

Service Date: January 13, 2006

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

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| IN THE MATTER OF NORTHWESTERN |) | UTILITY DIVISION |
| ENERGY, Application for Approval of Natural |) | |
| Gas Procurement Plan |) | DOCKET NO. N2005.6.101 |
| |) | ORDER NO. 6683b |

INTERIM ORDER

On June 15, 2005, NorthWestern Energy (NWE or utility) filed before the Public Service Commission (PSC or commission) draft rules to guide Montana default supply utilities' planning and procurement of natural gas supply. The Montana Consumer Counsel has been the only active intervenor in the proceeding. Hearing on NWE's proposal was held November 9, 2005. Briefs have been submitted.

NWE intends to begin implementing the guidelines through the filing of NWE's first guideline-recognized natural gas default supply procurement plan within the first few months of 2006. The PSC determines that guidelines applicable to NWE's procurement of natural gas default supply should be adopted on an interim basis prior to NWE's filing. The PSC determines that the guidelines initially proposed by NWE, with some exceptions, are acceptable for that purpose. The exceptions, as reflected in this interim approval, include the conversion of NWE's proposal from rule language applicable to natural gas default supply utilities to tariff language applicable to NWE, the renumbering of several guidelines, the addition of one year to NWE's proposed two-year planning horizon, the inclusion of numerous changes that primarily complete, clarify, or amplify certain aspects of the tariff guidelines, and minor edits.

This approval is an interim approval. With this order the tariff guidelines are in effect and are functional, but the PSC anticipates further consideration of the record, the proposed guidelines, and these interim tariff guidelines prior to PSC approval of permanent guidelines. It is possible, but is not anticipated at this time, that further proceedings on NWE's proposal will be warranted.

The tariff guidelines as approved on an interim basis are as follows. NWE must file tariffs in compliance with this order.

NORTHWESTERN ENERGY TARIFF GUIDELINES FOR PROCUREMENT OF A NATURAL GAS SUPPLY PORTFOLIO

GUIDELINE 1. INTRODUCTION AND APPLICABILITY

- (1) These tariff guidelines provide guidance to the utility regarding natural gas default supply resource planning and procurement. These tariff guidelines do not impose specific resource procurement processes and do not mandate particular resource acquisitions. These tariff guidelines provide a framework for considering resource needs, obtaining input on planned actions prior to finalization of procurement arrangements, and the recovery of prudently incurred natural gas default supply costs.
- (2) The utility should document its natural gas default supply portfolio planning processes, resource procurement processes, and management decision-making so that the utility can fully demonstrate to the utility's retail customers, the commission, and other stakeholders that natural gas default supply costs have been prudently incurred.
- (3) These tariff guidelines provide the basis for commission review and consideration of the prudence of the utility's natural gas default supply resource planning and procurement actions. As a result, the tariff guidelines should assist the utility in making prudent decisions and in fully recovering prudently incurred natural gas default supply costs. Successful application of the tariff guidelines requires a commitment from the commission, the utility, and other stakeholders to honor the spirit and intent of the tariff guidelines.

GUIDELINE 2: DEFINITIONS

- (1) "Commission" means the Montana Public Service Commission.
- (2) "Default supply costs" means the actual supply costs of providing default natural gas default supply service, including but not limited to planning and administrative costs and any other costs directly related to the purchase of natural gas, management of natural gas supply costs, storage costs, hedging costs, and provision of natural gas default supply and related services including demand-side management planning, program, and administrative costs.

- (3) “Default supply resources” means a portfolio of wholesale natural gas transactions and acquisitions, including, but not limited to, bilateral contracts, however structured, and spot market purchases of natural gas;
- (4) “Hedging” means, in part, activities entered into for the primary purpose of reducing the potential impact of price volatility on customers and includes the use of: financial instruments related to stabilizing future prices; fixed-price contracts that may vary in duration; layering of fixed-price contracts; derivatives and other industry standard price hedges; use of natural gas storage; and contracts for the future physical delivery of natural gas.
- (5) “Planning horizon” means the longer of:
- (a) the longest remaining contract term in the utility's current natural gas default supply portfolio;
 - (b) the longest contract term being considered for a new resource acquisition; or
 - (c) at least three years.
- (6) “Rate stability” means reduced price volatility, both month-to-month and year-to-year.
- (7) “Stakeholder” means a member of the public (*e.g.*, retail customer, individual, corporation, organization, group) who may have a special interest or expertise in, or may be directly affected by, the acquisition of natural gas default supply resources under these tariff guidelines.
- (8) "Utility" means NorthWestern Energy.

GUIDELINE 3. GOALS

- (1) The goals of these natural gas default supply resource planning and procurement tariff guidelines are:
- a) to provide guidance to the utility for the prudent acquisition and provision of adequate and reliable natural gas default supply service that is stably and reasonably priced over time;
 - (b) to facilitate the utility's ongoing financial health;
 - (c) to facilitate a process through which the utility identifies and cost effectively manages and mitigates its risks related to its obligation to provide natural gas default supply service in a retail choice environment; and

(d) to mitigate price volatility associated with index pricing through the effective management of storage and, where justified, other hedging actions.

GUIDELINE 4. OBJECTIVES

(1) In order to satisfy its natural gas default supply responsibilities, the utility should pursue the following objectives in assembling and managing a natural gas default supply portfolio:

(a) provide natural gas default supply customers adequate, reliable, and stably and reasonably priced natural gas default supply service;

(b) provide natural gas default supply service to natural gas default supply customers over the planning horizon;

(c) incorporate, where cost effective and appropriate, demand side management measures; and

(d) maintain a mix of supply contracts with staggered start and expiration dates and supply contracts with pricing provisions that mitigate price risk.

GUIDELINE 5. RESOURCE NEEDS ASSESSMENT

(1) Before seeking new resources for inclusion in the natural gas default supply portfolio, the utility should evaluate its existing natural gas default supply resource portfolio and analyze future resource needs in the context of the goals and objectives of these tariff guidelines and the planning horizon.

(2) The utility's natural gas default supply portfolio resource needs assessment should include:

(a) analyses of natural gas default supply customer loads including base load and peak demand requirements, seasonal and daily load shapes and variability, the number and type of natural gas default supply customers, load growth, trends in customer choice and retail markets, and identification of cost-effective demand-side management measures;

(b) an assessment of the types of natural gas default supply resources that could efficiently contribute to meeting portfolio goals and objectives, including indexed, fixed-price, convertible, full requirements, and others;

(c) an assessment of the source mix of the existing natural gas default supply portfolio with respect to contract types in the context of the goals and objectives of these tariff guidelines; and

(d) a discussion of the experience and practices of a sample of other local distribution companies.

GUIDELINE 6. RESOURCE ACQUISITION

(1) The utility should apply accepted procurement practices for the natural gas industry when acquiring natural gas default supply resources. The commission cannot prescribe in advance the precise industry accepted practices the utility must apply since industry accepted practices vary depending on jurisdiction, supplier, context, and circumstances. Generally, an industry accepted approach to resource procurement should encompass the following basic steps:

(a) obtain and consider upfront input and recommendations from an advisory committee throughout the planning and procurement processes;

(b) explore the full range of alternative supply resources, products, and prices available in the market;

(c) consider collecting contemporaneous proposals from various parties offering supply resources and products;

(d) negotiate the most appropriate contract; and

(e) anticipate changing circumstances and maintain flexibility in resource procurement.

(2) These basic steps may be achieved through a variety of methods. The utility may use bilateral negotiations with suppliers to meet its resource needs. Alternatively, the utility may use competitive solicitations. If used, competitive solicitations should treat bidders fairly and should be transparent. Irrespective of the method or methods used, the utility's resource acquisition process should conform to the following principles:

(a) clearly define and document the resources, products, and services the utility intends to procure, either before the utility begins discussions with potential suppliers for the purpose of acquiring new supplies, or before the utility issues a resource solicitation that communicates these

needs to potential bidders in any request for proposals; and

(b) establish the supplier qualifications and the criteria it will use in deciding whether to execute contracts.

(3) If the utility does not use competitive solicitations to acquire natural gas default supply resources, the utility should document the exercise of its judgment in evaluating and selecting supply options. It is recognized that competitive solicitations are often not used in natural gas procurement, due to the number of suppliers and supply options that are typically available to utilities and the rapidity of potential price changes.

GUIDELINE 7. MODELING AND ANALYSIS

(1) The utility's natural gas default supply portfolio planning and resource procurement and decision-making processes should incorporate cost-effective computer modeling and analyses.

(2) The modeling employed by the utility should support an informed dialogue with its advisory committee, and contribute to prudent and informed judgments in the portfolio planning and resource acquisition process.

GUIDELINE 8. RISK MANAGEMENT AND MITIGATION

(1) Prudent natural gas default supply resource planning and procurement practices include evaluating, managing, and mitigating risks associated with the inherent price uncertainty of natural gas supply markets and natural gas default supply load characteristics. The utility should identify and analyze sources of risk using its own techniques, market intelligence, risk management policies, and judgment. The utility should identify types of hedges available in the market, and the strengths and weaknesses of those hedges. The utility should document its decisions in regard to procurement strategy and use of hedges. The utility should monitor the ongoing appropriateness of the utility's strategy, including the use of hedges.

(2) The utility should use an independent advisory committee of technical and public policy experts as a source of upfront input to mitigate risk and optimize resource procurement outcomes in a manner consistent with these guidelines

GUIDELINE 9. TRANSPARENCY AND DOCUMENTATION

- (1) The utility should document the exercise of the utility's judgment in implementing all aspects of these tariff guidelines.
- (2) The utility must procure and manage a portfolio of natural gas supply contracts to serve the full load requirements of the utility's natural gas default supply customers. To justify the prudence of the utility's resource procurement decisions the utility shall document its natural gas default supply portfolio planning, management, and procurement activities.

GUIDELINE 10. DEFAULT SUPPLY PORTFOLIO RESOURCE PLAN

- (1) The utility must file a natural gas default supply portfolio resource plan by December 15 of each even numbered year [the utility's initial resource plan will be filed in early 2006, the utility's first annual filing will be December 15, 2006].
- (2) The plan should include the information, analyses, and documentation recommended in these tariff guidelines, specifically including: the resource needs assessment; a discussion of resource acquisition actions and strategies; a general discussion of storage refill strategies; a description of the modeling tools employed by the utility; and a discussion of the risk mitigation strategies and tools considered and employed by the utility, including a discussion of hedging as risk mitigation strategy.
- (3) The plan shall include information from third parties regarding the projected cost of natural gas deliveries in relevant trading areas for the period covered by the plan.
- (4) The plan should separately identify the utility's strategy, if any, for the hedging of natural gas default supply costs, and shall include the cost of any measures that the utility believes are appropriate to accomplish the hedging of natural gas default supply costs. The plan shall include the utility's analysis and rationale for any proposed hedging strategies.
- (5) The commission will provide any comments regarding the plan within 60 days of the utility filing of a plan.
- (6) Natural gas default supply hedging costs incurred pursuant to the plan and commission comments filed in response to the plan, will be approved by the commission in subsequent ratemaking actions, subject to commission review to determine whether the specific hedging activities were administered in a prudent manner.

Done and dated this 10th day of January, 2006, by a vote of 4-1.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

GREG JERGESON, Chairman

BRAD MOLNAR, Vice-Chairman
(voting to dissent)

DOUG MOOD, Commissioner

ROBERT H. RANEY, Commissioner

THOMAS J. SCHNEIDER, Commissioner

ATTEST:

Connie Jones
Commission Secretary

(SEAL)

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