

Service Date: May 31, 1996

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

* * * * *

IN THE MATTER of the Application) UTILITY DIVISION
of the MONTANA POWER COMPANY for) DOCKET NO. D95.9.128
Authority to Increase Rates for) ORDER NO. 5865d
Electric and Gas Service.) (REVENUE REQUIREMENT)

* * * * *

FINAL ORDER

TABLE OF CONTENTS

APPEARANCES i
FINDINGS OF FACT 1
BACKGROUND 1
MPC/MCC/LCG Stipulation 6
 Stipulated Electric Rates 7
 Stipulated Natural Gas Rates 9
Accounting Order for ADITC 10
Accounting Order for Kerr Dam Mitigation Costs 11
Blackfeet Loop 13
 MPC's Position 13
 Paladin Associates' Position 14
 Westcoast Gas Services (America), Inc.'s Position 14
 MPC Rebuttal 15
 Additional Westcoast Rebuttal 15
 Additional MPC Rebuttal 15
Commission Decision - MPC/MCC/LCG Stipulation 16

Commission Decision - Low Income Issues Stipulation16
Commission Decision - Blackfeet Loop17
CONCLUSIONS OF LAW19
ORDER19

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BEFORE:

Nancy McCaffree, Chair

Dave Fisher, Vice Chair

Bob Anderson, Commissioner

Danny Oberg, Commissioner

Bob Rowe, Commissioner

FINDINGS OF FACT

BACKGROUND

1. On September 21, 1995, the Montana Public Service Commission (Commission) received an application from the Montana Power Company (MPC or Company) for authority to increase electric and natural gas rates. MPC requested approval to raise electric rates to recover an additional \$34,916,235 in annual electric revenues, for a uniform percentage increase of 9.89 percent in base rates for all Montana jurisdictional electric customers. MPC requested an increase in natural gas revenues of \$12,006,821, as a uniform percentage increase of 10.45 percent for natural gas customers. MPC did not submit allocated cost-of-service studies nor proposed adjustments to its electric and natural gas rate structures in its application.

2. Concurrent with its general rate increase application, MPC requested an interim increase in electric rates of \$11,062,267 and an interim increase in natural gas rates of \$4,419,833.

3. On September 18, 1995, the Commission issued Protective Order No. 5865.

4. On September 25, 1995, the Commission issued a Notice of Application and Intervention Deadline and Procedural Order No. 5865a. The Commission established procedural requirements and a procedural schedule setting April 9, 1996, as the opening day of the hearing.

5. On October 24, 1995, the Commission issued a Notice of Staff Action that the Staff, pursuant to delegation, granted intervention in this Docket to the following parties filing before the intervention deadline:

Montana Consumer Counsel (MCC)

Large Customer Group (LCG)
Colstrip Energy Limited Partnership (CELP)
IHSB of Department of Public Health & Human Services
(HHS)
Department of Environmental Quality (DEQ)
Department of Administration (DOA)
Paladin Associates
Conoco, Inc.
Bonneville Power Administration (BPA)
Great Falls Gas Company (GFG)
Ferdig Oil Company, Inc.

6. On October 24, 1995, the Commission issued a Notice of Commission Action which granted late intervention in this Docket to Northern Montana Oil and Gas Association (MOGA) and District XI Human Resource Council (HRC).

7. On November 27, 1995, the Commission issued a Notice of Commission Action which granted late intervention in this Docket to Western Gas Resources, Inc.

8. On December 18, 1995, the Commission issued a Notice of Commission Action which granted late intervention in this Docket to MHA Ventures, Inc. and Westcoast Gas Services (America), Inc. (Westcoast).

9. On January 23, 1996, Montana Consumer Counsel filed its response testimony in this Docket recommending a decrease in total current electric utility revenues of \$3,693,858 and an increase in current natural gas utility revenues of \$3,614,485.

10. Westcoast, Paladin Associates, Ferdig Oil Company, DEQ, DOA and other intervenors raised a number of issues related to the allocated cost of natural gas service. At its duly scheduled work session on February 14, 1996, the Commission directed Staff to immediately open an Allocated Cost of Service/Rate Design Docket for transfer of all allocated cost of service issues raised in this Docket to a consolidated case which would include the 1995 natural gas revenue requirement. The Commission opened

Docket No. D96.2.22 and on February 20, 1996, issued Order No. 5898, Order Initiating Proceeding, directing MPC to file its comprehensive case on or before July 1, 1996. The Intervenor on the natural gas issues which were removed from Docket No. D95.9.128, as well as all parties in gas tracker Docket Nos. 94.11.50 and D95.12.166, were transferred with party status to Docket No. D96.2.22, along with related testimony, discovery and pending motions. Intervenor with issues remaining in Docket No D95.9.128 could still participate in this Docket.

11. On February 14, 1996, the Commission approved Interim Order No. 5865b which authorized MPC an interim increase in annual Montana jurisdictional electric revenues of \$5,812,594 and natural gas revenues of \$3,051,953. The order was approved by a vote of 3-2. Commissioners McCaffree and Rowe voted no. Commissioner Rowe attached a written dissent.

12. On February 14, 1996, the Commission approved Interim Order No. 5865c which authorized MPC an interim decrease in annual Montana jurisdictional electric revenues of \$1,524,387. The order was approved by a vote of 5-0. The decrease in Order No. 5865c reflected an adjustment for two accruals related to a change in the Electric Industrial Retention Interruptible Rate (EIRI-2) paid by Rhone-Poulenc Chemical Company (RP Chem) and a change in the PSC tax rate.

13. The EIRI-2 rate is the retention rate available to RP Chem until June 30, 1996. Pursuant to Docket No. 93.7.29, Order No. 5735b, MPC accrued the difference between RP Chem's industrial retention (discount) rate and the nondiscounted rate from October 13, 1993, (the date of interim approval of EIRI-2) to June 30, 1994, (Docket No. 93.7.29, Final Order

No. 5735c). From July 1, 1994, to June 30, 1995, MPC increased rates to its other customers by .4279 percent to recover the accrued differential.

RP Chem's rates increased on July 1, 1995, pursuant to the EIRI-2 Rate Schedules, resulting in a rate decrease for MPC's other customers. In Docket No. N95.54 the Commission allowed MPC to accrue the rate revenue difference plus interest for future rate treatment. The total accrual for the period July 1, 1995, through February 29, 1996, was a decrease in the electric utility revenue requirement of \$1,567,397.

14. In Docket No. 94.8.36, the Commission allowed MPC to accrue an over-collection of the PSC tax as a result of a legislated tax rate decrease effective October 1, 1994. In Docket No. 94.8.30, Order No. 5800, the Commission required MPC to amortize the accrual over a five month period, beginning May 1, 1995. Prior to Interim Order No. 5865c no change to that accrual was made. The continuing amortization resulted in an under-collection of \$129,729. The PSC tax rate decreased again on October 1, 1995, which resulted in an over-collection of \$86,719. The combined effect of the amortization under-collection and the tax rate decrease over-collection produced a net electric revenue requirement increase of \$43,010. The combination of the RP Chem and PSC tax rate adjustments resulted in the net electric revenue requirement decrease of \$1,524,387 as found in Interim Order No. 5865c.

15. On March 11, 1996, MPC filed rebuttal testimony in this Docket, reducing its request to \$27,511,291 in electric revenues and \$9,157,902 in natural gas revenues. The rebuttal filing represented a uniform percentage increase of 7.8 percent in base rates for all Montana jurisdictional electric customers and an

8.27 percent increase in base rates for all Montana natural gas customers.

16. On March 13, 1996, the Commission issued and published a Notice of Public Hearing stating that the hearing would begin April 9, 1996. The Notice also stated that separate "satellite hearings" might be scheduled at a later date.

17. At a duly scheduled work session on March 20, 1996, the Commission acted on various motions and a Staff recommendation to simplify this Docket. The Commission transferred Westcoast's testimony on interstate/intrastate gas rates, the Shoshone Pipeline Acquisition and the Moulton Area Purchase of crude oil properties for natural gas storage and Ferdig Oil Company's cross-rebuttal testimony with the rest of its case to Docket No. D96.2.22. The Commission retained the Blackfeet Loop issue in Docket No. D95.9.128 as a revenue requirement issue related to the 1994 test year under the Commission's optional rules which allow for known and measurable changes within a 13 month change period. The Commission directed Staff to prepare an Accounting Order for the three gas issues transferred to Docket No. D96.2.22, to be effective from the date of the final order in Docket No. D95.9.128.

18. On March 26, 1996, the Commission issued an Amended Notice of Public Hearing which changed the hearing date to April 16, 1996. All other information remained the same.

19. On April 11, 1996, the Commission issued a Notice of Commission Action and Change of Hearing Date which changed the hearing date to April 18, 1996, to enable MPC, MCC and (LCG) (Stipulating Parties) to work on a stipulation.

20. On April 17, 1996, the Commission received the stipulation of MPC, MCC and LCG, which listed agreements among the Stipulating Parties.

21. On April 18, 1996, the hearing on MPC's application in this Docket began at 9:00 a.m. with the introduction of the stipulation. John D. Haffey and Robert Gannon, policy witnesses for MPC, presented the stipulation. Counsel for the Stipulating Parties and the policy witnesses stated that the Stipulation resolved all issued in this Docket among themselves. Three issues remained contested by Intervenors who were not parties to the stipulation: the low income discount, the free weatherization issue and the Blackfeet Loop addition. Westcoast and Paladin Associates presented witnesses and conducted cross-examination on the Blackfeet Loop; HHS and HRC presented witnesses and conducted cross-examination on the low income discount and the free weatherization issues.

22. On May 1, 1996, the Commission issued a Notice of Public Satellite Hearing and on May 9, 1996, held a satellite hearing in Missoula, Montana. One public witness appeared and testified in opposition to the rate increase and asked a number of questions, particularly about the alternative rate proposal.

23. On May 3, 1996, the Commission received a second stipulation between MPC, HRC and HHS that proposed a settlement of the low income discount and the free weatherization issues.

MPC/MCC/LCG Stipulation

24. A copy of the first stipulation among MPC, MCC and LCG is appended to this Order as Attachment A. The stipulating parties reached a negotiated settlement resolving among themselves all outstanding issues including the depreciation issue. The stipulation also addressed the Alternative Rate Plan (ARP) MPC proposed in its original filing. Three issues remained: a proposal from HHS to increase the low income discount from 10 percent to 20 percent, increased funding for Free Weatherization

proposed by HRC and inclusion of the Blackfeet Loop in the natural gas rate base opposed by Paladin Associates and Westcoast.

25. MPC, MCC and LCG agreed to the following in the stipulation:

Stipulated Electric Rates:

(1) An increase of \$14.8 million in the total jurisdictional electric revenue requirement, an increase of \$9 million over Interim Order No. 5865b. This increase is specifically based on:

An 11 percent return on equity (ROE),

An after tax increase in depreciation expense of \$7,443,545,

An addition to the rate base for the Thompson Falls Upgrade which includes a matching adjustment to revenues.

(2) MPC may, at its sole discretion, increase electric rates by 2.4 percent on both January 1, 1997 and January 1, 1998. MPC must make compliance filings in November of 1996 and November of 1997 to execute these rate changes.

(3) Upon the occurrence of an Extraordinary Event, MPC may elect to make a general rate filing with the Commission for rate changes in lieu of subsequent scheduled rate adjustments. Any scheduled increase, based on the same test period as the general rate filing, shall be taken into account in determining any rate relief granted. An Extraordinary Event is any of the following occurrences:

Any new governmental impositions or charges not contemplated in MPC's 1996 Business Plan,

including income and property taxes and reclamation requirements mandated by law. The Event must cause MPC's jurisdictional revenue requirement to increase by over \$10 million per year.

Forced outages, caused by an act of nature or criminal activity (but not market conditions) or resulting from fire or explosion from any cause. The outage must have continued for six months and is projected to continue for nine months or more. The outage must result in a cumulative loss of revenues or an increase in expenses or capital expenditures exceeding \$10 million in revenue requirements.

The current Kerr Accounting Order will be amended so that if the revenue requirement relating to Kerr mitigation exceeds what is assumed in the 1996 Business Plan by more than \$5 million, the order will capture the difference until the Extraordinary Event filing occurs. This will be done only to the extent that the Commission ultimately allows the recovery of such costs in rates.

If, in the upcoming restructuring proceedings, the Commission approves cost increases for the Company, MPC will be allowed to apply for recovery of the costs during the period of this Stipulation. The Company may alternatively ask for an accounting order to defer any costs associated with restructuring to a general rate filing with rates effective after December 31, 1998.

(4) A sharing mechanism based on ROE included in the stipulation provides for a sharing of earnings in excess of 11.4 percent ROE, computed according to Schedule 27 of MPC's Annual Report to the Montana Public Service Commission. Upon exceeding 11.4 percent ROE, MPC will refund 50 percent of the excess earnings to the ratepayers in rates over a twelve month period

starting on April 1st of the following year. MPC will pay 11 percent interest per annum on the refund calculated from the last day of the year during which the earnings exceed 11.4 ROE. The refunds will be made on a uniform percentage basis to each customer class. In determining the ROE, Schedule 27 will include the Major Normalizing and Commission Ratemaking Adjustments. The adjustment will consist of various line items, including a line labeled "Decoupling," for a deduction of up to \$1.4 million but not less than \$0. The non-allowable adjustment will be based on the actual costs for Advertising, Benefit Restoration Plan and Dues/Contributions/Others, and a line item labeled "Docket No. D95.9.128 Settlement Items - \$2.5 million." These new line items only apply to the 1996, 1997 and 1998 annual MPSC reports.

(5) The stipulated rates shall become effective for services rendered on and after July 1, 1996, in conjunction with Docket No. D96.3.33 (Cost of Service Issues). Rate design issues and future allocated cost of service issues, which do not increase revenue requirements from MPC's customers, are not affected by the Stipulation. The \$14.8 million rate increase results in a total percentage increase of 4.1919 percent.

Stipulated Natural Gas Rates:

(1) A increase in natural gas revenues of \$6.7 million, for a net increase of \$3.6 million over the Interim Order 5865b. This increase is calculated using:

An 11.25 percent ROE,

An increase in after tax depreciation of \$963,857,

An addition to rate base for the Blackfeet Loop, which includes increased revenues for 1995 associated with the Flathead Pipeline.

(2) As a condition of the stipulation, MPC and MCC have agreed, for purposes of the "consolidated" natural gas filing (Docket No. D96.2.22) that MPC will request an 11.25 percent ROE and depreciation expense based on the accrual rates in Docket No. D95.9.128. MCC has agreed not to oppose these requests. Additionally, MCC has agreed to the inclusion in MPC's Docket No. D96.2.22 of the "Missoula Loop," which is a segment of pipe that will be constructed in 1996 along the existing Missoula lateral of the transmission pipeline, provided that the investment is used and useful within the 13 month allowable change period following the test year.

(3) Rates will be effective for services rendered on and after July 1, 1996, resulting in a uniform non-gas cost percentage increase of 7.5107 percent. This rate increase is a one time change which does not involve an ARP, and remains in effect until the Commission decision in Docket No. D96.2.22, the comprehensive natural gas case.

Accounting Order for ADITC

26. The second component of the stipulation between MPC, MCC and LCG requires the Commission to issue an Accounting Order regarding Accumulated Deferred Investment Tax Credits (ADITC). The Company will, after receiving the Commission Accounting Order, apply for an Internal Revenue Service (IRS) ruling allowing the ADITC adjustment. If approval is not received from the IRS, MPC will not make the ADITC adjustment but the remainder of the stipulation will remain in effect.

27. The ADITC adjustment will be used to increase earnings if the return on average common equity falls below 10.2 percent, as computed on the MPSC Annual Report Schedule 27. MPC will be allowed to accelerate the amortization for federal ADITC by an

amount necessary to increase earnings to a 10.2 percent ROE. The additional amount of ADITC will be amortized only to Account 420, Investment Tax Credits - Amounts Not Passed on to Customers. This account will only be reflected in non-operating earnings. The additional amount of ADITC will affect earnings but will not be reflected in operating income for ratemaking purposes. Any additional amortized amount will be assigned to the permanent earnings of MPC shareholders. The aggregate additional amounts of ADITC authorized during the period 1996-1998 will not exceed a cumulative amount of \$7,000,000.

28. MPC agrees to work with the Commission to develop criteria by which to measure and evaluate performance with respect to service quality and customer relations. MPC also agrees that the Company will maintain its service quality during the period of the Stipulation.

29. Stipulating Parties agree that the stipulation is a complete unified settlement arrived at through a process of compromise and negotiation.

Accounting Order for Kerr Dam Mitigation Costs

30. MPC has requested an amendment to the Accounting Order for Kerr Mitigation costs approved by the Commission in Docket No. 94.8.30, Order No. 5800c, Finding of Fact No. 28. At that time MPC estimated the cost associated with environmental mitigation for Kerr Dam to be \$32,568,320. MPC has revised its cost estimate to \$47,400,000. MPC may defer such costs for a period not to exceed three years. Amounts deferred pursuant to this Order must be amortized over the entire remaining life of the Kerr Dam license which runs through the year 2035. The amortization must occur ratably over the life of the license. Costs associated with the purchase of replacement power shall not

be deferred pursuant to this Order. The authority to defer these costs in no way guarantees the recovery of any of these costs in future rates. MPC maintains the burden of proof for these expenses.

Low Income Issues Stipulation

31. The stipulation between MPC, HRC and HHS appended to the Order as Attachment B, resolves the low income discount and the free weatherization issues that were not settled at the April 18, 1996, hearing. The components of the stipulation are:

- (1) The parties to the stipulation agreed to keep the low income discount at 10 percent.
- (2) MPC agrees to increase the funding level for the low income weatherization program from \$750,000 to \$1 million and the program design will be modified to allow greater participation for MPC natural gas customers. MPC has agreed to:

increase MPC's natural gas DSM resource expenditures and decrease MPC's electric DSM resource expenditures by \$540,750 for 1996. A decrease of .982 MW and .352 aMW of electric DSM resources will also be incurred to support this program modification. Similar impacts will be realized in 1997 and 1998,

extend the contract with HHS through December 31, 1998,

modify the 1996 Service Order to:

- a) increase the maximum dollar value from \$680,000 to \$900,000 (amounts include dollars paid to the HRCs by MPC for resource acquisition incentives),

- b) reduce the electric resource targets to a minimum of 1,442,564 Kwh and 698 Kw,
- c) amend the natural gas resource qualifications to allow payment by MPC consistent with 75 percent of the State's SIR audit allowance,
- d) finalize the program revisions within 30 days of the agreement.

Review with HHS the program design in the last quarter of the year and make any appropriate adjustments needed. The intent is to achieve as much electric resource as possible while still providing a design that allows the full Service Order amount to be invested in the program. The parties agree to design specific alternatives to the present program to allow it greater flexibility,

limit administrative costs to 10 percent of the total program budget.

(3) The parties agree to work together to develop a Universal Systems Benefits Charge or some other means to require all energy providers to offer a similar level of low income services, programs and discounts for their customers.

32. The Low Income Stipulation is a settlement of the low income issues raised by HRC and HHS in this Docket, intended to be effective from the date of this Order through December 31, 1998. Implementation of this stipulation will not affect the stipulation among MPC, MCC and LCG. The increase in additional funds for the Free Weatherization Program and the changes to the Service Order are an indication of MPC's commitment to provide low income assistance.

Blackfeet Loop

33. The Blackfeet Loop (Loop) is 36.5 miles of new, 12" diameter, underground steel natural gas transmission pipeline which traverses the Blackfeet Indian Reservation. The Loop begins at MPC's Flathead tap on the Carway to Cut Bank 16" transmission line and terminates at the boundary of the Blackfeet Indian Reservation, about three miles west of East Glacier. It runs parallel to a portion of MPC's existing 118 mile Carway to Kalispell 8" line. Construction began in July, 1995 and was completed in October, 1995 at an estimated cost of \$13.2 million.

MPC's Position:

34. MPC states that the Blackfeet Loop is needed to serve peak load growth, which the existing system will not be able to serve after the 1996-97 heating season. Additionally, increased reliability is needed since the Kalispell area was served only by the 8" line before this addition.

35. MPC evaluated four other alternatives before choosing the Blackfeet Loop alternative. These other alternatives were:

- (1) the "capacity limited" alternative which placed a moratorium on hookups in the Kalispell area.
- (2) the "compression" alternative which required the construction of compressor stations at various locations along the 8" line.
- (3) the "DSM" alternative which required the addition of DSM resources.
- (4) the "Kootenai Pipeline" alternative which required the construction of 84 miles of 16" pipeline from British Columbia to Kalispell.

Paladin Associates' Position:

36. Paladin witness Marie Owens testified that MPC provided flow calculations, pre- and post-Blackfeet Loop "distribution

lateral." She believed MPC's calculations failed to support the need for increased capacity because the 1994 test year actual Kalispell area peak was 24,021 Mcf/day, which is less than the pre-Blackfeet Loop capacity of 32,000 Mcf/day.

Westcoast Gas Services (America), Inc.'s Position:

37. Westcoast witness Richard Swinney reiterated the testimony of Paladin witness, Ms. Owens. He stated that MPC relied on outdated peak data from the megafreeze of 1989 to substantiate its need for the Blackfeet Loop. Mr. Swinney said that improvements in technology should be incorporated, and he provided calculations to be included in the changes. The calculations used 1995 customer counts and 1994 customer load data. Also, he did not feel that the Blackfeet Loop would increase reliability to Kalispell area customers because only 36.5 miles of the 188 mile Kalispell line is looped.

MPC Rebuttal:

38. MPC's witness Mr. Widhalm rebutted the testimony of witnesses Owens and Swinney, maintaining that use of 1994 data to compute peak conditions is inappropriate, and that 1989 "Big Chill" data should be used. The data is not outdated and use per customer has not declined since 1989. Mr. Widhalm stated that the Blackfeet Loop "enhances" reliability for Kalispell area customers.

Additional Westcoast Rebuttal:

39. Westcoast's witness Mr. Swinney suggested that MPC's intervention and withdrawal from a recent Great Falls Gas rate case shows that MPC miscalculated its peak day requirements. In the GFG case, MPC's testimony asserted that GFG should reserve more firm transportation capacity to meet peak, based on MPC's projections of peak. These projections utilized 1 MMBTU/day/customer plus a 13 percent market reserve. Mr. Swinney responded that MPC's withdrawal of its intervention after the January 30, 1996, peak demonstrated that GFG did not need as much gas as MPC had predicted. Also, Mr. Swinney suggested that the Commission postpone consideration of the Blackfeet Loop until Docket No. D96.2.22.

Additional MPC Rebuttal:

40. MPC witness Mr. Widhalm rebutted Westcoast by stating that MPC's testimony in the GFG case was only indicative of MPC's concern that GFG should have adequate gas supplies to meet its peak. The fact that GFG did not use as much gas as MPC estimated has no bearing on the need for the Blackfeet Loop. Mr. Widhalm performed an analysis of the need for the Blackfeet Loop that relied upon the maximum peak day usage by town over a ten year period of time ending in 1992. The results of the analysis, which used a 3.1 percent compounded customer growth rate, predicted that the Blackfeet Loop would be needed in the 1995-96 heating season. Mr. Widhalm reinforced that prediction by analyzing the actual January 30, 1996, peak day supply/demand situation and concluded that MPC could not have served the 1996 peak without the Blackfeet Loop.

Commission Decision - MPC/MCC/LCG Stipulation

41. The Commission finds that the agreement between MPC, MCC and LCG reaches a fair revenue requirement for both the electric and natural gas utilities. The Commission looked at the components of the ARP for the electric utility and determined that the end result falls within a range of reasonableness. The Commission reviewed the stipulation to be sure that there was a provision in the ARP addressing customer service. To further ensure the quality of customer service, the Commission directs MPC to work with Commission to develop measurable service quality standards and to attain those standards.

42. In the context of this settlement, the Commission accepts the agreed upon ROE of 11 percent for the electric utility and 11.25 percent for the natural gas utility. The Commission also accepts the increase to depreciation expense of \$7,443,545 for the electric utility and \$963,857 for the natural gas utility. Specific depreciation rates are shown in Attachment C.

43. The inclusion of the Thompson Falls Upgrade in electric rate base is found to be acceptable in this proceeding. The Upgrade is a known and measurable addition to rate base. Proper matching adjustments to revenues and expenses associated with this investment have been made.

Commission Decision - Low Income Issues Stipulation

44. The Commission finds that the allocation of additional funds to the Free Weatherization Program is a reasonable commitment by MPC. The increased contributions and the improvements to the Service Order are consistent with the Commission's desire to address low income issues.

Commission Decision - Blackfeet Loop

45. The main area of disagreement between MPC and Paladin/Westcoast pertains to the Blackfeet Loop and its necessity in serving the Browning to Kalispell area firm customers during peak periods. The most valuable evidence pertaining to whether the Blackfeet Loop is needed involves the performance of the Flathead System during the very recent January 30, 1996, peak event. MPC Late Filed Exhibit No. 4 shows for that day, a total Firm Sales Requirements market of 24,830 Mcf/day at 14.9 psia and 17,536 customers. The Flathead System, without the Blackfeet Loop, was capable of providing approximately 32,000 Mcf/day, assuming an inlet Maximum Allowable Operating Pressure (MAOP) of 868 psia. This capacity is greatly influenced by Carway/Nova supply source pressures. The actual pressure on the January 30, 1996, peak day averaged 762 psia, which implies less pressure during some parts of the day.

46. Based on MPC testimony, the Flathead Line, without the Blackfeet Loop, could supply a market of 25,710 Mcf/day, which is 103.5 percent of the actual firm market of 24,830, reflecting a system close to supply/demand balance without considering growth in the sales market. This balance is subject to various risks which need to be considered when deciding to build new pipeline capacity and when assessing the used and usefulness of a new pipeline addition.

47. The Commission analyzed the ability of Nova/Carway to supply MAOP of 868 psia, which would yield a supply capability of 32,000 Mcf/day without the Blackfeet Loop. The Commission also considered the effects of colder weather conditions, like those that occurred in 1989, which could increase usage per customer. The Commission finds that system growth should also be reflected for the period that final rates will be in effect. Recent experience demonstrates that a 6 percent growth rate should be

used. Applying that growth rate yields 18,986 customers. At 1.68 Mcf per day per customer, the peak requirement would be 31,896 Mcf/day, which approximates the maximum Flathead Pipeline capacity of 32,000 without the Blackfeet Loop.

48. Both the actual 1996 peak experience and the 1996 adjusted scenario as analyzed above suggest that the Flathead Line is near capacity, or will be at capacity during the rate effective period, assuming a critical peak event. Neither of these scenarios consider hourly peak requirements, which are 130 percent of daily peak divided by 24 (these are partially counted in the daily peak numbers). These scenarios also do not consider the possibility that the peak cold period could be worse than in 1989 if each load center were to simultaneously experience its worst ever peak day. Neither projection explicitly calculates the reliability of NOVA inlet pressures at the time of system peak. The weight of the evidence suggests that some combination of capacity additions and/or load reduction costs for the Flathead Line are used and useful during the rate effective period. The Commission agrees with MPC's decision in selecting the Blackfeet Loop, which is the cheapest alternative over time.

49. Finally, the question of increased reliability was discussed by the parties. Some value should be attributed to this factor, since the Blackfeet Loop provides for some duplication of an otherwise singular source of supply into the Flathead Valley. Although not quantified, the increased reliability for the Flathead Line adds weight to the case that the Blackfeet Loop is used and useful. The Blackfeet Loop addition increases natural gas revenue requirements by \$2.5 million.

CONCLUSIONS OF LAW

1. Montana Power Company furnishes electric and gas service for consumers in the State of Montana, and is a "public utility" under regulatory jurisdiction of the Montana Public Service Commission. Section 69-3-101, MCA.

2. The Montana Public Service Commission properly exercises jurisdiction over Montana Power Company's rates and operations. Section 69-3-102, MCA, and Title 69, Chapter 3, Part 3, MCA.

3. The Montana Public Service Commission has provided adequate public notice of all proceedings, and an opportunity to be heard to all interested parties in this Docket. Sections 69-3-303, 69-3-104, MCA, and Title 2, Chapter 4, MCA.

4. The rate levels approved herein are just, reasonable, and not unjustly discriminatory. Sections 69-3-330 and 69-3-201, MCA.

ORDER

THE MONTANA PUBLIC SERVICE COMMISSION ORDERS AS FOLLOWS:

1. Montana Power Company is authorized an increase in annual Montana jurisdictional electric revenues of \$14,800,000 and an increase in natural gas revenues of \$6,700,000 beginning on July 1, 1996. These increases are in lieu of and not in addition to Interim Order No. 5865b. The increased rates shall be on a uniform percentage basis.

2. Montana Power Company is hereby authorized to implement an increase in electric rates of 2.4 percent on January 1, 1997, and January 1, 1998. Prior to implementing these increases MPC will submit compliance filings in November of the preceding year.

3. Montana Power Company is ordered to refund, to all electric customers, 50 percent of the Return on Equity (ROE) that

exceeds 11.4 percent based on Schedule 27 of the MPSC Annual Report submitted by MPC. An interest rate of 11 percent per annum will be paid on the refund. The refund will be calculated from the last day of the year during which the ROE exceeded 11.4 percent. If the ROE falls below 10.2 percent as computed on the same MPSC Schedule 27, MPC is authorized to make an ADITC adjustment that will raise the ROE to 10.2 percent as directed in the authorized Accounting Order.

4. Montana Power Company is ordered to file compliance tariffs pursuant to this Order.

5. Montana Power Company is ordered to comply with any and all directives of the Commission as described in the body of this Order.

6. The effective date of this Order is July 1, 1996.

DONE AND DATED this 28th day of May, 1996, by a vote of 5 -
0.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

NANCY McCAFFREE, Chair

DAVE FISHER, Vice Chair

BOB ANDERSON, Commissioner
Concurring Opinion - Attached

DANNY OBERG, Commissioner

BOB ROWE, Commissioner
Concurring Opinion - Attached

ATTEST:

Kathlene M. Anderson
Commission Secretary

(SEAL)

NOTE: Any interested party may request that the Commission reconsider this decision. A motion to reconsider must be filed within ten (10) days. See 38.2.4806, ARM.

OPINION OF COMMISSIONER ANDERSON**Docket No. D95.9.128, Order No. 5865d**

I'm confident in the negotiating process and the parties who brought the stipulated agreement to the Commission and confident in the reasonableness of the result. It has many benefits, including decreased regulatory costs by the company and the other parties and stable, predictable rates for the next two years and customer sharing of excessive profits.

However, the stipulated agreement, and this order which embodies it, have a potentially serious shortcoming: they include important policy developed without the benefit of rich exchange through the Commission's contested case process and thoughtful consideration by the Commission. That policy has to do with the automatic rate-increase plan (ARP), which is the Commission's first foray into price cap or performance-based regulation (PBR) for an electric utility. The stipulation and the order are devoid of any discussion about the merits of the ARP.

The process.

With broad guidance from statutes, the PSC is responsible for policy. Good policy is developed by many minds and interests, through a process that stimulates debate, encourages competing ideas, holds the parties accountable through cross examination, and involves the public. The stipulated agreement approved by the Commission in this order is a take-it-or-leave-it proposition developed by three parties. Absent was the rich policy development the rate-paying public deserves.

Conventional wisdom holds that rate-of-return, rate base regulation will be replaced by performance-based regulation (PBR). Price cap regulation is a form of PBR common in telecommunications regulation. With a price (or bills) cap, rates (bills) in the next period are based on prices (bills) in the preceding period, adjusted upward by estimated inflation, adjusted downward by estimated productivity improvements, and, sometimes adjusted up or down by factors reflecting other regulatory goals. With the PBR in this order, the only knowns are the starting prices, the ending prices and the duration; unknown are the implicit inflation, productivity, or other factors.

A PBR should be established through a three-step process:

- goal setting
- formulating the structure and mechanism
- establishing the best numbers for the factors in the formula.

The purpose of PBR is to change the powerful set of incentives felt by a regulated utility. Herein lies a set of policy issues the Commission should consider.

Policy issues.

One of the most important elements of a price cap is the length of time it is in effect. Experience from the telephone industry indicates it must be long enough (3-5 years) to have the proper cost reduction incentives and alter the corporate culture to reflect the changed incentives. By that measure, the price cap in this order is too short in duration.

What incentives change with PBR? They include cost control, growth in sales, resource diversity and acquisition, reliability, environment, low income assistance, demand-side management (conservation) programs, research and development, and customer service quality. How will these incentives change with the price cap in this order?

Other issues include:

The merits of "bill caps" vs. "price caps" and the relationship to decoupling.

The relationship of this order to possible changes to MPC's corporate structure.

With this order, all we know is the resulting prices. The incentives imposed on the financial performance of the utility will be impossible to plumb. It probably has these incentives: cost cutting, increasing sales, and reducing conservation programs. However, these incentives are weak (because of the short duration) and are confused by mixed signals and the overlay of other proceedings.

This order is reasonable, but is it the best public policy?

It's impossible to know in the absence of a full hearing and of completion of the contested case. Hopefully, these and other policy issues the PSC must face in the transition to a more competitive electric industry will be raised in other proceedings.

RESPECTFULLY SUBMITTED this 28th day of May, 1996.

Bob Anderson, Commissioner

OPINION OF COMMISSIONER ROWE

Docket No. D95.9.128, Order No. 5865d

Deciding contested cases after a full hearing and based on the record is generally preferable. Parties should concentrate on presenting effective and informative cases upon which the Commission may base its decisions. Stipulations are appropriate to resolve tangential issues which might be lost in the complexity of a case or to structure uniquely beneficial settlements.¹

¹Longer-term "collaboratives" are also sometimes useful to resolve methodological and procedural issues, hopefully producing consensus rather than less-principled compromise. Examples include least cost planning, minimum filing requirements, and cost of service. Generally, these benefit from Commission staff participation.

To consider a stipulation, the Commission must have information sufficient to make an independent determination that its terms are appropriate.² In this case I fully accept the parties' representations that they all worked hard to reach a fair outcome. The Stipulation at least minimally meets my assessment of an appropriate outcome. I vote for the Stipulation primarily because I believe that a decision by the Commission after a full hearing might diverge even more from my own view of the record.³

Clearly, an increase in revenue is justified. Montana Power is spending significant sums on capital improvements which are used and useful to serve customers. The Thompson Falls dam

²The Model Settlement Guidelines, prepared by the NARUC Staff Subcommittee on Administrative Law Judges includes the following relevant provisions:

IV. Confidentiality of Settlement Proceedings.

B. In hearings on full or partial settlements or in which a settlement is contested, independent proof of facts in issue between the parties is required and may not be established by reference to information provided or obtained through the settlement process.

VI. Presentation of Settlements.

B. A settlement in a general rate case or other proceeding involving the public at large, or significant segments of a utility's customers, should only be accepted after a public hearing on the settlement, which includes the stipulation into evidence of all prefiled testimony and exhibits. Additionally there must be adequate independent evidence presented by the parties in support of the settlement to allow the hearing officer to make a reasoned decision on the benefits and shortcomings of the settlement. A party contesting part or all of the settlement must affirmatively do so through the presentation of an evidentiary case, legal arguments or written comments regarding the settlement. (Emphasis supplied.)

³I am particularly concerned about the direct and implicit precedential effect of the recent Montana-Dakota Utilities decision, in which the Commission voted 4-1 to grant a 12 percent return on equity and to allow substantial post-test year plant additions to rate base. Docket No. D95.7.90, Order No. 5856b, April 17, 1996 (Rowe dissenting).

upgrade and the Blackfeet Loop natural gas project are two examples. Montana Power will incur additional costs over the next three years. The Stipulation and the Alternative Rate Plan (or ARP) establish relatively small rate increases over this period, providing customers substantial certainty about electric rates over a three year period when capital expenditures and industry restructuring could otherwise result in greater rate increases.

Not all parts of the Stipulation are to my liking. Because the Stipulation includes a standard non-severability clause, the Commission may not pick and choose only those portions with which it agrees. Based on the record, I might have supported a lower return on equity after a full hearing. Various other adjustments proposed in pre-filed testimony might have caused me to support a lower revenue requirement.

The Alternative Rate Plan is also a mixed bag of attractive and less attractive proposals. Its benefits include: 1. Rate certainty over several years; 2. A customer-shareholder sharing mechanism if returns exceed a certain level; 3. Some assurance that customer service will be maintained.

To consider the first electric alternative rate proposal in Montana, the Commission (and the public interest) would have benefited from a fully-developed hearing record. Rate-of-return regulation in markets which are not effectively competitive has produced fair rates, good service, and reasonable security to investors. To the extent the ARP represents a move away from rate-of-return (a point of discussion), a full hearing could have developed a variety of issues. These include:

- * Is the inflation adjustment, 2.4 percent per year, correct? Economists debate whether consumer price indices, producer price indices, industry-specific or function-specific adjustments are correct.
- * Should the increase be pre-set based on economic forecasts as opposed to a variable adjustment according to actual changes?
- * Should the plan include an explicit productivity offset?
- * Is the customer-shareholder sharing mechanism appropriate? Some plans call for all earnings above a certain (rarely-reached) level to go to the customers.
- * Are service quality assurances adequate? In telephony the experience has been that because price caps encourage lowering the average cost of service they reward reduced service quality. Second-stage telephone price caps have included specific service quality measurements and penalties for failing to meet them.
- * Is the description of exogenous AZ factors@ which could trigger additional increases reasonable and correct? How likely are any of these events to occur?
- * How does the ARP relate to the Commission's restructuring inquiry and to the restructuring plan which MPC will file this fall?
- * Under what circumstances should the Commission consider terminating the plan? What authority does the Commission have to terminate the plan?
- * What additional steps should the Commission, MPC, or other parties take to ensure that the plan succeeds?

Implementing electric customer service standards was discussed during the hearing.

The Commission should have been presented expert testimony on these and other issues from all parties to the Stipulation.

The Commission also approves a separate stipulation concerning several issues of concern to moderate and low income customers. This stipulation includes programmatic changes which might have been more difficult to achieve without an agreement among the parties. However, the record in this case included powerful and detailed evidence concerning the worsening situation of moderate and low income utility customers. I would have liked the Commission to be able to act on that record directly.

RESPECTFULLY SUBMITTED this 28th day of May, 1996.

BOB ROWE
Commissioner