Service Date: November 13, 2008

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

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| 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 | ) | UTILITY DIVISION<br><br>DOCKET NO. D2008.6.69<br><br>ORDER NO. 6925f |

# FINAL ORDER

## Appearances

FOR THE APPLICANT:

<u>NorthWestern Energy</u>
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Richard J. Johnson, Moss & Barnett, 4800 Wells Fargo Center, 90 S. Seventh St., Minneapolis MN 55402-4129

FOR THE INTERVENORS:

<u>Montana Consumer Counsel</u>
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John P. Coyle, Duncan & Allen, 1575 I St. NW, Suite 300, Washington, DC 20005-1175

<u>District XI Human Resource Council/ Natural Resources Defense Council/Renewable Northwest Project</u>
Charles E. Magraw, 501 8th Avenue, Helena, Montana 59601

<u>Large Customer Group</u>
Donald Quander, 401 N. 31st St., Suite 1500, Billings MT 59101

BEFORE:

GREG JERGESON, Chairman
DOUG MOOD, Vice-Chairman
BRAD MOLNAR, Commissioner
ROBERT H. RANEY, Commissioner
KEN TOOLE, Commissioner

COMMISSION STAFF:

Leroy Beeby, Utility Rate Analyst
Al Brogan, Staff Attorney
Dave Burchett, Utility Rate Analyst
Eric N. Eck, Chief, Revenue Requirements Bureau
Scott Fabel, Utility Rate Analyst
Will Rosquist, Staff Economist
Kate Whitney, Administrator, Utility Division

## PROCEDURAL HISTORY

**1.** On June 27, 2008, NorthWestern Corporation d/b/a NorthWestern Energy (NWE) filed before the Public Service Commission (PSC or Commission) an Application for Approval of its Interest in Colstrip Unit 4 (CU4) as an Electricity Supply Resource under Certain Terms and Conditions Including Certain Treatment of Net Operating Losses.

**2.** The PSC issued a Notice of Application and Intervention Deadline on July 2, 2008. Parties who requested and were granted intervention in this proceeding are: Montana Consumer Counsel (MCC); Montana Large Customer Group (LCG); and District XI Human Resource Council, Natural Resources Defense Council, and Renewable Northwest Project (District XI/NRDC/RNP).

**3.** On July 2, 2008, NWE filed a motion for a protective order requesting protection for NWE's state and federal tax returns that might be requested in this Docket. On July 18, 2008, the PSC issued Protective Order 6925a granting the protection that NWE had requested.

**4.** On July 8, 2008, the PSC issued Procedural Order 6925 establishing dates for discovery on NWE's application, testimony from NWE and intervenors, and discovery on NWE and intervenor testimony. On July 15, 2008, MCC filed a motion to reconsider Order 6925's abbreviated 120-day procedural schedule. On July 22, 2008, NWE filed a response in opposition to MCC's motion. On July 31, 2008, the PSC issued a Notice of Commission Action denying MCC's motion.

**5.** On July 9, 2008, NWE filed a motion for protective order regarding identities of potential and actual bidders; contents of actual bids; NWE's evaluations of strategic alternatives and of bids; portions of a Confidential Information Memorandum provided to prospective bidders that contained information about projected coal costs, financial results, and capital expenditures for CU4 plus information about operations and maintenance expenses and revenues for CU4; and of a below-market 90-MW contract that is currently benefiting ratepayers, refinanced in 2007 its CU4 obligations to reduce its costs by acquiring the Mellon and SGE interests, and in 2008 conducted a strategic review to determine the value of NWE's CU4 interest.

**39.** According to Corcoran, the primary basis for NWE's CU4 rate-based cost of service request is the enactment by the 2007 Legislature of House Bill 25, which Corcoran said eliminated the remnants of deregulation from Montana law, eliminated customer choice and allows NWE to better plan for the long term and to own electric generation resources. He said, whereas NWE currently obtains all of its electricity supply through power purchase contracts, Montana law now allows NWE, with PSC approval, to rate-base utility-owned generation.

**40.** Corcoran addressed two specific PSC procurement rules that pertain to this filing. He claimed that NWE had satisfied the rule concerning resource acquisition. He contended the affiliate transaction rules do not apply to this filing.

**41.** Corcoran's Exhibit__ (PRC-01) is the revenue requirement analysis, which Corcoran said presents NWE's Generation Asset Cost of Service being requested by NWE for CU4. He asserted NWE developed the proposed CU4 revenue requirement in a manner consistent with the statutory definition of "Generation Asset Cost of Service" and the PSC's standard regulated revenue requirement methodology. Corcoran said the $407 million asset value of CU4 in the revenue requirement computation was derived by taking the $404 million sale price, plus the buyer termination fee of $6.25 million, minus an estimate of the avoided sale transaction costs of $3.25 million. Finally, Corcoran explained specific line items in Exhibit__ (PRC-01).

**42.** Corcoran stated that NWE proposes to rate base 100 percent of its interest in CU4 even though 102 MW (97 MW plus 5 MW losses) of the capacity is obligated to Puget Power through 2010. The revenue requirement is adjusted to reflect the test period revenues generated by that obligation. He explained that when the obligation to sell the 102 MW to Puget Power ends, this output will be made available to electric supply customers. In order to keep NWE whole from a cost recovery standpoint, NWE adjusted the net revenue requirement accordingly.

**43.** Corcoran stated that there are additional future CU4 costs that are specifically discussed in the testimonies of Barnes and Hines. These future costs would be requested in future CU4 revenue requirement filings. These costs will be legitimate operating and capital costs, and Corcoran said NWE expects to recover them as part of CU4 future generation costs.

**44.** Corcoran's Exhibit__ (PRC-02) presents the annual revenue requirement cost estimates through 2042. The rate base was based on the acquisition cost of $407 million plus additional $4 million in capital investment each year and escalated at 2.5 percent through year 2042. The rate base was reduced each year by the book accumulated depreciation based on a book life of 34 years, and also adjusted for the timing difference between book and tax depreciation method. Each year the return on the investment was computed based on the cost of capital of 9.15 percent. The cost of service for CU4 includes budgeted fuel cost, operating and maintenance and administrative and general expenses for each year, escalated by 2.5 percent for the outer years. The book depreciation expense was based on a straight-line basis, using 34-year life and increased each year by the additional capital investment throughout the life. Montana property taxes were based on the asset market value as described previously and escalated by 2.5 percent each year through 2042. The other taxes were based on 2007 actual and escalated by 2.5 percent annually through 2042. The MCC/PSC taxes were calculated based on the total revenue requirement using current tax rates in effect. The deferred income taxes were based on the timing difference between book and tax depreciation each year through 2042. The current federal and state tax rates were used to compute income taxes each year.

**45.** Corcoran stated that future increases in property taxes related to CU4 would be treated in its annual Property Tax Tracker Filing. He also stated that future increases in fuel cost related to CU4 will include actual fuel costs related to CU4 in its annual electric supply tracker filing. Corcoran stated that NWE proposes to include the cost of service in electric supply rates as part of its annual electric supply tracker in order to develop an all-in electric supply rate. The fuel costs, property taxes (60 percent incremental tax adjustment only), and revenue credits/miscellaneous revenues (through 2010) are variable and would be adjusted as appropriate based on actual annual activity from tracker to tracker. The remaining CU4 cost and miscellaneous revenue (after 2010) would be fixed and subject to adjustment only as the result of a future CU4 general rate filing. Corcoran explained a one-time cost adjustment related to CU4 Price Stability Contracts.

**46.** Regarding NWE's request for a declaratory order regarding NOLs, Corcoran stated the request was prompted because MCC has raised this issue in several different settings, the most recent being Docket D2008.4.36. According to Corcoran, MCC claims that tax credits associated with NOLs resulting from NWE's non-utility businesses belong to regulated utility customers in the form of a tax expense cost reduction when determining utility service rates.

**105.** Wilson contended the Company's evidence related to revenue requirement projections and its comparative evaluation of rate-basing CU4 versus other options do not demonstrate that NWE's rate-base request is the best option for Montana non-choice customers. According to Wilson, NWE witness Hines' conclusions are misleading and unreliable. First, he argued NWE's NPV comparisons of rate-basing CU4 versus alternative options omit consideration of the value of the existing below-market 90 MW and 21 MW contracts of CU4 output out to 2018 that would be terminated under NWE's proposal. Wilson added that other assumptions in NWE's NPV comparisons are invalid, such as the assumption that CU4 has a remaining life of 34 years while a new plant is assumed to have a life of 30 years and the assumption that NWE's only purchase option is the Mid-C spot market when NWE has historically made medium- and long-term purchases at lower prices. Wilson also claimed that Hines' NPV analysis was highly dependent on his assumed market prices that were based on Mid-C futures prices as of May 28, 2008. Wilson contended this was a single point in time at which both oil and natural gas, as well as the electricity futures prices that follow them, had achieved unusually high levels. According to Wilson, if Hines had used futures prices just three months earlier or average prices during the past 12 months, his results would have been entirely different. Wilson claimed by choosing an unusually high price point as a measure of alternative purchase costs, NWE was able to justify its recommendation to lock Montana ratepayers into rate-basing CU4 at the very high proposed $407 million cost level when a more moderate alternative power purchase cost assumption would have produced different results.

**106.** Wilson contended Hines' NPV results are derived from CU4 cost of service assumptions provided to him by Corcoran that Wilson alleges were understated. Wilson suggested Corcoran underestimated CU4 fuel costs. Wilson contended that Corcoran made other potentially conservative cost assumptions. Corcoran assumed that maintenance capital additions will be only $4 million per year (1 percent), escalating at only 2.5 percent annually when, according to Wilson, actual capital maintenance additions over the last two years (2006 and 2007) for NWE's 15 percent interest in the plant were $4.6 million per year, and over the last 5 years they have increased at an average rate of 16.6 percent annually. Wilson also said Corcoran assumed an annual inflation rate for all operating expenses (including fuel and power) of only 2.5 percent compared to NWE's 9 percent plus annual coal cost escalation rate (from 2009 forward) and Hines' estimated annual increase in tracker rates of more than 4 percent annually (2008-2021), assuming that CU4 is rate based, and more than 5 percent annually, assuming market rates. Wilson pointed out that neither Corcoran nor Hines included any potential mercury mitigation costs for their CU4 rate-base option, and they assumed no long-term outages or major capital replacement projects over their extended 57-year assumed plant life.

**107.** Wilson asserted that NWE accepts no responsibility if its optimistic forecasts are wrong. Wilson said if NWE would guarantee the price levels calculated by Corcoran, then it may be reasonable for Hines to use these costs in his comparative analysis. But, Wilson said, NWE will not do so and therefore Hines' evaluation cannot be relied upon.

**108.** Wilson presented his own NPV comparative analysis that he claimed corrected the errors in NWE's analysis. He said he incorporated the existing 90 MW and 21 MW low cost purchases, the Mid-C prices were calculated at the February 2008 strip rather than the May 28 strip used by NWE, CU4 operating expenses (including fuel) are assumed to increase annually at 5 percent rather than 2.5 percent as assumed by Corcoran, the remaining life of CU4 is assumed to be 24 years (total life of 47 years), rather than 34 years, 9.15 percent cost of capital is used as the PV discount rate, and the mistaken inclusion of "Bicent Offer" values in 2019 and 2020 is removed.

**109.** According to Wilson's NPV analysis (Ex. JW-3), rate-basing CU4 at a value of $407 million and giving up ratepayers' existing entitlements to 111 MW of much lower cost CU4 purchases could very likely have an adverse present value cost impact of at least $400 million. Wilson acknowledged his adjustments to Corcoran's cost assumptions may be too high or too low because it is not possible to be certain about future cost forecasts. Wilson claimed that NWE is asking the PSC to set aside low cost electricity purchase entitlements that consumers have secured and paid for over the next 10 years in exchange for highly speculative, risky and unlikely values that NWE will not assure in any way.

**110.** Wilson commented that CU4 interests were obtained with and have been supported by public utility funding. Wilson said that the PSC should not rate-base NWE's CU4 interest at $407 million, but instead consider rate-basing it at a value equal to its original cost less depreciation ($37.5 million) plus whatever portion of the acquisition premium ($187 million less net book value) as NWE is able to establish is appropriate and in the public interest. Wilson argued that if the CU4 interest is rate-based, the full cost of service should not be included in tracker proceedings as suggested by Corcoran because tracker proceedings exist to provide for contracts and meeting the remainder of the portfolio requirements with market purchases. However, he said, in 2015, when the 21-MW contract has expired, the CU4 rate-basing case is estimated to be about 3 percent lower than the market-based alternative, and in 2020, when the 90-MW contract has expired, the CU4 rate-basing case is estimated to be about 14 percent lower than the market alternative.

**160.** Hines argued that MCC appeared to ignore the fact that the value of the two below-market contracts is embedded in the $407 million rate-base value. He referred to Masud's testimony that the $407 million value, derived through a valid market determination, included the value of the existing CU4 contracts with NWE (and Puget), and that absent the two contracts, the value would likely have been higher. Hines contended the value of the two contracts will be retained by customers whether the CU4 interest is rate-based or sold to Bicent. Hines reiterated that NWE's analysis indicates that the best option, except in the high carbon scenario, is rate-basing CU4.

**161.** Hines said that, contrary to MCC's assertion that NWE's NPV analysis used a 30-year total life for a new coal plant, NWE assumed that a new coal plant would not be commercially available until 2013. Thus, according to Hines, the analysis for a new coal plant only encompasses 30 years but NWE did not make any assumption that the total life of a new coal plant was 30 years, did not claim any salvage value from either the CU4 or the new build coal plant in 2042, and did not assume that CU4 only had a total life through 2042.

**162.** Hines disagreed with the MCC's assertion that he used an unusually high Mid-C future price to justify his recommendation and said MCC had no basis for its implication that NWE deliberately chose a particular price point to justify a decision. According to Hines, NWE analyzed the information using the same methodology it has employed in past resource acquisition decisions and uses market price information that is current at the time an internal acquisition decision must be made when analyzing purchase opportunities. Hines said NWE did perform a market price sensitivity analysis and the results of the market price sensitivity case compared to the rate-basing option in revised Exhibit __ (JDH-2) resulted in significantly greater costs for ratepayers. Hines pointed to Exhibit __ (JDH-5) for an evaluation of more recent price strips that demonstrates there were numerous dates between May 28 and the filing date that could have been used to obtain even more positive results for the rate-basing option if NWE had been trying to game the analysis. Hines said the spot market price on May 28 was about at its lowest value for 2008.

**163.** Hines disputed MCC's assertion that the only purchase option considered by NWE was buying all alternative power at the Mid-C spot market price. Hines claimed that NWE evaluated a purchase option based on discounted Mid-C prices, but it also evaluated a future Mid-C priced product that is reduced by 10 percent and then discounted by an additional $3/MWh.

**164.** According to Hines, MCC's characterization of Mid-C forward price products as spot market prices is incorrect because the TFS strip on which NWE based its price estimate through 2018 is a forward market that shows what an entity was willing to trade on May 28 for future performance on a particular date well into the future, while a spot market represents transactions that take place in hour-ahead, up to the day-ahead. Hines added there are substantial differences in the volatility of a spot market compared to the forward market NWE used. Hines said NWE does not use the spot market to evaluate term or longer transactions.

**165.** Hines said, despite Wilson's reference in his testimony to errors in 2019 and 2020 regarding Bicent numbers, NWE stands behind those numbers.

**166.** Hines rejects Wilson's argument that Hines' analysis is suspect because NWE will not guarantee Corcoran's estimated costs. According to Hines, the costs are informed estimates but it is not reasonable to guarantee all costs through 2042.

**167.** Hines contended that Wilson's claim that NWE has been able to enter into medium- and long-term market contracts at lower-than-market prices is contrary to NWE's experience. For example, he said, NWE's recent reverse auction resulted in products priced at about future market prices and NWE's 7-year deal with PPL Montana was negotiated at a discount to market. He said NWE has no market purchase contracts for terms longer than seven years.

**168.** According to Hines, MCC's testimony in this case appears to contradict its testimony in Docket D2007.5.46 when MCC, citing a lack of competition in the generation market, urged the PSC to make clear to NWE that the company seriously consider existing supply resources that are available to be acquired and that the PSC will scrutinize NWE's failure to do so in future proceedings regarding resource acquisition. Hines argued that NWE's proposal to rate-base CU4 is clearly consistent with MCC's recent recommendation, yet he said, MCC has seemingly reversed its previous position.

**169.** Hines concluded with the following arguments in support of rate-basing CU4 as proposed: it is the resource option that best satisfies ARM 38.5.8203 which sets as one procurement goal the facilitation of adequate, reliable service at a stable and reasonable price and at the lowest long-term total cost; it is a lower-cost alternative than the new build options of a combined cycle combustion turbine or a supercritical coal plant (assuming it could be permitted and developed); it is more beneficial to consumers over time than discounted market purchase options including those cases where forward market prices were significantly discounted from the estimated market; it is also more beneficial to customers when compared to the potential Bicent PPAs in all scenarios except for the high carbon assessment case; rate-basing CU4 would result in a long-term resource for the electric portfolio (assumed for the analysis to be through 2042) that is relatively stably priced and would reduce the market price volatility for the portfolio, a goal NWE, the MPSC and the MCC have advocated in the past; and, it provides a unique opportunity to augment the resource portfolio with an existing coal fired generation facility that is located in Montana.

**Michael Barnes**

**170.** Barnes disputed Wilson's suggestion that the CU3 and CU4 plants will be abandoned by its current owners and that the life expectancy of the plants are shorter than the timeframe used in Hines' analysis. According to Barnes, NWE's assumption that that CU4 has a 34-year life expectancy is a reasonable estimate of the life of the plant because the plant owners have a solid capitalization plan with proven results, the CU3 and CU4 plants have been and will continue to be recapitalized to the extent necessary to maintain that operation for at least an additional 34 years, and it not feasible or justifiable to let the condition of the plant deteriorate to such a degree that that it would be worth the risk of losing the current operating permits/licenses and attempt to replace this asset with another coal plant.

**171.** Barnes does not agree with Wilson's assertion that the purchased power expenses of $6.13 million could be understated. Barnes said these power costs are known under a long-term contract with DB Energy Trading and that these are net costs incurred because power is sold at a fixed price under this contract and subsequently repurchased at a higher fixed price under the same contract.

**172.** Barnes contended that Wilson made a mistake in his assertion that Corcoran's capital expenditure cost assumptions are understated. Barnes argued Wilson used only the last two years' capital additions as indicative of annual capital expenditures when CU3 and CU4 are on three-year maintenance overhaul schedules, meaning that one year in three there is no scheduled overhaul. According to Barnes, in order to make a reasonable assumption of average capital costs an average of the last three years' capital is required. Barnes said that Corcoran, instead of using historical capital expenditures as the basis for his estimation of capital costs, used the average costs provide by the operator PPL Montana in the 10 year capital budget (2008-2017) to get an average cost of $3.975M, assumed $4M to be approximate, and escalated that number by 2.5 percent per year for future years.

**173.** Barnes disagreed with Wilson's assertion that capital costs have increased at an average rate of 16.6 percent over the past five years and that would be indicative of future capital costs. Barnes argued that using previous capital spending as the basis for future years is only indicative of what was needed previously not what is going to be needed over the next 10 years.

**174.** Wilson's assertion that Corcoran and Hines did not include any potential mercury mitigation costs for the CU4 rate-base option is not entirely correct, according to Barnes. He said the 10-year capital budget has mercury mitigation capital included and that document was Corcoran's basis for the capital predictions. He acknowledged that O&M costs associated with mercury mitigation were inadvertently excluded and that Corcoran and Hines have modified their testimony and exhibits accordingly.

**175.** Barnes said Corcoran and Hines factored in outages and major capital replacement projects in their analyses, contrary to Wilson's claim that they did not.

**176.** Barnes listed the following examples of what he said were arbitrary or inaccurate assumptions made by Wilson: Wilson's going back in time to choose a February price strip instead of the May 28 strip; Wilson's addition of $5 million to operating expense and 5 percent escalation rate when NWE had based its testimony on information from the plant and mine operators; the same $5 million addition and 5 percent escalation rate ignores the fact that the Puget-related expenses stop after 2010; Wilson's assumption of an overly high annual increase in operating expenses and his expectation that the recent oil price spike and spot market prices will self-correct to lower levels are contradictory because if oil and electricity prices go down, generation costs will also go down; Wilson's doubling the cost of capital additions to $8 million without any supporting material; Wilson's assertion that Corcoran's capital expenditures did not conform with what NWE's consulting engineers indicated would be` necessary when both Corcoran's and the engineers' report used the plant operator's 10-year estimate of capital requirements as their source; Wilson's shortening of the plant's life to 24 years with no supporting material; and Wilson's assertion that Corcoran assumed CU4 will not have outages or need major capital replacements when Corcoran included the owners' and operator's investment and outage plans in his assumptions.

**177.** Barnes argued there is no factual basis for any of Wilson's adjustments and that Wilson's assumptions can easily be discredited.

**Brian Bird**

**178.** Bird contended if the PSC adopted Wilson's recommendation regarding the determination of NWE's income tax expense in a future rate case (or other proceeding), it would simultaneously increase NWE's need for external financing and negatively impact its ability to obtain external financing at reasonable costs. Bird said the combination of these factors could require NWE to alter its investment plans and increase the costs of investments.

**179.** According to Bird, investors and ratings agencies will not accept Wilson's position that there are no current year income taxes as a result of the absence of cash payments to the Internal Revenue Service but will recognize that the practical effect of Wilson's recommendation is to reduce NWE's revenues and violate the expectations of investors that unregulated assets of NWE are separate from its regulated operations.

**180.** Bird argued that Wilson's recommendation would have an adverse impact on NWE's financial integrity and its ability to complete planned investments (mainly in Montana) at a reasonable cost. According to Bird, a reduction in earnings resulting from application of the unregulated NOLs would set back NWE's efforts to maintain or improve its credit ratings, increase NWE's reliance on external sources of capital, and negatively impact the marketability and increase the costs of NWE debt and equity.

**181.** Bird described NWE's efforts to improve its unsecured debt ratings, which include: using available cash flow to increase its investment in its utility businesses and to pay down debt, refinancing a significant portion of NWE's outstanding debt, which reduced the Company's interest expense, and purchasing the leasehold interests in CU4.

**182.** According to Bird, the rate-basing or sale of NWE's CU4 interest may have a favorable impact on the Company's credit rating. Bird said Fitch and Moody's each noted that either alternative could trigger an upgrade. The agencies, as well as NWE, see either of these options as the last step in the Company's return to a "back-to-basics" state-regulated utility model.

**183.** Bird contended that if the PSC adopted Wilson's recommendation regarding income tax expenses, the credit rating agencies would likely draw the conclusion that NWE's financial situation would be unlikely to improve in the near future and would instead be more likely to deteriorate. According to Bird, the implications of the credit rating agencies reaching this conclusion are serious because NWE has only recently achieved investment grade ratings for its unsecured debt and rating agencies remain concerned about NWE's regulatory environment in Montana.

**184.** Bird said the negative impact of Wilson's recommendation on the Company's earnings and cash flow would put downward pressure on the credit ratings and certainly the credit outlook. Bird said the agencies understand that the NOLs improve the Company's cash flow. If Wilson's recommendation were approved by the Commission, NWE would start backsliding from the progress it has made in improving its credit ratings since emergence from bankruptcy. Bird said investors and rating agencies are very sensitive to the regulatory environments of regulated utilities, because regulatory risk comprises a significant element of a utility's overall business risk.

**185.** According to Bird, adoption of MCC's recommendation on income tax expense will impact investors' views of the current regulatory climate in Montana. Bird said, while there have been some positive changes in the perception of NWE's regulatory environment in Montana, rating agencies and investors still have concerns. Bird argued that a change to the PSC's long-standing basis for calculation of income taxes for ratemaking and seizing the substantial value of the NOLs that resulted from unregulated losses for the benefit of ratepayers would be viewed as very negative changes in the Company's regulatory environment in Montana and would undermine NWE's prospects for improving its financial performance.

**186.** Bird explained the effect of debt ratings on consumers. The lower the debt ratings, the higher the interest costs on the investments in Montana and the higher the cost of service. The interest cost improvements the Company has been able to achieve will start to deteriorate, according to Bird, and this would be detrimental in this higher cost environment.

**187.** Bird contended that if MCC's recommendation were adopted, there would be downward pressure on the Company's stock price, which would likely result in shareholder pressure to reduce the amount of investment in Montana since actions like this would demonstrate an lose the bid, which would have ended any opportunity for NWE's CU4 interest to be rate-based. (Ex. NWE 10 at 12.)

**255.** The PSC finds that NWE's procurement of the CU4 resource is consistent with the PSC administrative rules in ARM Subchapter 82 that are relevant to this Application. The relevant rules concern: procurement objectives (ARM 38.5.8204), resource needs assessment (ARM 38.5.8210), resource acquisition (ARM 38.5.8212), modeling and analysis (ARM 38.5.8213), risk management and mitigation (ARM 38.5.8219), and transparency and documentation (ARM 38.5.8220). No party claimed NWE's actions were inconsistent with these rules.

**256.** The PSC notes that regarding 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.

**Cost of service and revenue requirement issues**

**257.** The PSC accepts NWE's overall cost of service and revenue requirement as reflected in the final versions of Exhibits NWE-2 and NWE-3. MCC witness Wilson argued that NWE's assumptions regarding CU4 operating and maintenance expenses understated likely costs. Wilson presented his own revenue requirement exhibit that reflected his projected higher costs, including his assumptions that operating and capital maintenance addition expenses would escalate annually by 5 percent rather than NWE's assumed 2.5 percent, that capital maintenance additions will be $8 million rather than NWE's assumed $4 million, that operating expenses should be adjusted upward to $40 million rather than NWE's $35 million, and that the remaining life of CU4 is 24 years rather than NWE's 34 years. (Ex. MCC-4 at 27 & JW-3.)

**258.** The PSC finds NWE's cost of service and revenue requirement testimony more persuasive than MCC's because NWE's cost of service analysis was developed by consulting with NWE's in-house expert Barnes and with the CU4 plant owners and operators who have actual expertise and interest in operating and maintaining the CU4 facility. (Tr. at 73.)

**259.** At hearing NWE witness Corcoran said his cost of service exhibit (in the initial filing, PRC-1, now Ex. NWE-2) that was attached to his direct testimony inappropriately included in the purchased power expense cost of service line item an annual charge of $6.1 million labeled the "Deutsche Bank Purchase Power Agreement." The inappropriately included cost also flowed through to his revenue requirement exhibit (in the initial filing, PRC-2, now Ex. NWE-3). According to Corcoran, that cost is a shareholder cost, not a customer cost, and he revised the two exhibits, NWE-2 and NWE-3, to reflect the adjustment. The PSC agrees the Deutsche Bank cost was inappropriately included in his cost of service and approves the adjustments made by Corcoran.

**260.** NWE proposed to include CU4 cost of service in electric supply rates as part of its annual electric supply tracker in order to develop an all-in electric supply rate. (Ex. NWE-1 at 23.) MCC said if the Commission decides to rate-base CU4 it should not allow NWE to create a separate set of rates for CU4 because it is difficult to track real costs for CU4 on a stand-alone basis and such a proposal that would include CU4 in NWE's tracker with regular adjustments assures that NWE has no risk of full recovery.

**261.** The PSC disagrees with MCC and believes that the use of a tracker is a reasonable way to recover costs. The Commission has successfully used trackers for many years and has experienced few difficulties with them.

**262.** Cost of capital was initially addressed in NWE's filing by Corcoran. He used an imputed CU4 capital structure of 50 percent equity and 50 percent debt to compute the overall rate of return. He based the return on equity of 10.75 percent on the last authorized return from Docket D2000.8.113 and the cost of debt is the weighted average cost of debt for CU4 at the end of 2007. (Ex. NWE-1 at 14.)

| **Capital Structure** | **Rate** | **Percent Capitalization** | **Rate of Return** |
|---|---|---|---|
| Equity | 10.75% | 50.00% | 5.38% |
| Debt | 7.55% | 50.00% | 3.78% |
| **Total** | | 100.00% | 9.15% |

Ex. NWE-2 at 3

**ORDER**

**1.** NWE's Application for approval of its interest in Colstrip Unit 4 as an electricity supply resource under certain terms and conditions is approved.

**2.** The PSC declines to issue a declaratory order on the treatment of NWE's net operating losses, however, net operating losses in the amount of $161 million will not be reflected in future Montana electric and natural gas delivery rates.

**3.** These Findings of Fact and Order supersede Order No. 5168 in Docket 85.11.145.

**4.** Any future sale, transfer, etc. of NWE's interest in CU4 will require regulatory approval of the PSC. The proper ratemaking treatment of any future gains on any activity involving CU4 will be determined by the PSC. In making that determination, the PSC will recognize that ratepayers have carried the risk of loss since the issuance of this Order.

**5.** All conclusions of law that can properly be considered an order and that should be considered as such to preserve the integrity of this Order are incorporated herein as an order.

**6.** NWE is directed to file tariffs to implement the rate-basing of CU4 for service on and after January 1, 2009.

DONE IN OPEN SESSION at Helena, Montana on the 13th day of November, 2008 by a vote of 4 to 1.

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BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

Greg Jergeson, Chairman

Doug Mood, Vice Chairman

Brad Molnar, Commissioner

Robert H. Raney, Commissioner

Ken Toole, Commissioner (dissenting)

ATTEST:

Verna Stewart
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 ARM 38.2.4806.