siemens for the cost of replacement power." NWE Br. at 17. Instead, recognizing that NorthWestern is the only party with the information necessary to properly evaluate such litigation, intervenors have argued that NorthWestern should have considered whether it could recover replacement power costs from Siemens or PPL (now Talen) before seeking to recover such costs from ratepayers. Direct Testimony of David Schlissel at 16 (NorthWestern should not have filed its application before "concluding an evaluation of whether an action against Siemens is warranted."); Direct Testimony of Dr. John Wilson at 13 ("Yes; it would have been prudent for Northwestern to have first made that determination [of whether it could recover replacement power costs from Siemens prior to seeking to recover such costs from ratepayers].").

The only evidence NorthWestern submitted on this issue consisted of an analysis conducted for purposes of this proceeding *after* NorthWestern had already filed its application, which was incomplete with respect to potential negligence claims against Siemens. *See* Rebuttal Testimony of James H. Goetz; *see also* NorthWestern Responses to MCC 57, 118 (as of November 2014 and March 2015, NorthWestern had not determined whether it could recover replacement power costs from third parties); Trans. 212:3-8 (Mr. Barnes did not know whether NorthWestern had examined potential causes of action prior to filing its application). NorthWestern's failure to evaluate, prior to filing this application, recovery of costs from third parties was imprudent, given that the outage was triggerd immediately after Siemens had performed maintenance on the generator that failed, and given that the Root Cause Analysis

identified Siemens' maintenance activities as one component of the most likely cause of the outage.

Under these circumstances, a prudent utility would conduct an analysis to determine whether there was a cause of action against the contractor who had been identified as causing a seven-month outage that cost millions of dollars. *See* Direct Testimony of David Schlissel at 18-20; Direct Testimony of Dr. John Wilson at 13, 17. Yet there is no evidence in the record that NorthWestern made such an inquiry prior to filing its application.

NorthWestern's *post hoc* legal analysis does not remedy this failure. NorthWestern hired Mr. James Goetz to evaluate potential causes of action against Siemens. Based on the equipment supply and maintenance contract between PPL Montana and Siemens, Mr. Goetz testified that even a "cursory" analysis would result in the conclusion that NorthWestern had no viable cause of action against Siemens. Rebuttal Testimony of James Goetz, at 8.

However, Mr. Goetz should have performed more than a cursory analysis. Article 81 of the contract provides that "neither party nor its suppliers will under any circumstances be liable under any theory of recovery, whether based in contract, in tort (including negligence and strict liability), under warranty, or otherwise for: any indirect, special, incidental or consequential loss or damage whatsoever." *Id.*, JHG-1, at 7. MEIC agrees that this language precludes any cause of action by *PPL Montana* against Siemens, and that because NorthWestern is not a party to the contract, NorthWestern lacks any cause of action *under the contract*. However, the contract in no way precluded NorthWestern from pursuing a cause of action against Siemens in tort, either for strict liability or negligence. *See* Trans. 306:6-13 (Mr. Goetz acknowledging that only PPL

and Siemens are bound by Article 81 of the contract). Mr. Goetz apparently did not analyze such a cause of action and neither did NorthWestern before seeking recovery from its ratepayers.[9]

In any event, the results of a hindsight analysis are not determinative in a prudence review. NorthWestern acted imprudently by failing to evaluate potential cost recovery from third parties before filing its application. The Commission should find that, under the particular circumstances here, where Siemens was identified as one of the two causes of the outage and there were no contractual limits on NorthWestern's ability to sue Siemens in tort, NorthWestern should have at least evaluated whether it could recover replacement power costs from the company who caused the outage, Siemens, prior to seeking to recover those costs from ratepayers.

Moreover, NorthWestern could have approached Siemens to determine whether the parties could negotiate an agreement, without filing litigation, in which Siemens compensated NorthWestern for at least some of the replacement power costs. *See* Trans. 313:8- 314:6. Mr. Goetz testified that such negotiated resolutions, reached without litigation, "sometimes that does happen, quite often, I think." Trans. 314: 4-5. Based on the evidence in the record, NorthWestern never made so much as a phone call to Siemens to negotiate some reimbursement for replacement power costs. Similarly, based on the record, NorthWestern did not request a single meeting with Siemens to discuss the matter. NorthWestern was the customer who paid Siemens significant amounts of money to perform maintenance, which wound up causing the outage. Yet, even after receiving a Root Cause Analysis that explicitly identified Siemens' actions as one component of the most likely cause of the outage, NorthWestern did not even

[9] Mr. Goetz also failed to evaluate potential causes of action against Siemens for direct damages, such as recovery of NorthWestern's portion of the property insurance deductible. *See* Trans. 300:22 – 301:15, 304:1-5.

attempt to negotiate a resolution whereby Siemens would pay for any of the costs that it caused NorthWestern to incur.

Finally, Commission staff requested briefing regarding the Commission's authority to pass on any judgment proceeds related to the outage to ratepayers. MCA § 69-8-210 authorizes this approach by providing that "[t]he commission may include other utility costs and expenses in the cost recovery mechanism if it determines that including additional costs and expenses is reasonable and in the public interest" and, more generically, by providing for "rate adjustments for cost differences resulting from cost changes." MCA § 69-8-210. Here, crediting judgment proceeds to rate payers would account for "cost differences resulting from cost changes." However, MEIC believes the better approach in circumstances in which a utility properly evaluates third-party recovery would be to stay the portion of the tracker docket related to the potential recovery until the utility has determined whether or not to pursue such recovery.

In any event, the Commission need not grapple in this proceeding with the accounting vehicle to accommodate such circumstances. Because NorthWestern failed to evaluate third-party recovery before seeking ratepayer reimbursement for its Colstrip Unit 4 outage costs—and then submitted testimony and argument in this proceeding about Siemens' conduct which likely precludes it from taking any different position in potential litigation—the Commission should find that NorthWestern's actions were imprudent and deny recovery.

III. NORTHWESTERN'S INITIAL TRACKER FILING FALLS SHORT OF REGULATORY STANDARDS.

As discussed in the Legal Standards section, "NorthWestern bears the burden of showing that its electricity supply costs were prudently incurred." *In the Matter of Nw. Energy's 2011-2012 Elec. Supply Tracker*, Dkt. D2012.5.49, Order 7219H ¶ 102 (Oct. 22, 2013). In addition, the statute expressly makes recovery of electricity supply costs "subject to the provisions of 69-

8-419, 69-8-420, and [C]ommission rules." MCA § 69-8-210(1). NorthWestern, then, can recover its electricity supply costs only if the company took appropriate steps to "provide adequate and reliable electricity supply service at the lowest long-term total cost" and to "identify and cost-effectively manage and mitigate risks related to its obligation to provide electricity supply service[.]" MCA § 69-8-419(2)(a), (c).

NorthWestern seeks reimbursement for significant replacement power costs due to the extended CU4 outage, but made only a passing mention of the outage in its application, did not estimate the replacement power costs, and failed even to disclose the cause of the outage. NorthWestern's entire 271-page 2014 tracker filing included a mere two pages discussing the Colstrip Unit 4 outage. *See* Direct Testimony of Kevin J. Markovich, at KJM-9 to KJM-11. Regarding the cause of the outage, although a Root Cause Analysis already had been performed, NorthWestern stated only that, "[o]n July 1, 2013, CU4 tripped off line on generator protection relaying. The relay action indicated a stator ground fault in the generator." *Id.* at KJM-9:9-10. And rather than identifying the cost of the outage, NorthWestern claimed that doing so "would require NorthWestern to make scores of assumptions and interpretations regarding what might have happened absent the outage that, in the end, may or may not be valid or even yield meaningful results." *Id.* at KJM-10:20-23.

NorthWestern's paltry initial filing appears to be a trend. In the 2008 docket approving Colstrip Unit 4's inclusion in the rate base, the Commission observed:

> [R]egarding compliance with the minimum filing requirements (ARM 38.5.8228), NWE's Application as filed did not include the full complement of supporting work papers and documentation that are required under this rule. Intervenors and the PSC were able to obtain the required information through discovery propounded on NWE, but they should not have had to resort to that option. While the PSC did not reject the Application for incompleteness or otherwise take action to require NWE to bring the filing into

> compliance, the PSC advises NWE to comply in full with the minimum filing requirements in future applications.

Dkt. No. D2008.6.69, Order 6925f, ¶ 256.

NorthWestern's approach demands heavy reliance on Commission and intervenor fact-finding through data requests and other means, creating a significant burden to meaningful public participation in the proceedings and leading to costly and inefficient docket management. For example, as a result of NorthWestern Energy's failure to supply, or even to mention, the November 18, 2013 Root Cause Analysis with its initial tracker filing, MEIC served a data request (MEIC-9) requesting documents regarding the cause of the Colstrip Unit 4 outage September 29, 2014. No documentation having been produced two months later, MEIC was forced to request a stay of the procedural order and file a motion to compel production, citing a Commission rule that "encourages providers to make requests for protection of confidential information at the earliest possible time in a proceeding, including in anticipation of a proceeding if the provider knows that claimed confidential information will be submitted in the proceeding." ARM 38.2.5007(9). Finally, Siemens intervened in this proceeding for the limited purpose of seeking a protective order and the Root Cause Analysis was produced on February 18, 2015.

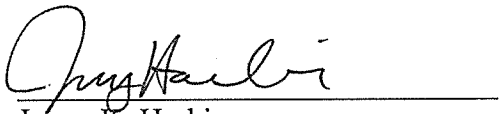
NorthWestern certainly was aware that information regarding the cause of the Colstrip Unit 4 outage and the company's actions to repair the Unit was essential to the Commission's investigation of the prudency of costs incurred as a result of the outage. Thus, NorthWestern should have made efforts to protect any such information that either it or Siemens considers confidential at the outset of this proceeding and to disclose the information with its initial filing or very shortly thereafter. NorthWestern's failure to do so unnecessarily delayed this proceeding.

NorthWestern's approach to its application reflects its cavalier belief that it need only defend the prudence of its actions in response to an intervenor's allegation of imprudence. NorthWestern failed to heed the Commission's prior admonishment in 2008 "to comply in full with the minimum filing requirements in future applications." Dkt. No. D2008.6.69, Order 6925f, ¶ 256. To incent NorthWestern to comply with its legal obligations to include sufficient information and analysis in its obligations to enable the Commission and the parties to meaningfully evaluate the application, MEIC respectfully requests that the Commission discount NorthWestern's recovery in this proceeding or assess a monetary penalty, in an amount determined by the Commission.

CONCLUSION

For the foregoing reasons, the Commission should find that the replacement power costs attributable to the 2013-2014 Colstrip Unit 4 outage were not prudently incurred, and that NorthWestern did not identify and cost-effectively manage the risk of an outage and associated replacement power costs. The Commission should deny NorthWestern's request to recover the $8,243,475[10] in replacement power costs. The Commission should also order NorthWestern to refund to ratepayers any amount of replacement power costs that ratepayers have already paid as a result of the interim rate order.

Respectfully submitted on this 18th day of December, 2015,



Jenny K. Harbine
Earthjustice

[10] This amount represents NorthWestern's "most accurate estimate of what replacement power costs are." NWE Resp. to MEIC-5; see also NWE Resp. to MEIC-5, Attachment 3.

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On behalf of Intervenors Montana Environmental Information Center and Sierra Club

CERTIFICATE OF SERVICE

I hereby certify that on this 18th day of December, 2015, I served the foregoing "Montana Environmental Information Center's and Sierra Club's Response Brief" by first-class mail, postage prepaid, to the following:

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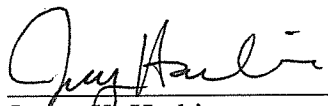

Jenny K. Harbine