Service Date: December 7, 1989

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 the MONTANA POWER COMPANY for Authority to Adopt New Rates and Charges for Electric and Natural Gas Service in the State of Montana. | ) | UTILITY DIVISION<br><br>DOCKET NO. 88.6.15<br><br>ORDER NO. 5360e |

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ORDER ON MOTIONS FOR RECONSIDERATION

FINDINGS OF FACT

PART A

GENERAL

On August 14, 1989, the Public Service Commission (Commission or PSC) approved Order No. 5360d, which disposed of all matters pending in Docket No. 88.6.15. On August 18, 1989, the Commission issued Order No. 5360d, which included an effective date for services rendered on and after August 29, 1989.

On August 28, 1989, the Commission, in response to motions from F. Lee Tavenner, the Montana Consumer Counsel (MCC), Stone Container, the Montana Power Company (MPC, Company or Utility), and Northern Plains Resource Council (NPRC), extended the deadline for reconsideration of Order No. 5360d until September 20, 1989, 12 days past the September 8, 1989, deadline for the Company's filing of default avoided cost tariffs in compliance with Order No. 5360d Finding of Fact Nos. 364-366.

On August 28, 1989, MPC filed a motion to extend the deadline for filing default avoided cost tariffs. By Notice of Staff Action the Commission granted an extension of that deadline to September 20, 1989, and once again extended the deadline for motions for reconsideration to October 2, 1989.

By October 2, 1989, the Commission received motions for reconsideration from MPC, MCC, Stone Container, NPRC, District XI Human Resource Council, and HRDC Directors' Association (HRC), the Montana Department of Natural Resources and Conservation (DNRC), and F. Lee Tavenner. On October 3, 1989, the Commission received a request from MPC that all parties have 10 days to respond to these motions. MPC also requested that the Commission waive ARM Section 38.2.4806(5) and (6)[1]. By Notice of Staff Action the Commission granted the requests, giving parties until October 12, 1989, to file responses to the Motions for Reconsidera
tion, and stating that the appeal time would not start until 30 days from the issuance of the order on reconsideration. A Corrected Notice of Staff Action was issued indicating that the 30

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1 (5) Denial. A motion for reconsideration shall be deemed denied when it has not been acted upon within ten days of its filing.

(6) When Order Final For Purpose of Appeal. A Commission order is final for purpose of appeal upon the entry of a ruling on a motion for reconsideration, or upon the passage of ten days following the filing of such a motion, whichever event occurs first. If no motion to reconsider is filed, the order is final and appealable within 30 days of its service.

day period of appeal would begin to run upon the entry of an order for reconsideration.

By October 12, 1989, the Commission received responses to the Motions for Reconsideration from MPC, MCC, NPRC, and Stone Container. The Commission accepted a late response from HRC.

On October 23, 1989, the Commission received from F. Lee Tavenner a Motion to Strike those portions of MPC's Response to Motions for Reconsideration that call into question the LTQF-1A methodology for computing "annual forecasted energy costs."

On November 1, 1989, the Commission received a Response to Mr. Tavenner's Motion to Strike from MPC.

## PART B

## LOADS AND RESOURCES

The various parties requested that the Commission reconsider several findings relating to loads and resources, and the acquisition of Colstrip 4 and future resources.

The Commission will address MPC's motion for reconsideration of preapproval first, followed by the various parties' motions for reconsideration of loads and resources. The Commission will then address DNRC's acquired resource proxy cost motion, MCC's

test year/forecast matching motion, and DNRC's motion regarding forecast conservation. The Commission will then address NPRC's motion for competitive bidding and DNRC's petition

for Commission participation in the Least Cost Planning group. Lastly, the Commission will address Mr. Tavenner's 1988 Default Tariff motion.

## Preapproval

MPC requests that the Commission reconsider its findings regarding preapproval, even though MPC is not requesting that the purchase be reconsidered. MPC petitions the Commission to reconsider its decision to deny the purchase based upon advanced consideration of a major utility expenditure. MPC argues that advance consideration of utility expenditures is needed to ensure lowest cost, reliable service, to customers in the long run. MPC insists that advance consideration does not necessarily place the utility's customers at greater risk, but may reduce risk to the utility's shareholders. MPC believes that the regulatory process in Montana is too risky under after-the-fact ratemaking:

> The time has come to adjust the regulatory approach to provide advance consideration of major utility investments or commitments by the Commission in pursuit of lowest cost, reliable service from a financially healthy utility. (MPC MFR, p. 21)

The Commission finds MPC's motion for reconsideration of the broad determination of preapproval moot in this proceeding since Colstrip 4 is no longer available to the Utility. Additionally, the Commission agrees with the MCC when it asserts that preapproval would represent a fundamental shift in the regulatory process (MCC RMFR p. 16). The Commission believes that it would be inappropriate to issue a major policy decision in an order on reconsideration of a specific utility issue. The Commission will review its preapproval policy. If, following that review, the Commission concludes that it is necessary or desirable to solicit comments, a notice will be issued concerning the appropriate procedure. For the above reasons, MPC's motion for reconsideration of the Commission's finding on preapproval is hereby denied.

## Loads and Resources

MPC believes that the Commission required energy ratings for Colstrip units 1, 2 and 3 are in error, as well as the hydro

upgrades and Kerr hydro facility ratings. However, MPC states that it is not seeking reconsideration of the Commission's findings, but that it intends to address these issues before the Commission in its next general rate filing.

MCC argues for reconsideration of the Commission's findings on Corette, Colstrip 1, 2 and 3 capabilities. MCC argues that MPC did not meet the burden of proof necessary for the Commission to accept a derating of Corette to 156 MW, arguing that the record supports a rating of at least 164 MW. MCC also argues that Colstrip 3 should be given a rating of 220 MW rather than the Commission accepted 216 MW rating. Additionally, MCC argues that the record is not adequate to sustain MPC's proposal to derate Colstrip 1 and 2 in this proceeding.

NPRC requests that the Commission reconsider Corette and Bird thermal plant capabilities. NPRC argues that Corette is capable of generating more than 156 MW at peak, indicating that the record supports a peak rating of 164 MW. NPRC also argues that the evidence in this proceeding indicates that Bird is capable of providing more than 3 MW of energy, proposing that the Commission require MPC to include an energy rating of 6 to 9 MW for Bird in its L&R Plan.

As a preliminary matter, the MCC points out that the issue of Corette capability became an issue when MPC submitted its filing. The Commission agrees with MCC that Corette capability became an issue with MPC's filing, not with the submission of MCC testimony. The Commission agrees that the burden of proof is upon the Company to change prior Commission accepted determinations.

The Commission finds that from a Colstrip 4 power purchase perspective, the various parties' motions for reconsideration of thermal and hydro resource capabilities and the use of BPA's 1987 NR forecast are moot issues in this proceeding, since the Colstrip 4 resource is no longer available to the Utility. However, the Commission believes that its decisions on these motions will effect avoided cost prices to QFs. To the extent motions for reconsideration of resource capabilities are granted, the Commission believes that QF rates will fall. The Commission believes that if DNRC's motion to accept the Salem based scenario is adopted on reconsideration, avoided QF rates will increase. Additionally, the Commission recognizes that changes adopted on reconsideration may effect the cost of service study required by this Order.

The Commission believes that load and resource planning is crucial from the standpoint of setting appropriate avoided and marginal cost based rates. However, the Commission notes that its Order indicates that thermal and hydro generation capabilities are issues which need to be addressed further in a future proceeding (see Order No. 5360d, FOF 335 and 342). The Commission's recognition that MPC should expand its analysis should be interpreted as an indication that the Commission is not satisfied that this issue is resolved. Moreover, the Commission believes that all parties' proposals may be flawed. As an example, the issue of Corette capability became an argument over how many times Corette has to hit a given capability before it can be considered the peak capability. MCC argues that if Corette achieves a given capacity once, that is enough to set peak capability. MPC argues that a determination of Corette peak capability should be considered using a broader set of data. In motions for reconsideration MCC revises its position, stating that a capacity rating somewhere between its original proposal and the Company's proposal is justified. NPRC's motion argues that Corette should be given a rating of 164 MW since it achieved that level eleven times.

In making its original determination, the Commission simply found MPC's recommendation the most reasonable presented in this proceeding. The Commission believes that its original determination of thermal and hydro resource capabilities is the best possible decision, given the record in this proceeding. Therefore, all motions for reconsideration of thermal and hydro resource capabilities are denied, although the Commission wishes to emphasize that it intends to revisit thermal resource capability issues further in the proceeding required by this Order.

Acquired Resource Proxy

In its Order, the Commission determined that MPC must use BPA's forecast of the Medium NR-87 rate as its proxy for the cost of acquired resources. DNRC requests that the Commission reconsider its findings and accept the DNRC proposed Salem based resource scenario as a proxy for the future cost of acquired resources. In support of its motion, DNRC notes that no party rebutted its testimony that the BPA NR rate is fatally flawed. Since the NR rate is flawed, DNRC argues that any analysis using that rate will also be flawed. Additionally, DNRC points out that the Commission issued a strong recommendation that MPC move away from its heavy reliance upon proxy costs for acquired resources.

The Commission reminds DNRC that it also determined that, "DNRC's Salem scenario is not a realistic resource alternative for MPC at this time" (emphasis added) (Order No. 5360d, FOF 358). DNRC does not raise any issues that the Commission did not consider in making its initial determination. For these reasons, DNRC's request for reconsideration of proxy resource costs is hereby denied.

Matching Test and Forecast Year

The MCC's motion for reconsideration addresses the issue of the Commission's acceptance of a load forecast which does not match test year loads. MCC states that to accept a forecast that does not match in the test year, "endangers a fundamental aspect of regulatory oversight to which it has adhered faithfully over the years; i.e., the need to match test year revenues with test year expenses" (MCC MFR, p. 7).

On reconsideration, the Commission agrees with MCC on this point. If the value of Colstrip 4 is determined using a forecast of demand that does not match test year billing determinants, then the Company is determining an expense that is to be included in the test year, when that expense is not based upon the same test year billing determinants used to determine revenues. The Commission agrees with MCC that this is where the mismatch occurs. The Commission notes, however, that argument is now moot since the price of Colstrip 4 is no longer an issue.

The Commission believes that although a mismatch is apparent in this proceeding, a mismatch will not occur during the course of a typical rate case. The Commission notes that the results of a cost of service study are generally used to allocate

revenue responsibility among the various customer classes, it is not generally used to determine test year expenses.

The Commission finds the MCC's motion for reconsideration of forecasts based upon test year matching moot. However, the Commission believes that the MCC's motion is noteworthy and may be valid in any future proceeding where forecast loads effect test year revenue requirement.

## Conservation Estimates

DNRC requests that the Commission reconsider the issue of forecast conservation. DNRC argues that it would be incorrect to reject its estimates of conservation on the basis that the cost effective level is higher than the estimated value of Colstrip 4. DNRC argues that a higher cost effectiveness level may be appropriate because its supply curves do not measure the value of capacity gained by expenditures on conservation.

In its Order, the Commission indicates that the DNRC's cost effective level may be approximately 66.55 mills/kWh when converted to nominal terms (Order No. 5360d, FOF 346). The Com mission also required that MPC calculate the avoided cost value of Colstrip 4 power in compliance with the Commission's Order (Order

No. 5360d, FOF 366). MPC's compliance filing indicates that the avoided cost value of Colstrip 4 power is approximately 37.13 mills/kWh.

In its Order, the Commission states that the DNRC's cost effective level for conservation may over-estimate MPC's cost effective conservation potential (Order No. 5360d, FOF 347). Now that the Commission has examined the Company's compliance filing, the Commission believes that it is very likely that DNRC's estimate of the cost effective level for conservation is too high, notwithstanding the fact that no credit is given for capacity saved. The Commission finds that the basis for its original decision remains valid, therefore DNRC's motion for reconsideration is denied.

## Competitive Bid

In its Order, the Commission issued a finding indicating that it has never been more apparent that the long term solution for giving Utilities and QFs equal and consistent treatment is a competitive bid (Order No. 5360d, FOF 380). However, the Commission did not require MPC to develop a competitive bid resource acquisition process. NPRC argues that the Commission does

not explain why it is not ready to require a competitive bidding process, and submits that there is no reason to delay the development and implementation of competitive bidding. NPRC requests that the Commission require MPC to submit a competitive bid proposal to the Commission within a reasonable time frame and to establish by rule making the implementation of competitive bid resource acquisitions in a timely manner.

The Commission believes that ordering MPC to establish a competitive bid resource acquisition plan represents a major policy decision by this Commission. As with MPC's motion to reconsider preapproval issues, the Commission does not believe that an order on reconsideration is the appropriate place to issue such a decision. If the Commission chooses to explore competitive bidding, it will do so via a separate proceeding. The Commission also believes other regulated electrical utilities should be allowed an opportunity to participate in any proceeding from which competitive bidding may result.

## Least Cost Planning

Although not formally a part of this proceeding, nor an actual motion for reconsideration, the DNRC petitions the

Commission to recognize and participate in the Least Cost Planning Advisory Committee group. The DNRC notes that Commission staff currently attends the meetings as observers. Furthermore, DNRC argues that there is no danger of preapproval in staff participation.

The Commission notes that the results of the committee's efforts may appear before the Commission and its staff in the context of a proceeding. If so, the Commission will review the committee's efforts at that time. The Commission is comfortable with staff's current level of participation with the Least Cost Advisory Committee group, and finds that there is no need to actively participate in the group at this time.

## 1988 Default Tariffs

F. L. Tavenner argues that the Company should provide 1988 default tariffs to comply with the Commission's Order, citing the Order, and prior Commission Orders that state that the compliance filings shall be performed annually.

The Commission notes that the last LTQF compliance filing approved by the Commission states that the energy price under

Option B is for production in the 1987-1988 Contract Year (1987 Compliance Filing). Similarly, the Company's 1989 LTQF compliance filing states that the energy price under Option B is for production in the 1989-1990 Contract Year (1989 Compliance Filing). The following is the definition given to the term "Contract Year" in the generic QF contract filed with the Commission:

> j."Contract Year" - A twelve month period of time commencing immediately after midnight on July 1 of any year and ending at midnight on June 30 of the following year. (Cogeneration and Small Power Production Agreement)

Given this definition, it appears that there will have been no tariffed price for energy delivered under Option B in the 1988-1989 Contract Year without a compliance filing. For this reason, the Commission requires MPC to file 1988 compliance tariffs for energy Option B. The Commission finds that this compliance filing must include workpapers supporting the energy price calculation, and must be consistent with the Company's 1988 load and resource plan that does not include Colstrip 4 as a resource adjusted for the Commission's findings on resource levels in Order No. 5360d.

On October 23, 1989, Mr. Tavenner submitted a Motion to Strike portions of MPC's Response to Motions for Reconsideration. In his Motion, Mr. Tavenner argues that MPC is introducing a "change in methodology" into the proceeding, and argues that the Commission should not allow this change.

The Commission denies Mr. Tavenner's Motion to Strike for the following reasons. The Commission agrees with MPC that the "methodology" used to calculate LTQF rates is appropriately determined by the Commission's prior Order No. 5091c. The Commission finds that until a change in Order No. 5091c methodology is accepted by the Commission, the prior methodology remains valid. The Commission notes that it is requiring MPC to file 1988 LTQF rates under energy Option B. This rate will be reviewed and must be found in compliance with Order No. 5091c methodology before it will be approved by the Commission.

Regarding the issue of whether MPC must pay QFs delivering energy under Option B: The Commission believes that this is an issue of normal contract administration and individual contract language. In issuing the previous finding, the Commission is simply requiring MPC to file 1988-1989 energy rates for delivery

under Option B, not offering prejudgment of any complaint filing that may appear before the Commission regarding the appropriate energy payments that QFs should receive under Option B for deliveries in the 1988-1989 Contract Year.

## PART C

## REVENUE REQUIREMENTS

### Conservation Expenditures

Parties Requesting Reconsideration
- Montana Power Company
- Montana Department of Natural Resources and Conservation
- District XI Human Resource Council and Directors Assoc.

Parties Opposing Reconsideration
- Montana Consumer Counsel

Effect on MPC's Revenue Requirement

| | |
|---|---|
| MPC Electric (Total Jurisdictional) | $(28,895) |
| MPC Natural Gas | $(28,565) |

Discussion

In Order No. 5360d, the Commission found a 15-year amortization period for MPC's investment in conservation to be proper. In their Motions, DNRC and HRC suggest a 10-year amortization period. In its Motion, MPC does not specify a preferred amortization period, but disagrees with the use of 15 years and says that 10 years is the longest amortization period for conservation resources used by regulators in other states. In its Reply to the Motions, MCC states that the Commission should not modify the approved 15-year amortization period.

MPC

In its Motion, MPC says that the Commission's decision to amortize the conservation costs over 15 years causes risk that MPC will not be able to include those costs as an asset on its books and acts as a disincentive to make substantial investments in conservation. MPC mentions Jerry Pederson's testimony that he is unsure whether or not a 15-year period is short enough to allow MPC to record conservation costs as an asset on its books and that 10 years was the longest period used by regulators around the country. MPC says that favorable regulatory treatment is the only assurance the investor has that the investment has value.

DNRC

In its Motion, besides questioning the approved amortization period for conservation expenditures, DNRC also asked the Commission to include a specific and early date for MPC to submit a conservation accounting proposal. DNRC says that MPC's proposal should include a review of the accounting treatment of conservation investments in other jurisdictions and the extent to which writeoffs were taken for investments amortized over periods longer than 10 years. DNRC argues that early debate and ruling on such a proposal would resolve some of the uncertainty surrounding MPC's conservation planning.

Concerning the proper amortization period of conservation expenditures, DNRC says that the record only supports a shorter amortization period and no expert witnesses knew of utilities currently booking regulatory assets for more than 10 years. DNRC concludes that a 10-year amortization period would encourage the development of conservation and send a signal to MPC's stockholders and Wall Street as well as MPC management.

HRC

In their Request for Reconsideration, HRC argues against the 15-year amortization period. HRC agrees with MPC's argument of accounting limitations keeping a portion of the investment off the books a regulatory asset making the utility appear "poorer" to its investors and causing there to be a disincentive to conservation. HRC says that, at a minimum, the Commission could approve a 10-year amortization for now to encourage conservation to recognize the difference between a utility-owned and a regulatory asset. HRC says that the Commission could state its concern for matching benefits and costs and state an intention to re-evaluate this issue as the program expands and information is acquired.

MCC

MCC argues against MPC, DNRC, and HRC in its Reply to the Motions. Concerning MPC's reference to Mr. Pederson's doubt that 15 years would be an acceptable period for booking purposes, MCC quoted Mr. Pederson showing him unable to make any judgment about MPC's ability to put the conservation investments as an asset on the books if a 15-year amortization period were used. MCC argues against MPC's reliance on SFAS No. 92 concerning phase-in plans saying that this Statement, which calls for the recovery of regulatory assets within 10 years, relates only to major, newly completed plant. MCC then discusses other "regulatory assets" amortized longer than 10 years, such as deferred plant expenses which are amortized over the life of the plant and carrying costs accrued on Colstrip #3 which were also amortized over the life of the plant. MCC points out that MPC does not directly attempt to make the same accounting argument of HRDC concerning "accounting limitations." MCC concurs with DNRC's suggestion that MPC should submit a conservation accounting proposal.

Commission Analysis

In Order No. 5360d, the Commission emphasized that, as of yet, there are no rigid guidelines for proper ratemaking treatment of conservation costs and that a cautious approach is proper under the circumstances. Therefore, the Commission ap proved a 15-year amortization period for conservation investments and said that the matter could be addressed in a subsequent rate filing. MPC is expected to make a general electric rate filing within the next 12 months.

The Commission finds the arguments for reconsideration of the proper period of amortization for conservation costs not to be persuasive. MPC's concerns about whether or not such assets created by its regulators can truly be recognized as assets with an amortization period of 15 years are based on the unknown, as reflected in the testimony of Mr. Pederson of MPC (Order No. 5360d, FOF 53). Concern over the unknown hardly seems reason enough to change the amortization period. HRC says that if MPC is unable to carry these investments on its books as an asset, then there will be a large disincentive for the development of the conservation program. Again, the Commission finds no reason for alarm based on the record in this proceeding, which strongly indicates a lack of

certainty on the subject of whether or not MPC would be able to carry conservation investments on its books with a 15-year amortization period in place.

Proponents of a 10-year amortization period cite various reasons for support of this proposal. Without endorsing a 10-year amortization period, MPC says that a 15-year amortization period causes a disincentive to MPC making substantial investments in conservation. DNRC says that a 10-year amortization period would encourage development of conservation and send a strong, positive message to MPC's stockholders and to Wall Street. HRC echoes those comments of DNRC and says that MPC's conservation program could be evaluated as the program expands. The Commission disagrees with these "incentive/disincentive" arguments at this point in the development of MPC's conservation program. These concerns at this time are no more than speculation on the part of the proponents of the 10-year amortization period, and these are matters that can be addressed in a future proceeding. MPC and all other proponents of a shorter amortization period can present their views during the next MPC rate filing, when more information about this subject is actually known. At that time, perhaps those parties can also

address MCC's statements that a 10-year amortization period applies only to newly completed plant.

Concerning proper accounting procedures for conservation, Order No. 5360d said that MPC should present a proposal for review. The Commission finds that the proper approach in resolving this issue is to open a generic docket in the near future that will allow the Commission to direct its attention to this specific question. Such a proceeding will allow all interested parties to make proposals and to comment on the proposals of the other parties, including an analysis of approaches being used or considered in other jurisdictions. The Commission will, therefore, be able to make a well informed decision after considering a full record. Consistent with past practice, the Commission emphasizes that accounting procedures do not dictate proper ratemaking determinations and methodologies. In this instance, however, the Commission acknowledges the unusually heavy weight that the outcome of this upcoming accounting proceeding will likely have on future ratemaking treatment of utility investment in conservation. This approach should address the concerns expressed by DNRC and MCC.

Based on the above discussion, the Commission finds that the Motions of MPC, DNRC, and HRC concerning the proper amortization period of conservation investments are DENIED.

## QF Buyouts

Parties Requesting Reconsideration
Montana Power Company

Parties Opposing Reconsideration
Montana Consumer Counsel

Effect on MPC's Revenue Requirement
MPC Electric (Total Jurisdictional) $(277,426)

### Discussion

In Order No. 5360d, the Commission approved MCC's proposal to eliminate $187,000 in expenses and $516,402 in rate base related to the buyout of QF projects. In its Motion, MPC argues that the elimination of these costs should be reconsidered because the decision fails to recognize the environment in which the QF contracts were administered and because the decision represents poor public policy. In its Reply to Motions, MCC argues that assurance that settlement costs will always be recovered is inappropriate and has been rejected by the Commission.

MPC

In its Motion, MPC explains that the environment concerning the QF contracts was one in which MPC believed it had an obligation to be cooperative with QF's to give QF's the benefit of the doubt, resulting in MPC's decision not to strictly enforce QF delivery dates and not to include strict requirements for timely delivery in QF contracts. MPC says that the Commission has responsibility for creating this environment. MPC then lists a variety of representative Commission actions creating the environment, such as the following: the prohibition on liquidated damages; the March 14, 1986, letter; many informal advisories; and the Commission's refusal to suspend the QF rates for "fully negotiated" contracts in Docket No. 84.10.64, Order No. 5091a.

MPC says that the second reason for reconsideration is that the decision represents a policy that encourages litigation, and the costs of litigating the termination of the QF contracts could easily be as great as the costs of the mutual terminations. Also, MPC says that while risk of liability for punitive damages was small, even a small risk of punitive damages, given their potential huge size, must be seriously considered in deciding whether to settle or to litigate. MPC is concerned that the

Commission's decision suggests MPC must always litigate disputes if it is to have any assurance that the costs will be recoverable in rates.

Finally, MPC states that by settling these contracts, the Commission and its staff were spared from having to devote considerable resources to the numerous disputes which MPC believes unilateral termination would have unquestionably spawned.

MCC

In its Response to Motions, MCC argues against MPC's assertion that the Commission ignored the environment surrounding the QF contract formation and termination. Reference is made to Finding of Fact Nos. 61-74 and MCC's Opening and Reply briefs.

Concerning the encouragement of litigation, MCC says that the Company bases its concern on the absence of a 100% guarantee that settlement costs will be recovered. MCC says that the fundamental flaw in this argument is that there is no such guarantee with respect to any of MPC's expenses. MCC states that the standard to guide future decisions of such matters is one of prudence. MCC says that, as opposed to always litigating, acceptance of MPC's

arguments would mean that the Commission would always defer to the Company's judgment.

Commission Analysis

The Commission finds that MPC's position regarding the role of the Commission throughout this QF contract situation and particularly concerning the QF environment over time is worthy of consideration. However, the overriding facts remain that MPC had every opportunity to terminate these contracts for lack of performance. However, MPC chose to extend those contracts time and time again. The Commission stands on its reasoning in Order No. 5360d, FOF Nos. 61-74, on this matter and continues to believe that the QF buyout costs should not be shouldered by MPC's ratepayers.

Concerning MPC's argument that this decision is poor public policy as it encourages litigation, the Commission disagrees and points to FOF No. 73 in Order No. 5360d. There is no guarantee of recovery for any of MPC's expenses because they are all subject to a prudence review and the various standards of proper ratemaking. Any and all settlement costs must stand on their own merit in the ratemaking arena. The alternative prospect, always deferring to the judgment of MPC on such matters,would be counter to the statutory

role of the Commission. As should always be the case in management decisions, the Company must weigh the pros and cons of agreeing to settlements and assess the risk of recovery in rates.

Saving PSC staff time can be a positive goal or approach in evaluating potential settlements, and the Company is to be commended for this recognition. The Commission, however, wonders how much time was really saved in this instance and believes that the value of such time savings must be weighed by MPC management along with all other considerations in its decision making process.

Therefore, the Commission finds that MPC's Motion concerning QF buyout costs is DENIED.

## CIS/FMS

Parties Requesting Reconsideration
Montana Power Company

Parties Opposing Reconsideration
Montana Consumer Counsel

Effect on MPC's Revenue Requirement

| | |
|---|---|
| MPC Electric (Total Jurisdictional) | |
| Remove CIS Costs | $(1,142,337) |
| Remove FMS Costs | $(184,786) |
| MPC Gas | |
| Remove CIS Costs | $(256,863) |
| Remove FMS Costs | $(35,350) |

Discussion

In this proceeding, MPC proposed to include the costs of the Customer Information System (CIS) and Financial Management System (FMS), but did not include any associated benefits, which are estimated by MPC to be quite substantial on an annual basis.

In response to Staff data requests, MPC provided the amount of rate base and expenses associated with CIS and FMS that are included in this case and the expected annual benefits, which are not proposed to be included in this proceeding, as follows:

| | |
|---|---|
| CIS | |
| Rate Base | $1,481,084 |
| Expense | $ 586,489 |
| Expected Annual Benefits | $5,900,000 |
| FMS | |
| Rate Base | $ 1,650 |
| Expense | $ 289,057 |
| Expected Annual Benefits | $1,100,000 to $9,300,000 |

In Order No. 5360d, the Commission found that rate treatment for costs associated with CIS and FMS would not be proper given the matching, known and measurable, and used and useful problems. The Commission said in Finding of Fact No. 122, "In a

subsequent proceeding, when MPC can demonstrate that matching of costs and benefits has occurred and that the systems are fully implemented, the Commission will consider the proper ratemaking treatment for CIS and FMS." Therefore, the Commission disallowed all CIS and FMS costs, resulting in a reduction in electric rate base of $905,830 for CIS and $1,102 for FMS and a reduction in expenses of $913,566 for CIS and $183,912 for FMS and a reduction in depreciation of $65,952 for CIS and $9 for FMS.

MPC

In its Motion, MPC argues that the evidence does not support the disallowance and that the adjustment was made without complying with the requirements of due process of law. MPC states that CIS and FMS are indeed used and useful within the reasonably foreseeable future, that their costs are known and measurable, and that substantial benefits from those systems are reflected in the test period in this case. MPC says that CIS was fully operational in December of 1988 when MPC's old billing system was completely out of service. Some parts of FMS were operational in 1988, and it should be completely in operation "within the coming year." Based on the premise that rates from this proceeding can logically be

expected to be in effect for a period of at least one year, MPC says FMS will be used and useful within the reasonably foreseeable future.

Concerning the benefits of CIS and FMS, the Company states that the Order has added a new requirement to the rules by requiring that the benefits of new known and measurable costs must be quantifiable and included in the test period. MPC says that this requirement is not found in the minimum filing requirements and the Commission has not imposed this requirement on MPC in the past. As an example, MPC discusses a new substation replacing an old one without benefits of the new one being reflected in rates. MPC says that it recognizes that when benefits are quantifiable, they should be reflected in the test year; however, when benefits are not quantifiable, this new requirement imposes impossible burdens on the utility. Also, concerning FMS, MPC claims that the Commission's decision leads to the "almost incredible" result that the costs of MPC's billing and general accounting systems are not allowed to be reflected in rates.

MPC makes an argument that the Commission must reconsider its decision because it is not based upon a process which met the

requirements of due process of law. MPC discusses Constitutional due process in administrative proceedings. MPC describes the Commission staff as an "active prosecutor" behind the scenes making the recommendation that these costs be disallowed in a fashion that did not allow MPC any ability to challenge the recommendation or to provide evidence to address the staff's statements. MPC says that, until the Final Order, MPC was unaware that disallowance of these costs was even being considered and that simply receiving data requests about a subject cannot be considered notice of a recommendation to disallow costs. Additionally, MPC says that the Commission's Interim Order No. 5360a, which called for the capitalization of CIS and FMS costs, also did not give MPC notice that CIS and FMS costs would be totally disallowed. MPC says that, if the Commission staff takes advocacy positions, then it has a responsibility to make those positions known to MPC either through an express notice, rules, or through testimony and to provide MPC an opportunity to present a case responding to the allegation. MPC believes that it was not given a full and fair hearing on the CIS and FMS issues.

Finally, MPC says that, if it is assumed that the decision was proper, then the Commission must allow MPC to defer

depreciation and amortization and accrue carrying costs for future recovery on the disallowed costs from the in-service date, as originally determined by MPC, to the time when these costs are allowed in rates. MPC says that, without such an allowance of CIS and FMS costs, the Commission will have stranded costs which are ultimately determined to be reasonable.

MCC

In its Reply to Motions, MCC argues in favor of the Commission's decision concerning CIS and FMS. First, MCC states that the question of used and useful centers around FMS, whose full implementation date seems rather uncertain, and says that MPC provides no authority for the Commission to ignore the term "actual" in "actually used and useful."

MCC then argues that the matching of costs and benefits is not new and points to Order No. 5020b in MDU Docket No. 83.8.58, where the Commission disallowed, on the basis of a mismatch, the inclusion in rate base of a gas compression plant because the related expense reduction was not reflected in proposed rates. MCC states that the aforementioned adjustment was upheld in District Court in 1985 on the basis of the matching principle. In that

District Court Order, the Judge stated, "An important consideration in carrying out this principle is that expenses should be compared only to revenues which were generated by the same investment which caused the expenses." MCC concludes this argument by saying, "Inappropriate ratemaking is certainly not justified by its repetition."

MCC next addresses MPC's arguments that CIS and FMS do provide benefits in the test period. MCC concludes that the mixture of CIS and the old Customer Accounting System costs and benefits creates a mismatch.

Concerning MPC's claim that its due process rights have been violated, MCC says that the Commission should reject this argument on the basis that MPC did in fact know that CIS/FMS costs were at issue and that MPC did not request the opportunity to submit additional evidence or a rehearing of the issue. In particular, MCC points to Interim Order No. 5360a, data requests, and cross-examination. Finally, MCC says that if the Commission wants to reconsider the CIS/FMS costs, the action should be limited to granting MPC an opportunity to submit further evidence.

Commission Analysis

Upon reconsideration, the Commission agrees with MCC that more evidence should be taken in order to gain a more full understanding of this issue. Therefore, the Commission finds that a procedural schedule should be developed so that all interested parties, presumably MPC and MCC, can present whatever evidence is needed in order to allow for a full discussion of this matter of CIS and FMS. The procedural schedule should provide an opportunity for discovery, testimony, and a re-hearing so that the all concerns and questions can be addressed in cross-examination. Accordingly, the Commission finds that all informa tion concerning CIS and FMS that is already in the record in this proceeding should be made part of the record of the subsequent proceeding, which will serve as an extension of this same Docket No. 88.6.15.

In making the decision to allow for a re-hearing of the CIS/FMS issue, the Commission wants to make it abundantly clear that the granting of this re-hearing only applies to matters that seem to be in question as they relate to proper ratemaking. This re-hearing on CIS and FMS will address only proper ratemaking concerns, principles, and concepts such as deferring costs, carrying charges, capitalization, matching, used and useful, and known and measurable.

As discussed below, the Commission finds that MPC's arguments about the role and actions of the Commission staff and due process of law in the matter of CIS/FMS are unfounded and totally without substance; therefore, the Commission finds that those portions of MPC's Motion, as they pertain to CIS and FMS, are DENIED.

Due Process Issue

In addition to the substantive arguments that MPC makes in support of its contention that the Commission should reconsider its decision to disallow costs associated with the CIS and the FMS, MPC argues that that decision should be reconsidered because it was not "based upon a process which met the requirements of due process of law." MPC Motion for Reconsideration (MFR), p. 12. MPC cites to Morgan v. United States, 304 U.S. 1 (1938), in support of the due process truism that a contested case "requires that parties have notice of the claims against them and a reasonable opportunity to be heard to contest them." MPC MFR, p. 13. MPC quotes from the Montana Administrative Procedure Act (MAPA), < 2-4-612(1), MCA: "Opportunity shall be afforded all parties to respond and present evidence and argument on all issues involved." MPC MFR, p. 13. In addition, MPC quotes from Cascade County Consumers Association v. Public Service Commission, 144 Mont. 169, 188, 394 P.2d 856, 866 (1964): "Our numerous opinions concerning these administrative bodies have cautioned that they would be strictly held to the elementary and fundamental requirements of due process in all their proceedings."

Weighing the process afforded by the Commission in reaching its decision on the FMS and the CIS, against the fundamental requirements of due process required by statute and case law, MPC alleges that the Commission's process was defective in the following particulars: 1) Commission staff made an unlawful ex parte recommendation to the Commission that FMS and CIS costs be disallowed; 2) MPC had no opportunity to challenge staff's recommendations or "to provide evidence to address the Commission staff's statements." MPC MFR, p. 14; 3) Commission staff acted as an "active prosecutor" behind the scenes on these issues and MPC did not have adequate notice that disallowance of these costs was being considered, and to respond to such possible disallowance.

The Commission agrees with MPC that there are certain due process requirements that must be afforded parties in an administrative contested case proceeding. The Commission disagrees, however, that its decision on CIS and FMS was made without sufficient process and opportunity to be heard by all parties.

The Commission staff, in the vast majority of proceedings before the Commission, functions in an advisory capacity. Duties of an advisory staff include reviewing filings before the Commission, investigating the books, records and activities of public utilities,

and evaluating the proposals of utilities in light of Montana law, Commission precedent, and traditional rules of ratemaking. In addition, it is the staff's responsibility to make sure that the record before the Commission is full and complete, and will provide the basis for a range of reasoned decisions by the Commission. Finally, the staff reviews with the Commission the various positions of the parties, other positions and conclusions that may be sustained by the record, and, if requested, makes recommendations for the Commission to consider[2].

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[2] The Commission staff does not make recommendations on every issue to be decided. It often simply presents to the Commission a number of options that in the staff's opinion may be supported by the record. Staff recommendations are obviously not always accepted by the Commission.

This communication by staff with the Commission is not ex parte contact. The prohibition against ex parte is codified at 2-4-613, MCA:

> Unless required for disposition of ex parte matters authorized by law, the person or persons who are charged with the duty of rendering a decision or to make findings of fact and conclusions of law in a contested case, after issuance of notice of hearing, shall not communicate with any party or his representative in connection with any issue of fact or law in such case except upon notice and opportunity for all parties to participate.

This section makes clear that it is contact between a party and a decision maker on an issue in a contested case that is proscribed as unlawful ex parte communication. This type of communication is also prohibited by Commission rule at ARM 38.2.3905. The Commission staff, while having the rights and responsibilities of a party in Commission proceedings, is explicitly excluded from party status by Commission rule. Moreover, Commission rule contemplates discussions between the Commission and its staff and distinguishes such contact from ex parte communications. Section ARM 38.2.601(n), reads in pertinent part as follows (emphasis added):

> "Party" means an individual, partnership, corporation, governmental body, or other identifiable group or organization, with the exception of the commission staff, ... The commission staff shall have the full rights and responsibilities of parties under these rules, but shall not be bound by the rule governing contact between parties and the commission.

In addition to not violating the statutory prohibition on ex parte communication, and being explicitly authorized by Commission rules, communication between the Commission and its staff on contested issues is contemplated by Montana law. The case law cited by MPC does not support a contrary conclusion.

Section 69-1-109, MCA, provides that, "The commission shall also have the power to appoint stenographers, inspectors, experts, and other persons whenever deemed expedient or necessary by said commission to the proper performance of its duties." One of the most important duties of the Commission is ensuring that charges made for public utility service are reasonable and just. See 69-3-201, MCA. The Commission has deemed it both expedient and necessary to hire staff to assist it with the proper performance of that duty. There is nothing in Title 69, MCA, that specifies a particular role for Commission staff in providing that assistance. No particular model, either advocacy or advisory, for

staff participation in the decision making process has been mandated by the legislature. Rather, the legislature gave the Commission broad authority "to do all things necessary and convenient" in the exercise of its powers. See 69-3-103, MCA. The advisory model that the Commission has chosen is at least implicitly sanctioned by Montana law. Section 69-4-612(7), MCA, states that "|An¬ agency's experience, technical competence, and specialized knowledge may be utilized in the evaluation of evidence." Certainly, a large part of the Commission's experience, technical competence, and specialized knowledge resides with its staff. When the Commission sits down with its staff to review the often very technical, complicated evidence in a rate case, to ask for recommendations, and to reach decisions on the issues, it is doing what the law allows, and what reasoned ratemaking requires.

MPC cites to Morgan and Cascade County, supra, to support the conclusion "that ex parte-like communication to the decision maker violate|s¬ |the¬ basic requirement of notice and opportunity to be heard."[3] MPC MFR, p. 13. The Commission, of course, agrees with MPC that ex parte communication by a party to a decision maker on an issue in a contested case is unlawful as a violation of due

process. However, the Commission denies, for the reasons previously stated, that the routine contact with its staff in the course of reaching decisions on the issues is ex parte communication. The instant situation is clearly distinguishable from Morgan and Cascade County on its facts. In Morgan the decision maker accepted the findings

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[3] The Commission is unclear what MPC intends to convey by the term "ex parte-like communication." As noted earlier, the Commission understands MPC to be arguing that the Commission staff's communication to the Commission on the FMS and CIS costs constituted illegal ex parte communication. The Commission denies that this communication, or other communication between it and its staff on record evidence, is either illegal ex parte or ex parte-like communication.

of government prosecutors, "after an ex parte discussion with them and without according any reasonable opportunity to the respondents in the proceeding to know the claims thus presented and to contest them." 304 U.S. 1 at 22. The Court found this a violation of due process. The Commission finds that the advisory role its staff plays in the decision making process is not remotely analogous to the role of government prosecutors. Therefore, the Commission finds that Morgan provides no support for MPC's contention that Commission procedure in deciding the FMS and CIS issues violated due process. In Cascade County two members of the then three-person Commission met with officials of the Montana Power Company to discuss issues in a contested case to which MPC was a party. The other parties to the case were not advised of the meeting. This has no similarity to nonparty advisory staff meeting with the Commission in a noticed meeting to discuss record evidence.

MPC complains that it had no opportunity to challenge staff's communications on the FMS and CIS issues. It is true that parties do not have the opportunity to challenge staff communications made during the deliberative process that precedes the issuance of a final order. Commission work sessions with its staff to discuss issues in a rate case are conducted after the record is

closed; they are held in the open, but without participation by observers. There are some crucial differences between the roles of Commission staff and judicial law clerks; but there are also some striking similarities. A law clerk discusses issues with the judge. He or she often writes draft memoranda or opinions without specific direction and then later discusses and defends the merits of the draft with the judge. Unlike Commission deliberations, communications between law clerk and judge are not conducted in the open. The Commission is not aware of any argument that communications between a judge and a law clerk constitute a violation of due process; yet it is obviously true that no party has the opportunity to challenge a recommendation of a law clerk. In fact, MPC has had the chance in this case to challenge any staff recommendations, because to the extent that the conclusions in the final order reflect staff recommendations, MPC has had the opportunity to challenge those recommendations on reconsideration. Reconsideration forces the Commission, based on argument from parties, to redeliberate many conclusions it has reached in a final order. In addition, as will be noted below, parties have the option of requesting rehearing if they think they have been

deprived of the opportunity to present evidence on a given issue.

MPC argues that the Commission staff acted as an "active prosecutor" behind the scenes on the FMS and CIS issues and that MPC did not have adequate notice that disallowance of these costs was being considered, and to respond to such possible disallowance. The Commission simply denies that its staff is prosecutorial on contested issues or performs any other kind of an advocacy function in utility rate cases. The staff does have an interest and a duty and that is to give the best possible advice in the furtherance of just and reasonable rates. Every party to a rate case has an opinion on what just and reasonable rates should be. That opinion is driven by the particular concrete interests of each party, as perceived by that party. Generally speaking, in the case of the utility, that interest is in the health of the company and the prosperity of its stockholders; in the case of consumer representatives, that interest is in the lowest rates possible. The communication that Commission staff has with the Commission on particular contested issues is not driven by client or constituency interests. Rather, it is driven by an abstract, but nonetheless very real, goal: to set rates at a precise point designed 1) to

ensure adequate service and promote the financial health of the utility necessary to maintain that service, 2) to maximize the economic efficiency of the utility and the efficient provision of utility service, and 3) to extract the absolute minimum amount from the consumers of utility service necessary to maintain the reasonably adequate service the consumers expect and the law requires. The Commission finds that MPC's characterization of the staff function as prosecutorial and adversarial is inaccurate and inconsistent with the advisory, non-party role of the staff.

MPC's contention that it was without notice that the FMS and CIS costs might be disallowed is without merit. When a utility files a request with the Commission for a change in rates it carries the burden of demonstrating that present rates are unjust and unreasonable. This constitutes implicit notice that the utility may be found to have failed to meet that burden on all items or on individual items that make up the total requested change. Furthermore, all Commission notices of hearings on utility rate change requests specifically state that all matters pertaining to utility rates are at issue. The Notice of Public Hearing in this docket said that, "The basic issue in this case is whether the

company is entitled to any increase in its electric or natural gas rates." Further, the Notice stated,

> In considering this case, the Commission may examine all matters pertaining to MPC's electric and natural gas operations, including, but not limited to, rate base, rate of return, revenue requirements, allocation methods for distributing levels of revenues found appropriate to individual customers, and expenses.

With respect to CIS and FMS costs, not only were they the subject of Commission staff data requests, but the interim order in this Docket addressed CIS and FMS costs. See Order No. 5360a, Finding of Fact No. 2(c). MPC had every opportunity, both in responses to data requests, and at the hearing, to buttress its position that FMS and CIS costs should be allowed. Further, to the extent that MPC thought it was surprised by this issue, and not given adequate opportunity to support its position, it could have asked for rehearing on the issue.

While the Commission finds that MPC has received due process in all phases of this proceeding, it takes seriously, and is concerned by the fact that MPC believes it has been treated unfairly. The Commission believes that it should be generous with

the process it affords all parties that appear before it and it takes serious the Montana Supreme Court's admonition in Cascade County that "all administrative boards and tribunals should zealously guard against any appearance of unfairness in the conduct of their hearings." Id. at 186. Therefore, the Commission will institute a proceeding to solicit comments and suggestions regarding its decision making process. Following a review of these comments and suggestions the Commission will decide whether any change in its procedure is advisable. The Commission invites participation in this forthcoming proceeding with the following cautionary comments: First, parties should guard against allowing unfavorable Commission decisions on the merits to influence their conclusions with respect to procedural fairness. Second, the Commission will not be receptive to suggestions that it deviate from an advisory staff model in the context of a typical rate case. However, suggestions that work within that model will be seriously considered.

## Life Insurance Refunds

Parties Requesting Reconsideration
Montana Power Company

Parties Opposing Reconsideration
None

Effect on MPC's Revenue Requirement

| | |
|---|---|
| MPC Electric (Total Jurisdictional) | $(133,278) |
| MPC Gas | $(25,479) |

### Discussion

During the 1980's, MPC has made payments and received dividends from its life insurance policy, which was changed in 1989 causing there no longer to be payments and dividends.

From 1985 through 1988, MPC either received dividends or there was no transaction, as shown below:

| | | |
|---|---|---|
| 1985 | $84,383 | Dividend |
| 1986 | $391,420 | Dividend |
| 1987 | $ 0 | |
| 1988 | $156,555 | Dividend |

The 4-year average of these dividends is $158,090.

In Order No. 5360d, the Commission found that, since 1985, rates have reflected life insurance premiums for MPC which were overstated. Therefore, the Commission found it proper to average the dividends received by MPC over a four-year period from

1985 through 1988 and to reduce the expense by that average amount. The effect was a reduction in electric expenses of $132,795.

MPC

In arguing against this adjustment, MPC says that because the experience of dividends and payments varied from year to year, they were never included in a normalized test year for ratemaking purposes. MPC also says that the decision ignores the fact that from 1978 through 1984 rates reflected premiums which were understated, and that the Commission has no evidentiary basis for simply considering the time period 1985 through 1988. MPC describes the Commission action as an arbitrary and capricious focus only on years in which dividends were paid. MPC explains that life insurance premiums are set based upon normal claims experience, and dividends and payments are required when actual experience differs from what would normally be expected. MPC states that ratemaking uses normal levels of costs, and, if actual experiences in costs or revenues differ from normal, ratemaking does not retrospectively adjust rates to reflect actual experience. Finally, MPC says that, similar to the issues of CIS and FMS, MPC was not afforded due process rights on this issue.

Commission Analysis

After further review of this issue, the Commission finds that MPC's discussion about normalization is persuasive in this particular instance. In its response to Data Request No. PSC-183, MPC said the retrospective life insurance payments and dividends from 1978 through 1988 have never been included in a normalized test year for ratemaking purposes. A four-year average of refund/payment activity could very likely be a proper approach to reach a normal level of insurance premiums, but, upon reconsideration, the Commission believes that such an adjustment is not proper in this proceeding. MPC's assertion that the Commission's approach was arbitrary and capricious are rejected on the basis that a four-year average, under other circumstances, could be a wholly proper ratemaking method to attain a normal level of expense.

Therefore, the Commission finds that MPC's Motion concerning life insurance refunds is GRANTED. In granting MPC's Motion, the Commission separates out the portion of the Motion pertaining to the allegation that the use of a four-year average was arbitrary and capricious and the portion of the Motion per-

taining to due process of law and DENIES those portions of MPC's Motion. The former portion of MPC's Motion is denied on the grounds discussed in the paragraph directly preceding this one, and the latter portion of MPC's Motion is denied on the same grounds discussed in the above section of this Order on Reconsideration concerning CIS and FMS.

In granting MPC's Motion, the Commission finds that MPC should accrue the annual increase in both gas and electric operations' revenue requirement associated with the life insur ance refunds adjustment (in the amount listed under the heading of this section of this Order on Reconsideration), including carrying costs on an annual basis equal to MPC's granted overall rate of return in this proceeding of 10.44 percent for electric and 10.62 percent for gas. This approach is preferred rather than changing MPC's rates to reflect this relatively minor change in MPC's revenue requirement in order to provide for rate stability. The practice of accruing this small change in revenue requirement, along with certain carrying charges, is consistent with past Commission practice for rebates.

## Salem Project, Carter Ferry Project, and Hauser Study Costs

Parties Requesting Reconsideration:
Montana Power Company

Parties Opposing Reconsideration:
Montana Consumer Counsel

Effect on MPC's Revenue Requirement
MPC Electric (Total Jurisdictional)

| | |
|---|---|
| Remove Amortization of Salem Costs | $(1,869,771) |
| Remove Amortization of Carter Hydro | $(225,927) |
| Remove Amort of Hauser Capacity Studies | $(165,914) |

### Discussion

In Order No. 5360d, the Commission disallowed all costs related to the Salem Project and the Carter Ferry Project and the Hauser Capacity Study. In its Motion, MPC requests the Commission to reconsider these adjustments on the basis that the Final Order did not adequately consider the adverse resource planning implications of the decision. In the case of the Hauser Study, MPC says that decision represents a more extreme and troubling policy. In its Reply to Motions, MCC argues that the Commission's rejection of MPC's amortization requests on these projects is consistent with Montana law and long standing precedent.

MPC

MPC begins its argument by saying that the Commission's Order did not adequately consider the adverse resource planning implications of its decision, is notably silent on the issue of the effect of its decision on sound and flexible resource planning, and ignores the related evidence presented by DNRC. MPC quotes the testimony of DNRC in support of rate recognition of these costs of preliminary survey and investigation. MPC then says that the Commission also ignored the evidence that such disallowance will be a clear incentive to MPC to abandon the investments, thus decreasing resource planning flexibility. MPC states that this decision ignores the loss of the benefits of retaining those potential resources and the flexibility they allow in resource planning. MPC questions whether this decision produces sound public policy.

Concerning a statement in the Final Order referring to proper decision-making resulting in reward for the risk takers, MPC says that if the Salem or Carter Ferry projects become pro ducing resources, the carrying costs of the investment over the years, calculated at about $8.4 million so far, will not ever be recovered. MPC says its shareholders have certain losses as a

result. Also, MPC says that there is no evidence that these projects represented improper decision making, but the end result is losses for shareholders, not rewards.

Concerning Hauser, MPC explains that the studies were only feasibility studies of the potential for expansion of generation at the location. The studies were an initial consideration of a particular resource alternative and involved no costs related to actually performing the expansion. MPC reasons that risk should not be shouldered by investors for the study of particular resource alternatives made as part of the logical process of resource evaluation. MPC discusses its obligation to meet customer load growth needs and related costs associated with studying resource alternatives and points to a Commission directive in the Final Order (Finding of Fact No. 363) to do a further study of resource alternatives rather than relying on the BPA NR rate as a proxy for actual resource costs. The point is that if the Company complies with the finding to study resources, apparently the costs of studying particular resources which are eventually determined to be not least cost or feasible will not be recovered. MPC says that this result serves as a disincentive to least-cost planning, is unfair to investors, and will harm customers in the long run.

Further, MPC says that the Commission apparently allows recovery of the costs of resource studies which are general in nature and which are expensed on the books, but for the costs of specific studies a different set of rules apply. MPC explains that the specific study costs must result in an actual resource addition or shareholders are penalized.

MPC says that the Hauser studies are a part of the continuing Missouri River evaluation and relicensing to optimize the utilization of the Missouri River hydro resources. Also, MPC says that, to encourage least cost planning, the Commission should reconsider its decision concerning initial feasibility studies, such as the Hauser studies.

Finally, MPC says that the Commission's position on all of these issues (Salem, Carter Ferry, and Hauser) reflects an unnecessarily restrictive interpretation of "used and useful." MPC argues that the Commission could take a broader view of "used and useful" and that the Company's amortization requests are distinguishable from the cancelled plant costs in the PP&L abandonment case. MPC also says that other states have allowed such costs that have not resulted in generating resources.

MCC

In its Reply to Motions, MCC first states that the Commission's rejection of MPC's amortization proposal is consis tent with Montana law and long standing precedent. MCC then rebuts the position of DNRC by saying that the Commission's risk analysis discussed in Finding of Fact Nos. 412 and 413 in Order No. 5360d adequately considered the concerns about resource planning flexibility and a resource portfolio. MCC says that problems of hindsight underscore the wisdom in the used and useful law in Montana. MCC also says that DNRC's concerns over a flexible strategy to allow quick responses do not reflect the ability of a utility to avoid the steps leading to resource acquisition when a resource is needed and uses Colstrip #4 as an example.

MCC points out that the amortizations disallowed by the Commission are related to capital costs, not expenses, that will earn a return and be recovered through depreciation if the plant is built. MCC claims that if the plants are built, some of the written-off costs will be duplicated and the cost of the plants will be reduced. MCC compares such an arrangement to CWIP. MCC says that if these costs are classified as "expenses," then the Commission must ask whether they are recurring or extraordinary in

nature. MCC also says that the Commission should ask MPC why it did not seek to recover these expenses in past rate cases and whether recovery now would constitute retroactive ratemaking.

Concerning least-cost planning, MCC gives support to the advisory committee and says that those expenses are not subject to the Commission's used and useful disallowance. Like wise, the expenses involved in MPC's efforts to stay abreast of the power market would not be disallowed. MCC says all that is subject to disallowance are those costs which would properly be capitalized rather than converted to expenses.

Concerning incentives to abandon projects, MCC refers to the testimony of its witness, Al Clark, and says that amortization of initial costs could actually reduce incentives to pursue the projects since MPC would be less likely to abandon a project in which it has a financial stake.

Concerning the other states allowing recovery of investments which have not produced used and useful resources, MCC acknowledges that such actions have occurred, but points to the Commission's PP&L plant abandonment order as evidence of this Commission taking a clearly contrary and well reasoned view. MCC also lists other similar actions by states, including a Penn-

sylvania case where that Commission was reversed in its attempt to allow amortization of plant costs which were not used and useful, a determination which was recently upheld on appeal to the U.S. Supreme Court.

Commission Analysis

Concerning the Salem and Carter Ferry Projects, the Commission found that these costs are associated with projects not yet cancelled or under construction (FOF 412). Upon this foundation, the Commission found amortization of them as expens es to be irrelevant. The Commission continued, in FOF 413, with an analysis of risks and rewards, as they relate to the perspectives of shareholders and ratepayers. Such analysis reasoned that the risk for the study and development of new generating resources, historically, has been the responsibility of utility management and stockholders. Arguments raised in the Motions do not change this basic ratemaking tenant, nor do they change the material fact that the projects have not been abandoned. Upon this basis, the Commission denies MPC's Motion concerning the amortization costs of the Salem Project and the Carter Ferry Project. Such denial,

however, is tempered, but not changed, by the discussion that follows.

The Motions raised other topics relating to planning that the Commission feels compelled to answer. Particularly, MPC specifies that the Commission order did not adequately consider the adverse resource planning implications of its decision. MPC's argument is premised on reasoning, most aptly explained in DNRC's motion, which requests that the Commission reconsider FOF 413 as it relates to risk sharing and the used and useful test:

> DNRC prefiled direct testimony (DNRC exhibit 1, pp. 29-32) pointed out the benefits to ratepayers of the utility holding a portfolio of cost-effective resources that had undergone permitting and preliminary engineering. Such a portfolio would allow a utility to respond quickly and efficiently to unexpected changes in loads. A flexible strategy will result in lower costs in the long run than a strategy without flexibili ty. The customary use of disallowances assumes the utility can have perfect foresight. Not only is this not possible, but it is also impossible for the Commission to determine what the cheapest alternative would have been. The Commission cannot know all the possible resources and purchased power opportunities that were available to the utility. And even if the Commission could define optimal behavior given perfect hindsight, it will not be able to reconstruct what the utility should have done given the knowledge available at the time. The utility will react to the threat of disallowances with strategies that minimize the

> risk to shareholders, thereby increasing costs to ratepayers.

In effect, DNRC asserts that the Commission lacks an adequate capacity to review prior resource planning decisions; and that such review of prior decisions would cause MPC to choose a high-cost-to-ratepayers, low-risk-to-stockholders resource strategy. The Commission infers from DNRC's comments that comparison of a newly completed resource with other available resources, and review of the need for the new resource, will produce a similar high cost, low risk result. This inference, if correct, is at the heart of the used and useful standard, as interpreted by the Commission.

The solution suggested by DNRC, which, presumably, will lower ratepayer costs, as well as stockholder risks, is inclusion in ratemaking costs of a full assortment of ready-to-build resources. It is unclear, however, what authority DNRC would have rule upon the reasonableness of the resource options so included; i.e., which options should not be included, and which options should have been included, but were not. Assuming that authority to be the Commission, it is unclear whether or not DNRC then expects the Commission to choose one of the options as the most viable contender, if a new resource is needed. Assuming it does

not expect the Commission to choose, because in so doing the Commission may prejudice its ability to consider the used and usefulness of the resource when it is completed (as a surrogate for a competitive market response), it is somewhat unclear why circumstances would differ from those which exist presently. If a utility is to face the same used and useful test as it presently does, it stands to reason that the same low-stockholder -risk, high-ratepayer-cost behavior, as alleged by DNRC, would also be continued.

DNRC testimony (pp. 29-32, Ex.1), suggests, in a general way, that overall ratemaking costs of shorter construction schedules, which would be associated with ready-to-build resources, would be less than overall ratemaking costs of longer planning and construction schedules associated with resources not yet given siting authority by the State of Montana. This may be so, but DNRC has not shown it in this case, other than by general opinion, nor has MPC. Such general opinion is insufficient, by itself, to cause the Commission to abandon such basic ratemaking tenants as those discussed in FOF 413.

The Commission is interested in reviewing specific evidence, such as cost and benefits studies, on this question.

Therefore, it invites parties to petition the Commission to present such evidence. It also invites parties to similarly address, in detail, the associated assertion that resource options are used and useful because they, in effect, are a form of insurance. Additionally, and in the same manner, the issues of how the Commission is to determine which resource option costs should be included as ratemaking costs, and whether or not the Commission should choose one of the resource options as the most viable contender, need to be addressed.

MPC's Motion "especially" urges that reconsideration be given for initial feasibility studies, such as the Hauser studies, which MPC opines are used and useful, and necessary to the conduct of its business. It specifies: "...the Hauser decision represents a more extreme and troubling policy" than the Salem/Carter Ferry decision. It also states: "Even in a world in which all new utility resources were purchased from others, the utility would still have to study the costs of potential resources in order to have a realistic value with which to compare proposals."

Accounting guidelines, which the Commission has approved, specify the following:

> "Preliminary Surveys and Investigation Charg-
> es--This account shall be charged with all

> expenditures for preliminary surveys, plans, investigations, etc., made for the purposes of determining the feasibility of utility projects under contemplation. If construction results, this account shall be credited and the appropriate utility plant account charged. If the work is abandoned, the charge shall be made to account 426, Miscellaneous Income Deductions, or to the appropriate operating expense account."

Although these accounting guidelines do not control ratemaking practices, it is clear that they do not distinguish between initial feasibility studies as they pertain to a specific project, and costs incurred subsequent to that phase. Evidence presented on the record of this proceeding also does not make such a distinction. However, if this distinction is observed in actual practice and can be demonstrated, as MPC implies, such initial feasibility costs may be used and useful, based on the logic espoused by MPC. The nature of these costs would likely fall somewhere between general resource studies, which are allowed as used and useful, and those preliminary survey and investigation costs which pertain to a specific resource, which have historically not been allowed as used and useful until a project is completed and operating. The point of demarcation, as has been presented, however, is hazy.

The Commission is compelled to deny MPC's Motion on the amortization of costs associated with Hauser Studies because of the absence of clear evidence, as expressed above, which contradicts Order No. 5360d. However, it is anxious to have MPC further explain its opinion. It invites MPC to again petition the Commission on this question, and to advance its new theories, so as to clear the haze surrounding the issue. The Commission would very much like to facilitate the planning processes of MPC, within the prudent perspective of a reasonable risk/reward standard.

Based on the above discussion, MPC's Motion concerning the amortization costs of the Salem Project, Carter Ferry Project, and Hauser Studies is DENIED.

## Effective Date of Final Order

Parties Requesting Reconsideration
Montana Consumer Counsel
Stone Container

Parties Opposing Reconsideration
Montana Power Company

Discussion

The approval date of the Order No. 5360d was August 14, 1989, and the Commission stated in the Order section of that Final Order that the effective date of the Final Order was for services rendered on and after August 29, 1989. The reasoning for the two-week delay of the implementation of the Final Order, as explained in Order paragraph No. 5 in Order No. 5360d, was to coordinate with the timing of the reflection of the annual phase-in of the Colstrip #3 Rate Moderation Plan, which was scheduled to go into effect on August 29, 1989. In its Motion, MCC requests the Commission to modify the effective date so that ratepayers are not forced to pay rates already found to be unjust and unreasonable. In its Response to Motions, Stone Con tainer concurs with MCC. In its Response to Motions, MPC disagrees with MCC and says that the Commission has the latitude in such exceptional circumstances to modestly delay a rate change.

MCC

In its Motion, MCC says that the Commission has allowed a 15-day collection of rates already found unjust and unreasonable, amounting to an overcollection and windfall to MPC of approximately

$679,000. MCC says that this windfall has the effect of negating some of the adjustments approved by the Commission in Order No. 5360d. MCC recognizes the Commission's efforts to minimize the number of rate changes, but says that the same effect could be achieved by requiring MPC to accumulate the difference between August 14th and 29th and to amortize that amount over a period of 2 or 3 years.

Stone Container

In its Response to Motions, Stone Container (SC) agrees with the arguments of MCC and applies that rationale to MPC's natural gas rates. SC says that this overcollection for both the electric and natural gas utilities of MPC is indefensible. SC states that scheduling concerns over implementation of rates cannot be ignored, but requests that such concerns not be elevated above the considerations of fairness and ratepayer impact. Again SC points to the MCC Motion and says that the mer its of the case, not expediency or scheduling, should dictate Commission action. Finally, SC agrees with MCC's proposal to accumulate the difference in rates between the Order approval date and effective date and to amortize that amount over a couple of years, and SC requests similar treatment for the continuing natural gas overcharges.

MPC

In its Response to Motions, MPC agrees that usually rate changes should be made effective the date of the Final Order. In this particular case, however, MPC says that the Commission has the latitude and should be able to make the change effective on the date of an already scheduled rate change, especially since the two

dates are relatively close to each other. MPC says that since the effective date was explicitly made for services rendered on and after August 29th, it would be inappropriate now to change the rates retroactively.

MPC also disagrees with MCC's calculation of the related adjustment. The Company says that MCC assumed equal revenues in each month and that there were only 11 days between the service date of the Order, the 18th, and the effective date, the 29th. MPC provides its own calculation of the adjustment resulting in a figure of $409,937.

Finally, MPC says that if such an adjustment is made for the electric utility, a similar adjustment must be made for the gas utility to collect the underrecovery for the same 11 days. MPC concludes that if MCC's position is approved, in future cases the Commission must provide the same treatment for rate increases.

## Commission Analysis

The Commission finds that the arguments of MCC and Stone Container concerning the effect on rates of the span of time between the approval date and effective date of Order No. 5360d are not persuasive. The major factor in delaying the effective date

for approximately two weeks was so that rate stability could be achieved. The Commission continues to find that the goal of rate stability is a valid reason to cause the delay of the effective date. Furthermore, the Commission finds that the relatively small delay between the approval and effective dates is well within the bounds of Commission authority to set effective dates of orders.

Therefore, the Commission finds that MCC's Motion concerning the effective date of Order No. 5360d is DENIED.

## PART D

## GAS RATE DESIGN

### Gas Rate Design Issues

One party, Stone Container (SC), submitted an Initial motion for reconsideration on Order No. 5360d Gas Rate Design Issues. Three parties (SC, MCC and MPC) submitted Responses to Initial motions for reconsideration on Gas Rate Design Issues. SC's Initial motion and the three Response motions are discussed.

Gas Rate Design Motions

SC's Initial motion for reconsideration has four arguments which follow. First, MPC's across the board natural gas rate increase unquestionably overcharges certain customers, is arbitrary and unsupported by evidence. Second, the "nonuniform" percent increase benefited only MPC's Firm Utility class, and is prejudiced against the Interruptible Industrial (II) and Residential classes. Third, the merits of the case, not mere expediency or the relative scheduling of various Commission orders, should dictate the method approved by the Commission. Fourth, SC argues to restructure Finding of Fact 509 to ensure integration of Docket Nos. 87.8.38 and 88.6.15. After a review of the Responses, the Commission's decision will elaborate on these arguments.

Gas Rate Design Responses

MPC's Response recommends rejecting SC's motion due to a misrepresentation of the facts. MPC's first argument regards SC's premise that the whole Docket No. 87.8.38 record was incorporated into Docket No. 88.6.15. MPC notes that only final orders and compliance filings are included. MPC further adds that gas rate

structure issues were not in the Docket No. 88.6.15 record. Thus MPC adds, since rate structure issues are not included, any retroactive change to the interim order is impossible. In any case, MPC holds ratemaking prohibitions disallow retroactive adjustments.

MCC's Response to SC's motion is twofold. First, MCC argues that the Commission's gas rate design decisions are reasonable and should be affirmed, not modified. The thrust of MCC's argument is that the decision was within the discretionary bounds of the Commission's authority to set rates, given the judgmental nature of and the level of confidence one can place on cost of service studies.

Second, MCC addressed SC's motion as regards refunds, the retroactive ratemaking issue previously discussed. The thrust of MCC's comments on the issue of refunds is, since the cost of service studies are now dated, there is no assurance the results of a refund today would not be reversed in the near future. MCC added that in any case SC provided no guidance on how a refund should be flowed through to other customer classes.

SC's Response ("Brief") on motions draws upon an argument in MCC's Initial Motion wherein the MCC requested a revised effective date for the changed electric prices (see MCC's initial Motion, pages 9 and 10). SC concurs with MCC's Initial motion, to revise the effective date for electric price changes adding, MCC's motion parallels SC's motion for rebates: Natural gas customers likewise should not be forced to pay rates already found unjust and unreasonable.

Commission's Decision: Gas Rate Design Issues

The Commission denies all of SC's motions regarding gas rate design issues for the below reasons. First, the Commission finds merit in both MPC and MCC's Responses to motions in this regard. Second, since the Commission has issued its rate design order in Docket No. 87.8.38, the parties, including SC, are aware the Commission made decisions that raised the Residential class' revenue requirement with a concomitant reduction in certain other classes' revenue requirements. Thus, the Commission has begun the process of addressing the revenue requirement concern raised by SC. Even if Docket Nos. 87.8.38 and 88.6.15 were totally melded, the Commission would find merit in the final revenue requirement shifts made in the Docket No. 87.8.38 rate design order. Furthermore, the Commission will, as MCC stated, address gas cost and rate design issues again in the very near future.

Third, the Commission finds merit in MCC's concern for using old cost data. In the same vein, the Commission also finds relevant a comment on the level of confidence one should place on extant gas costing theories and outcomes: Because Docket No. 87.8.38 marks the first time gas marginal and avoidable costs were

debated in Montana, merit exists in moderating revenue requirement shifts at this time. There is no assurance that in the next docket better theories and cost data will buttress the outcome of Docket No. 87.8.38. One only has to look back at the PURPA electric cost of service and avoided cost dockets to appreciate the likelihood of future changes. The Commission's Order No. 5410 and 5410a decisions simply reflected the best knowledge at the time the orders were issued.

The Commission also finds merit in clarifying that part of Finding Of Fact 510 which states: "As a practical matter, this approval is a nonuniform percent increase with uneven distribution across classes, and the impact on the industrial class should be less than with a total uniform percent increase in rates." Some necessary findings in this regard follow:

SC is correct that it received an increase that exceeds the system average increase of 6.53% out of Order No. 5410. However, when MPC applies the Docket No. 87.8.38 revenue requirement impact to the Commission's Docket No. 87.8.38 changed revenue requirements, the opposite will occur. This is one reason why the Commission qualified its finding with "should." Thus, while SC is correct in its argument, its argument failed to account

for the sequence of events outlined in the prior Finding (No. 509). Ultimately, as stated in No. 509, Docket No. 88.6.15 impacts must be "applied" to the outcome of Docket No. 87.8.38.

The Commission also finds merit in discussing SC's proposal to credit or debit customer classes depending on whether they over- or under-paid since the time of the Docket No. 88.6.15 interim order and up until the effective date of Docket No. 87.8.38 rate changes. The Commission does not find a parallel between this and MCC's argument to change the effective date for electric price changes, with rebates. The Commission's rebate policy generally involves the circumstance MCC's Initial Motion raised: When final revenue requirements fall below an interim level, rebates with interest are forthcoming. Such is not the case in SC's proposal. SC's proposal is impractical. The Commission's Docket No. 87.8.38 objective was to move in the right direction of efficient pricing.

PART E

CONSERVATION PROGRAMS

MPC's Conservation Programs

Two parties filed motions for reconsideration on Part K of Order No. 5360d. Each motion is discussed in turn. No Response motions were filed addressing the Initial motions raised by these parties.

Part II of DNRC's motion addressed Part K of Order No. 5360d. While DNRC states it agrees with many of the analytical issues involved with conservation resources, as addressed in Part K, DNRC nonetheless petitions for a wholesale reconsideration of Part K arguing that the technical resolutions of Part K are premature and should be deferred to either a technical conference, a separate docket or MPC's LCPAC.

HRDCDA's motion addressed one issue in Part K regarding "take back." While stating Order No. 5360d represents the strongest-yet endorsement of conservation in Montana and the Commission wisely stated its willingness to consider new information e.g., the LCPAC, HRCDA recommends that the take back effect be excluded, at least for low-income programs, unless MPC determines

that take back is not reversed by nominal marginal rate increases.

Commission's Decisions: MPC's Conservation Programs

As a general finding, meant to address both parties motions, the Commission finds need to restate the intent of Part K. The Commission's decisions were not meant to close the door on any subsequent conservation analyses. In this regard, Finding of Fact No. 540 is relevant: "Of course issues the Commission may include in an order may still be voluntarily addressed by the LCPAC or MPC." Findings of Fact No. 542 and 547 are in the same vein. Thus, the Commission fully appreciates that analytical conservation issues have not fully matured. In the Commission's estimation, Part K raised analytical issues that needed discussing. As stated in Order No. 5360d, MPC and the LCPAC are encouraged to further explore the issues raised, and any others the Commission did not speak to, in developing methods to analyze conservation resources. The Commission finds necessary the below findings on certain detailed issues raised in motions.

The Commission denies DNRC's motion to remove Part K from Order No. 5360d. As stated above, the LCPAC and MPC is encouraged

to explore the issues raised in Part K. The Commission does not believe the inclusion of Part K "could complicate the development of conservation analysis of Montana", as DNRC's motion states. If anything, it should enable the development of efficient Load/Resource planning by expressly raising issues that need to be addressed. Ultimately, the Commission expects MPC will raise the issues addressed in Part K. At such time the Commission can revisit the logic of the detailed decisions rendered in Part K.

As regards the "take back" effect, HRCDA's motion is constructive. After the LCPAC process concludes, MPC and other parties will have an opportunity to present to the Commission the merits or demerits of factoring such effects into future conservation cost/benefit analyses for all classes or excluding such effects for just the low-income, as HRCDA suggests.

## CONCLUSIONS OF LAW

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

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.

The Montana Public Service Commission properly exercises jurisdiction over the rates, terms, and conditions for the purchase of electricity by public utilities from qualified cogenerators and small power producers. Sections 69-3-102, 69-3-103, and 69-3-601 et seq., MCA. Section 210, Pub.L. 97-617, 92 Stat. 3119 (1978).

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. Section 69-3-303, MCA, Section 69-3-104, MCA and Title 2, Chapter 4, MCA.

The rate level approved herein is just, reasonable, and not unjustly discriminatory. Section 69-3-330, MCA and Section 69-3-201, MCA.

ORDER

THE MONTANA PUBLIC SERVICE COMMISSION HEREBY ORDERS:

Applicant's Motion to Reconsider the matter of life insurance refunds and payments is GRANTED. All other Motions For Reconsideration submitted by all other parties in this proceeding are DENIED.

In granting MPC's Motion concerning life insurance refunds and payments, Applicant is directed to abide by the conditions of Finding of Fact No. 91 in this Order No. 5360e concerning accruing the related increase in annual gas and electric revenue requirement to reflect the reversal of this adjustment.

All other motions or objections made in the course of this proceeding which are consistent with the findings, conclusion, and decision made herein are GRANTED; those inconsistent are DENIED.

This Order is effective for service rendered on and after the 27th day of November, 1989.

DONE AND DATED this 27th day of November, 1989, by a 5 - 0 vote.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

_____
CLYDE JARVIS, Chairman

_____
HOWARD L. ELLIS, Commissioner

_____
WALLACE W. "WALLY" MERCER, Commissioner

_____
DANNY OBERG, Commissioner

_____
JOHN B. DRISCOLL, Commissioner

ATTEST:

Ann Peck
Commission Secretary

(SEAL)

NOTE: You may be entitled to judicial review in this matter. Judicial review may be obtained by filing a petition for review within thirty (30) days of the service of this order. Section 2-4-702, MCA.