Service Date: October 18, 1985

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

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IN THE MATTER Of The Application Of MONTANA POWER COMPANY For Authority To Establish Increased Rates For Electric Service In The State Of Montana. Colstrip Unit No. 3 and Related Facilities	))))))	UTILITY DIVISION DOCKET NOS. 84.11.71, 84.10.64 & 83.9.67 ORDER NO. 5113c

FINDINGS OF FACT

1. On August 28, 1985, the Public Service Commission (PSC) issued Order No. 5113b, the final order for Dockets No. 84.11.71 and 83.9.67. On September 16, 1985, the Northern Plains Resource Council, District XI Human Resource Council, Missoula County, Montana Low Income Coalition, Montana Senior Citizens Association, Low Income Group for Human Treatment, and Butte Community Union, filed a Motion for Reconsideration. The PSC finds the petitioners to be proper Intervenors in this proceeding and their Motion to be timely filed. Accordingly, the PSC will consider the Motion.

2. The Intervenors first and foremostly asserted that the PSC should not enter a final order because portions of Order No. 5051c, Docket No. 83.9.67 are being appealed to the Montana Supreme Court. They reasoned that a stable rate base policy should be developed and the Court's ruling is needed apparently before any plant is rate based. They further stated that the first phase revenue level of Montana Power Company's (MPC) phase-in plan was in effect on an interim basis, thereby removing the need to issue a final order.

3. The PSC finds the above reasoning to be faulty. Order No. 5113b found the rate basing policy previously used by the PSC for Montana-Dakota Utilities' (MDU) Coyote plant to be reasonable given the record in Docket No. 84.11.71. Specifically, Finding No. 33 stated: "This approach is consistent with former Commission cases as well as meeting, coincidentally the terms of Judge Sullivan's order. It is the approach adopted by the majority of commissions who have considered new plant additions to rate base". Evidence presented ln this case with respect to Colstrip 3 rate base treatment suggested that it: 1. Not be rate based; 2. Be rate based at fair market value; 3. Be studied further and the rate base decision be deferred; 4. Be rate based in its entirety; 5. Be rate based with a surplus energy sales offset. The first three recommendations were made by John Duffield, Missoula County's witness. The fourth by MPC and the fifth by MCC. Duffield's third recommendation is in essence what the Motion urges. The PSC rejected this notion in Finding No. 47: "The Colstrip 3 issue has been before the Commission for almost two years and has consumed very substantial resources in the process. The plant began commercial operation in December, 1984 and "further study" would further delay a final ruling until, at least, the fall of 1986. MPC is entitled to a ruling on its proposal." The PSC finds that the filing of an appeal of Order No. 5051c does not change the state of the record in this later Docket (84.11.71). Duffield's first two recommendations were considered and rejected in Order No. 5113b. Reconsideration has not been sought for this part of the order. Although the PSC allowed Colstrip 3 into rate base it did so only with the provisio that all excess energy be sold off system, which was the MCC recommendation. The Intervenors raise certain questions

regarding the MCC recommendation and the PSC approval of it. These will be addressed below. Finally, the PSC will not delay a final order because to do so would be harmful to MPC even though interim rates reflected the full amount of the year 1 phase-in revenue. Without Order No. 5113b MPC would not be able to defer for future collection the difference between the first year phase-in amount and the total revenue amount approved.

4. The Intervenors asserted that carrying charges associated with Colstrip 3 should not be allowed after August 3, 1984, the date Order No. 5051c was issued. They argued that language from Order No. 5051a contemplated that the carrying charges should run from January 10, 1984 "for a period of approximately seven months". While it is true that the PSC's intention was to limit the time frame for which the carrying charges could accrue when Order No. 5051a was issued the legal effect of Sullivan's order was to render inoperative the finality of Order No. 5051c. Order No. 5113b became the final order for Docket No. 83.9.67, thereby allowing the 5051a carrying charges to accrue for the period January 10, 1984 through August 29, 1985. The PSC would note that any amounts associated with Colstrip 3 included in Interim Order Nos. 5113 and 5051j have been netted against the carrying charge finally approved. Finally, the petitioners are correct in their contention that, should the Supreme Court overturn Sullivan's order in total, the final order date for purposes of computing Order No. 5051a and b carrying charges would be August 3, 1984, a period of approximately seven months.

5. The Intervenors contended that the PSC erred in determining the used and usefulness of Colstrip 3 to meet peak loads during the time rates would be in effect. Their contention is

founded primarily upon cross-examination of MPC witnesses. The PSC will address these concerns but finds it must clarify a potential misperception implied by the Motion. While the PSC found MPC's analysis convincing with respect to the usefulness of Colstrip 3 (Finding No. 62) it rate based the plant based on the reasoned expertise and testimony of MCC's witness (Finding No. 67).

6. The Motion specified the following points of error:

   A. MPC did not contemplate a rate-basing decision on the basis of peak loads, but rather filed its case based on prudency. The PSC specifically rejected MPC's prudency arguments (Finding No. 60). The PSC finds that the only remaining basis contained in MPC testimony for rate base inclusion was usefulness of the plant (see Finding Nos. 59-61). This coupled with MCC recommendations and past PSC precedent formed the basis for PSC approval.

   B. Reliance on peak load was inappropriate as the basis for Colstrip 3 inclusion. The PSC adopted reliance on peak load to rate base Colstrip 3 as a policy matter based on the consistency of this approach with past PSC decisions and based on MCC's recommendation. It also adopted MCC witness Clark's analysis of the validity of MPC's projected peak in this case as being technically correct (Finding No. 65). The PSC found as a policy matter that MCC's position, which included the off system sale of excess energy, to properly balance the interests of the stockholder and ratepayer.

C. The Intervenors argued that the 1985-86 peak load was not known and measurable and that it was not adjusted, citing various transcript references to cross-examination of MPC witnesses. The PSC would point out that it uses the known and measurable criteria only as a test of reasonableness, not a standard of law. The only substantive review of the 1985-86 peak load was done by Clark, who after adjusting for increased hydroelectric peak capability, found the forecast be reasonable, as adjusted. The PSC finds the additional adjustment for Anaconda Co. peak load would not alter the conclusions reached in Order No. 5113b, assuming the Petitioners contention to be valid.

D. Order No. 5051c casts doubt on the need of Colstrip 3, contrary to the findings in Order No. 5113b. Specifically, Order No. 5051c raised the question of providing service from least cost alternatives to serve increased load (Finding No. 142). To answer this question the PSC requested that a lifecycle study be performed. The PSC hoped the lifecycle approach would cure various potential problems with 5051c resource policy. Obviously, the PSC considered the 5051c approach to be transitionary in nature. Both MPC and the Intervenors presented their studies in this case and the PSC, for various reasons, rejected them. While the PSC may consider ways to cure statutory constraints inhibiting adoption of the lifecycle

approach, it does not intend to reinstitute the transitionary approach used for Order No. 5051c.

E. The PSC should have used an annual peak deficiency as opposed to a monthly deficiency and should not allow plant maintenance at the time of the system peak. Finding Nos. 64 and 65 discuss the monthly -vs- annual peak question raised in the motion. The PSC does not find the motion persuasive and will not reconsider the findings. Even if it were persuaded to use an annual peak, however, it would not affect the conclusion reached in the order. With respect to the allegation that plants were down for maintenance at the time of the system peak, the PSC has reviewed p. 7 of Ex. 23 and finds that no plants were down for maintenance during January, 1986, the month of the system peak.

F. PSC approval of MCC's off system sales adjustment causes ratepayers to "eat" the difference between the off system sales price and the fully distributed cost of Colstrip 3. The PSC also finds distasteful the idea that short term spot market prices do not equal Colstrip 3's fully distributed cost. It is apparent that long term firm sales of Colstrip 3 output would approximate that cost, such as in PP&L's sale of its Colstrip 3 output to BHP&L. When the characteristics of the system warrant it, the PSC will insist that the off system sales price nearly approximate fully distributed cost, as it did in PP&L's Colstrip 3 order. This

however, contemplates a long term sale of output with little or no ability to use the resources output to serve native load. The PSC found Colstrip 3 to be used and useful to serve MPC load, so it must in turn recognize the lower, short term, nonfirm sales prices which allow full access to the plant's output when it is needed to serve MPC load. The other side of the equation is off system sales volumes. The PSC approved a far higher level of sales volumes than proposed by MPC. The PSC's analysis indicated that MPC could most likely actually make the sales, although the adjustment would have been made irregardless based on Clark's recommendation that it be imputed to balance the risk of new power plant additions between shareholders and ratepayers.

G. The Bird plant availability study should be completed in five months rather than fifteen so that its output could be used during the time rates would be in effect. The PSC finds this point basically moot. The January, 1986 peak would occur before the study could be completed even if the PSC were to request the study within five months. This says nothing of the time it would take to analyze the study or to repair the plant. Additionally, Order No. 5113b recognized a 61mw peak deficiency, but did not allow revenues for ratemaking purposes to compensate MPC for the purchase of resources to serve this load. If Bird were available its running

cost may need to be included for ratemaking purposes. As it now stands, the PSC finds that when MPC wishes to establish rates to cover its peak deficiency it will need to show that the resource is least cost, especially compared to Bird (see Finding No. 79). This, of course, applies only on a prospective basis.

H. HRDC witness Logan's trended rate base proposal could be adopted for a 10 year period if the PSC objects to his 36 year proposal. Further, Logan's approach did not inadvertently forget to consider the cash shortfall referenced in Finding No. 88. He specified the t MPC's financial condition could not be accurately analyzed because of Colstrip 4's effect on MPC's financial condition. The PSC fails to be persuaded by either point. The record was not sufficiently developed on the point of how a conversion to conventional ratemaking at year 10 would work. Would all revenue deferred up to year 10 be collected in a lump sum in year 11? Or would it be collected ratably over the first 10 years? Or would it be collected ratably over the remaining life of the plant? Any of these assumptions could produce radically different results from those reflected in Logan's exhibits. With respect to the cash shortfall, it is clear from Logan's exhibits that they pertain only to the capital costs associated with Colstrip 3. If they do not permit recovery of Colstrip 3's capital costs where would

these monies come from? Apparently from borrowings (which could have been factored into Logan's proposal) or from other assets, which would cause a shortfall there. The PSC therefore, rejects the Motion's contentions.

7. Intervenors urge the PSC to reconsider its rejection of the inverted residential rate proposal submitted by HRC (Direct Testimony of Dr. Thomas Power, Exh. 10). Intervenors argue that without rate-basing Colstrip 3, there will be no dramatic rise in price and therefore inverted rates are necessary to get prices up to a cost-based level (Motion, pg. 16, lines 13-19).

8. Intervenors also cite the apparent inconsistency in 1) recognizing the regional surplus while 2) rate-basing Colstrip 3 (pg. 16, lines 20-22). The regional surplus, the Intervenors maintain, is contingent on conservation, which is, in turn, contingent on inverted rates. Furthermore, Intervenors maintain, the Northwest Regional Power Planning Council "strongly endorses" inverted rates (pg. 16, line 22; pg. 17, line 1).

9. The Intervenors also argue that the regional marginal cost cited by the PSC does not include "transmission, distribution, or customer service, but rather reflects generation alone." Therefore, prices are less than marginal cost (pg. 17, lines 2-7). Because prices are still less than marginal cost, the Intervenors argue, raising a tail block rate towards marginal cost does not entail a subsidy and thus does not require a taxing authority (pg. 17, lines 19-21).

10. The Intervenors maintain, in summary, that "the conflict between rate-basing a large coal plant as used and useful while rejecting an inverted rate because of a glut of power is

inescapable. Failure to face this conflict . . . puts the Commission and ratepayers back on the roller coaster of overdevelopment and subsequent promotion of growth." (Pg. 18, lines 2-7).

11. The PSC finds the intervenors argument unconvincing and absent of any support. Throughout the argument, Intervenors fail to recognize 1) the distinction between sunk resource cost and marginal resource cost that even its witnesses cite, and 2) the distinction between the "public interest" and the interest of the "ratepayers" the Intervenors represent.[1]

12. The Intervenors' argument that a reversal of the decision to rate-base Colstrip 3 would avoid a "dramatic" increase in prices causing a need for higher (inverted) prices is a fallacy. Missoula County's "least cost alternative" to Colstrip 3 was barely less "expensive" than Colstrip 3 (see footnote 5, Order No. 5113b). Failure to rate base Colstrip 3 would cause, by even Missoula County's calculation, a similar stream of embedded revenue requirement -- including the construction of an otherwise unneeded baseload plant in 1996.[2]

13. The Intervenors' assertion that there exists a conflict between the decision to rate base Colstrip 3 and reject inverted rates indicates their failure to distinguish sunk from avoidable resource cost. The "inescapable" reality is that it is the <u>sunk</u> existence of Colstrip 3 that leads to low incremental (avoidable) costs that deters the need for inverted prices. HRC witness, Dr. Robert Logan (Rebuttal Testimony, pg. 4, first answer), in the context of straight-line depreciation, points out this phenomena: "When a unit such as Colstrip 3 is brought on line and the electric utility has the increased capacity to meet greater loads, rates

increase and restrict the increase in demand." The Intervenors' proposal exacerbates the problem -- leading to further surplus and inefficiency.

14. The Intervenors allege that the "projected surplus is contingent upon achieving an assumed level of conservation. Inverted rates are an integral part of any conservation strategy." Here the Intervenors apparently fail to realize that a surplus is a cost, not a benefit. The entire thrust of the NWPPC in their 1985 plan is to minimize the cost of the surplus (e.g., see Draft Plan, pg. 2-1). This is precisely why inverted rates are now ill-timed. The problem is not a shortage, the problem is a surplus:

> "The size of the current surplus is so large that it does not make economic sense at this time to acquire conservation that could be postponed until the region has consumed the surplus and needs new resources." (Draft Plan pg. 8-17).
>
> "The rate of conservation acquisition must - reflect the need for power in the region. The Council's current load forecast and draft resource portfolio do not indicate any current need to acquire resources from the existing residential building sector. This finding has the support of regional conservation groups which, like the Council, have expressed the goal of acquiring the least-cost environmentally sound resources to meet regional loads. To achieve this goal, conservation, like other resources, should only be purchased when needed." (Draft Plan pg. 9-7).

Inverted rates at this time would only worsen the costly surplus market conditions.

15. The PSC did not as the Intervenors allege, ignore transmission, distribution, and customer service costs. It is partially the substantial embedded revenue requirement associated with these services being reflected in the retail energy (¢/Kwh) prices that leaves it questionable whether prices will be greater than or less than marginal energy (¢/Kwh) cost over the next four year period.

16. Lastly is the alleged "inescapable conflict". Here, Intervenors again confuse "ratepayers" with "public interest" and sunk resource cost with avoidable (additional) resource cost. There is no conflict in l) utilizing a sunk resource investment with low incremental cost to its fullest extent (i.e., rate base Colstrip 3), and 2) providing proper price signals to ration <u>future</u> resource investment (i.e., reject inverted rates). This is precisely why the NWPPC's resource portfolio includes Colstrip 3 while excluding additional retrofit conservation.

17. The immediate threat of overdevelopment appears to be, l) excess production of deferrable (i.e., non-lost opportunity) conservation which should be aggressively optioned, but then optimized over time, 2) the construction of <u>additional</u> generation facilities to replace the <u>sunk</u> resources sold out of region, and 3) excessive "avoided cost" prices causing costly resource investment (e.g., AEM) during an extended surplus. All three sources of overdevelopment are the result of the Intervenor's position -- a position the PSC rejects.

<u>CONCLUSIONS OF LAW</u>

1. All Findings of Fact are hereby incorporated as Conclusions of Law.

2. MPC furnishes electric service to consumers in Montana, and is a public utility.

3. The PSC properly exercises jurisdiction over MPC's rates and operations.

ORDER

1. The Intervenor's Motion is hereby DENIED.

DONE IN OPEN SESSION at Helena, Montana this 7th day of October, 1985 by a 4-1 vote.

FOOTNOTES

1. It is worthy to note here that the Commissioners are elected by the entire body of Montana residents -- i.e., the public interest. This includes nonjurisdictional ratepayers as well as non-users of electricity whose concern is Montana's resources.
2. It is the irrationality of this position -- getting rid of an existing base load plant so that we can hurry up and build another one in Eastern Montana -- that leads the NWPPC to recommend that investor owned utilities and public utility commissions avoid long term sales of sunk resources (see Draft Plan pgs. 9-33 as well as pg. 8-22). Such sales would cause the incurrence of costly additional resource development. That is, the stream of incremental resource cost associated with

Intervenors' "least cost alternative" is <u>greater than</u> the incremental resource cost with Colstrip 3.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

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CLYDE JARVIS, Chairman

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HOWARD L. ELLIS, Commissioner

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TOM MONAHAN, Commissioner

_____
DANNY OBERG, Commissioner

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JOHN B. DRISCOLL, Commissioner
(Dissenting)

ATTEST:

Trenna Scoffield
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 38.2.406, ARM.