Service Date: February 1, 1991

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 by the MONTANA POWER COMPANY for Authority to Increase Rates for Natural Gas and Electric Service.	))))	UTILITY DIVISION DOCKET NO. 90.6.39
IN THE MATTER OF The Application of the MONTANA POWER COMPANY for Authority to Establish New Rates Required to Implement its Gas Transportation Plan.	)))))	DOCKET NO. 90.1.1 ORDER NO. 5484h

AMENDED PROCEDURAL SCHEDULE, ORDER ON MOTION TO STRIKE, ORDER ON OBJECTIONS, ORDER ON PETITION FOR LIMITED INTERVENTION

Background

On August 31, 1990, in Order No. 5484b, the Commission consolidated the above dockets and issued an amended procedural schedule that set a hearing beginning on February 25, 1991. Two things have occurred that cause the Commission to further amend the procedural schedule in these Dockets and to continue the hearing date.

First, the Commission staff has identified several additional issues in Docket No. 90.6.39 (see paragraph 6, below). The Commission finds that these issues should be addressed by the Montana Power Company (MPC), as well as by other interested parties. Second, MPC has recently indicated to the Commission that its rebuttal testimony in Docket No. 90.1.1 will contain substantial modifications to its initial proposal. The

Commission finds that the existence of additional issues in Docket No. 90.6.39, and the change of position in Docket No. 90.1.1, requires that all parties have the opportunity for additional testimony and discovery.

Objections, Motion to Strike, and Petitions to Intervene

The Commission has received the following objections to data requests in Docket No. 90.6.39:

1. Objection from Rhone-Poulenc (Rhone-Poulenc) Basic Chemical Company to MPC data requests 1-173, 1-174, 1-176, 1-177, and 1-178;

2. Objection from Rhone-Poulenc to Commission staff data requests PSC-357, PSC-358, and PSC-359;

3. Objection from the Federal Executive Agencies to Commission staff data requests PSC-364, PSC-365, and PSC-366.

On January 25, 1991, at a scheduled work session, the Commission voted to sustain the objections to Commission staff data requests, and to MPC data requests 1-176 and 1-177. The Commission voted to overrule the objections to MPC data requests 173, 174, and 178, and directs Rhone-Poulenc to respond to these requests by March 1, 1991.

MPC has filed a Motion to Strike pages 40-52 of the testimony of HRC XI witness Thomas M. Power on the grounds that that testimony relates to natural gas transportation issues being considered in Docket No. 90.1.1. HRC XI is not a party in Docket No. 90.1.1, but has requested limited intervention. The Commission agrees with MPC that under the existing schedule this testimony should be stricken. However, given that the revised schedule allows time for discovery and rebuttal/cross-answer testimony by MPC and other parties on Mr. Power's testimony (see paragraphs 7(e) and 7(g), below),

the Commission will grant late intervention to HRC XI in Docket No. 90.1.1. HRC XI shall answer data requests on its Docket No. 90.1.1 testimony within two weeks of the requests, or according to the schedule at paragraph 7.

The Commission has also received a request for late intervention from the Montana Irrigators. Once again, given the revised schedule, the Commission grants late intervention to the Montana Irrigators in Docket No. 90.6.39. The Montana Irrigators may prefile testimony as indicated at paragraph 7(d) of the revised schedule.

Additional Issues

MPC should respond by written testimony to the issues described below:

a) Intercompany Power Transactions and Business Relationships. During the Public Service Commission's 1987 and 1988 investigations of Montana Power Company's operations, the Commission staff reviewed certain documents which described potential relationships between Montana Power Company (MPC), Idaho Power Company (IPC) and Washington Water Power Company (WWP.) Specifically, an 82 page document from Reid and Priest, a New York law firm, described in detail potential forms of organization involving the three companies, including regulatory approvals needed and Public Utility Holding Company Act requirements under various scenarios. A Booz-Allen Hamilton report entitled "Positioning MPC for Success in the Utility Business" explained how MPC should develop new wholesale and retail markets, and establish new relationships with WWP and IPC. One of the important reasons for the emphasis on WWP and IPC was the low variable costs of power production exhibited by them. In early 1988 McKinsey and Company made an oral presentation entitled "Assessing the Economic Benefits of Closer Coordination." This followed a presentation made to the three companys' Chief Executive Officers, which was entitled "Developing a Joint Operating Agreement." Subsequent to these presentations, a team of professionals from all three companies (WIM) was assembled to decide uniform forecasting methodology, update WIM load and resource forecasts, develop an economic model of future WIM resources, analyze pooling savings under various scenarios, evaluate reserve margins and maintenance coordination, assess benefits of long term joint generation investment, determine resource blocks available for sale "off system" under pooled and individual generation scenarios, survey WIM marketing staffs to estimate price premiums and nonprice benefits of integrated "off system" sales, analyze economic benefits under current load and resource assumptions, assess Western Systems Coordinating Council (WSCC) supply and demand as it relates to integrated "off system" marketing, evalu ate major transmission paths and constraints to integrated "off system" sales, assess the WIM competitive situation under multiple macroeconomic scenarios, and other relevant matters. Various conclusions were reached as a result of these studies. Staff interviews of MPC management during 1988 led to the conclusion that the investigation of WIM business relationships had been put on hold. However, prefiled testimony in Docket No. 90.6.39 suggests that there have been significant, recent power

transactions among the WIM group. These include a substantial intermediate term power purchase by MPC from IPC, a substantial long term seasonal power exchange between IPC and MPC, a substantial intermediate term power sale from MPC to WWP and a MPC/WWP transmission agreement, which facilitated MPC's sale of power from Colstrip Unit 4.

At this juncture the Commission has no opinion about the propriety of the transactions and relationships between MPC, IPC and WWP. It is of the opinion, however, that prefiled testimony should provide sufficient background information about the status of the WIM effort. If such effort continues to be pursued, either formally or informally, the Commission would appreciate a complete explanation of how it might relate to existing MPC power transactions, and how it will affect future MPC power transactions, both in a general and a specific sense. Because of the large dollar magnitude of such power transactions and their potential effect on ratepayers, the Commission expects the explanations and descriptions to be very complete.

b) Colstrip 3 and 4 "Off System" Sales. In a 1985 order for Docket No. 84.11.74, the Commission approved the dedication to retail public utility service and the rate basing of Colstrip Unit 3. Such action was very significant, both in terms of its very large monetary impacts on MPC retail customers, and the implied dedication of this generating plant primarily to the service of MPC retail customers for its life cycle, absent extenuating or materially changed circumstances.

MPC has recently signed contracts to sell power to the Los Angeles Department of Water and Power (LA) for the period July 17, 1989 through December 29, 2010, and to the Puget Sound Power and Light Company (PS) for the period October 1, 1989 through December 29, 2010. Such contracts appear to total 212.5 megawatts, which is measured at the Colstrip 3 and 4 busbar. Contract provisions also appear to equally implicate the physical power output of Colstrip Units 3 and 4, which are each nominally rated at 210 megawatts. Colstrip Unit 4 costs, which are significantly lower than those of Colstrip Unit 3 because Coltrip Unit 4 is leased, appear to provide the basis for pricing provisions contained in the contracts.

At this juncture, the Commission has no opinion about the propriety of MPC's apparent contractual dedication of Colstrip Unit 3 output to LA and PS. However, the Commission is interested in the ramifications which the LA and PS sales have for Colstrip Unit 3 ratemaking, both from the perspective of whether physical delivery of power from Colstrip Unit 3 to retail custom ers will always be possible while the same power is obligated contractually to LA and PS, and from the perspective of whether the LA and PS contract provisions affect the implied dedication of Colstrip Unit 3 to MPC retail customers for its life cycle, absent extenuating or materially changed circumstances. The attendant rate basing of Colstrip 3, naturally, is implicated by such dedication. Because the ratemaking costs of Colstrip 3 are so significant, the Commission requests that very thorough analysis of these issues be presented.

c) Appropriate Level of Research and Development Expenses. The Commission is interested in comments from the parties on the appropriate level of

research and development (R&D) expenses which should be allowed in rates. What constitutes an adequate level of R&D expense for MPC?

If parties feel that additional R&D is needed, please indicate how much should be allowed and what projects the funds should be directed toward. Who should be responsible for selecting and monitoring the projects? In the comments on this issue, indicate what the ceiling should be in terms of expenditures. Also, what controls should be placed on these funds? For example, should R&D funds be earmarked, and used to reduce rates in the next year if not expended?

Do parties foresee MPC engaging in independent R&D, or joining in other existing programs? If the ratepayer funded R&D results in significant commercial applications, should the profits flow to the ratepayers? In other words, if ratepayers pay for unsuccessful research, should those same ratepayers enjoy the benefits of projects which earn solid returns?

d) Refunds and Settlements. In Docket No. 86.11.62 (9), the issue of BPA refunds and medical insurance refunds, each with a dollar value of approximately $2 million, was reserved for discussion in the next general rate case. In Docket No. 88.6.15, Mr. Pederson addressed this matter in his direct testimony and recommended that the Commission should not reflect the refunds in rates on the basis that they were not significant enough to be included (MPC Exh. 33, p. 20.) He also said that if it is determined proper to include such items, then a policy needs to be established so that similar rate treatment is afforded refunds and payments in the future (MPC Exh. 33, pp. 20-21.)

The Commission found that those refunds, totalling about $4 million should not be reflected in MPC's rates in Docket No. 88.6.15. However, the Commission indicated that the matter required further exploration to determine the proper ratemaking treatment of refunds. The Commission requested that MPC and MCC provide testimony giving observations and recommendations on refunds in the next MPC general rate case (FOF 478, Order No. 5360d). No testimony on the ratemaking treatment of refunds was filed by either MPC or MCC in Docket No. 90.6.39.

In Docket No. 89.12.53 (an MPC Gas Tracker), Interim Order No. 5454, the Commission allowed the costs of two gas cost disagreement settlements. The first with the Blackfeet Indian

Tribe was settled for $427,500 and the second with the Department of State Lands for $160,946. In that Interim Order the Commission indicated that it is committed to development of a policy for the proper ratemaking treatment of refunds and settlements in MPC's next general rate filing.

In Docket No. 90.12.84 (an MPC Gas Tracker), Interim Order No. 5528, the Commission allowed a gas cost disagreement settlement with Northern Montana Gas Company in the amount of $710,438. Again, the Commission indicated that it is committed to development of a policy for the proper ratemaking treatment of refunds and settlements in MPC's general rate filing.

Given the time which has elapsed since the subject of refunds first came up in Docket No. 86.11.62 (9), the issue of a policy on the proper ratemaking treatment for refunds and settlements is ripe for discussion. All parties are encouraged to file comments with recommendations for such a policy. In particular, what level of refunds and settlements is significant and merits a filing which would change rates. The importance of the proposed policy is underscored by the asymmetrical treatment which has been applied in the orders discussed above.

e) Fiber Optic Ground (FOG) Wire. On June 16, 1989, MPC entered into the Montana Optical Ground Wire Agreement with AT&T and Telecommunications Resources Inc. (TRI), an affiliated company under Entech. A second agreement, the Optical Ground Wire Agreement, between MPC and TRI was also executed that same day. The two agreements (provided by MPC in response to data request no. MCC-127 and the revised response to MCC-127) relate to the deployment, ownership, operation and maintenance of a FOG Wire project. In addition, the agreements define the roles, responsibilities, financial costs and rewards, etc., for each of these participants in the FOG Wire project. From MPC's responses last summer to several PSC data requests not in Docket No. 90.6.39, the Commission understands that the project was substantially completed in July, 1990.

The Commission invites all Parties in this proceeding to comment on whether the terms of the agreements are reasonable and provide the electric utility with fair compensation and safeguards for the use of its properties and employees. The Commission would also like Parties to comment on whether the revenues and costs associated with this project should be reflected in the determination of revenue requirements in Docket No. 90.6.39.

f) Colstrip Computer Allocations. MPC's responses to PSC-145 and PSC-167 showed that computer costs allocated to the Colstrip partners during 1989 and 1990, including MPC, decreased significantly due to increased usage of the Company's new Customer Information System (CIS) and increased efficiency of the Colstrip Automated Reporting System (CARS).

While the Commission expects a certain amount of such costs to shift when usage shifts, the magnitude of these shifts, $247,407 in 1989 and $503,035 in 1990 through October, causes the Commission to be concerned about the procedures and methods employed by the Company to allocate computer costs.

Again, the Commission reiterates that a certain amount of computer costs naturally should vary with usage. This sends proper signals to the departments/operations that place incremental burdens on the Company's current hardware and software. Such incremental use potentially causes future costs to be incurred to meet the incremental load. However, the Commission believes also that a certain amount of computer costs should be directly assigned to the Company's departments/operations whose usage caused the computer resources to originally be acquired. Basically, the Commission believes that computer cost allocations should be based on a fair balance of directly assigned and usage dependent factors.

The Commission would like the Parties in this proceeding to address the reasonableness of MPC's computer cost allocation procedures and methods. Primarily, the Parties should address the question of whether or not MPC's procedures and methods achieve a fair balance of directly assigned and usage dependent factors. If the Parties believe that a fair balance does not exist, the Commission expects such Parties to suggest alternative procedures and methods to achieve such goals. If the Parties believe a fair balance does exist, the Commission would appreciate testimony to that effect.

g) Bond Ratings and Commission Rankings. On pages 10 through 12 of his pre-filed direct testimony, MPC witness C.E. Olson compared the regulatory risks of Montana with other utility regulatory commissions throughout the country and found, in his opinion and the opinions of various brokerage and investor services, that the regulatory risks faced by utilities operating in Montana are some of the highest in the nation. As partial proof of his conclusion, Mr. Olson showed that five brokerage and investment service companies from an investment community perspective gave this Commission their lowest possible ranking. Two others gave rankings slightly below average and labeled the Commission as "restrictive & unsupportive of utilities" (Exh. ___ (CEO-1), Sch. No. 2).

The Commission believes that all reasonable options to minimize utilities' costs of operation, including capital costs,
should be explored by this Commission, the companies it regulates, and the customers served by those companies. Therefore, the Commission believes that this potentially significant issue raised by MPC should be thoroughly explored in Docket 90.6.39.

The Commission has conducted a limited investigation in this area. Using the information contained in Merrill Lynch's Electric Utility Industry Financial Summary 1988, staff performed a simple linear regression of weighted average (revenues per jurisdiction) Commission Rankings (independent variable) versus S&P Bond Ratings (dependent variable) and found a weak relationship to exist (R-Square = 0.1468, R-Square Adjusted = 0.1385). Additionally, staff has presented the Commission with literature regarding independently conducted research that suggests bond ratings have a significant affect on utilities' cost of capital and on the total price of electricity charged to ratepayers.

The Commission is interested in developing an understanding of which significant regulatory practices in general, and this Commission's regulatory practices uniquely, have on MPC's cost of capital and the price of electricity charged to ratepayers. The Commission is also interested in attempting to determine the significance and scope of quantifiable measures of the other major issues of risk (business cycles,

environmental/citing laws, management capabilities, general business climate of the state, etc.) faced by MPC's utility operations and the impacts of such other factors on the cost of capital and the price of electricity charged to ratepayers. Basically, this Commission would like parties to independently identify the most significant areas where improvements can be made to minimize capital costs to MPC and electricity prices charged to ratepayers while still maintaining a high quality of service. Results of the Commission's preliminary investigation are available, but they should not replace or supplant the independent analysis requested of the parties.

h) Gas Plant Accounting Detail. A recent Commission investigation of some of MPC's gas plant accounting processes revealed that gas records are not kept at a level of detail which could reasonably allow actual physical inventories to be compared to accounting records. Workpapers from a 1978-79 audit conducted by MPC's internal auditors implied a similar conclusion. MPC's electric plant records, on the other hand, are itemized according to Federal Energy Regulatory Commission criteria, and are very descriptive. It is not clear that MPC's external auditors would feel compelled to verify physical gas plant items, as long as all recorded plant is included in the regulated rate base. The Commission would appreciate explanations of MPC's gas plant accounting and physical inventory processes. Included in such explanations should be discussions of whether sufficient controls and tests of reasonableness exist which assure that gas plant recorded in MPC's rate base accurately reflects gas plant which actually exists and is used to provide natural gas utility service.

Amended Procedural Schedule

The following procedural schedule replaces the schedule at paragraph 6(k) through 6(o), Order No. 5484b. Parties are reminded that all dates are mailing dates, and that arrangements may be made among parties for the use of express mail or fax transmissions.

a) February 12, 1991: Docket Nos. 90.6.39 and 90.1.1 -- Final day for completion and service of rebuttal testimony by MPC in response to testimony filed pursuant to paragraph 6(h), Order No. 5484b; final day for service of testimony by parties other than MPC which is in response to testimony filed pursuant to paragraph 6(h), Order No. 5484b, or which is in response to testimony filed pursuant to paragraph 4(g) of the original Procedural Order in Docket No. 90.1.1, dated February 14, 1991; final day for MPC to file opening testimony on the additional issues described at paragraph 6, above.

b) February 19, 1991: Docket Nos. 90.6.39 and 90.1.1 -- Final day for written discovery directed to all parties that filed testimony pursuant to paragraph 2(a); such discovery must be directly related to the testimony filed pursuant to paragraph 2(a).

c) March 4, 1991: Docket Nos. 90.6.39 and 90.1.1 -- Final day for completion of answers by all parties to discovery made pursuant to paragraph 2(b).

d) March 18, 1991: Docket Nos. 90.6.39 and 90.1.1 -- Final day for completion and service on MPC and other parties of the prepared testimony and exhibits

that are in response to MPC's testimony on additional issues (Docket No. 90.6.39) and modified initial proposal (Docket No. 90.1.1); final day for completion and service on MPC and other parties of the answer testimony of the Montana Irrigators.

e) March 25, 1991: Docket Nos. 90.6.39 and 90.1.1 -- Final day for written discovery to all parties by MPC on prepared testimony and exhibits submitted pursuant to paragraph 2(d); final day for intervenor discovery to parties other than MPC on testimony and exhibits submitted pursuant to paragraph 2(d); final day for discovery by MPC and other parties to HRC XI on answer testimony in Docket No. 90.1.1

f) April 2, 1991: Docket Nos. 90.6.39 and 90.1.1 -- Final day for completion of answers by all parties to written discovery made pursuant to paragraph 2(e).

g) April 10, 1991: Docket Nos. 90.6.39 and 90.1.1 -- Final day for completion and service of rebuttal testimony by MPC in response to testimony filed pursuant to paragraph 2(d); final day for service of testimony of parties other than MPC which is in response to testimony filed pursuant to paragraph 2(d); final day for service of rebuttal/cross-answer testimony by MPC and other parties that is in response to the answer testimony of HRC XI in Docket No. 90.1.1; final day to provide the Commission and parties with a witness list indicating for each Docket the sequence that witnesses will be called by the parties at the hearing; final day for any party that intends to introduce evidence, data requests, or other discovery as part of its basic case, to notify all parties of the specific data requests or other discovery it plans to so introduce.

h) April 16, 1991: Opening day of hearing in Docket No. 90.6.39, followed by hearing in Docket No. 90.1.1. An extended recess may be scheduled between parts of the hearing.

DONE AND DATED this 28th day of January, 1991 by a vote of 5-0.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

_____
HOWARD L. ELLIS, Chairman

_____
DANNY OBERG, Vice Chairman

_____
BOB ANDERSON, Commissioner

_____
JOHN B. DRISCOLL, Commissioner

_____
WALLACE W. "WALLY" MERCER, Commissioner

ATTEST:

Ann Peck
Commission Secretary

(SEAL)

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