# ENVIRONMENTAL QUALITY COUNCIL

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**ENVIRONMENTAL QUALITY COUNCIL**
**Energy Policy Subcommittee**
**FINAL MINUTES**
**December 10, 2001**

## COUNCIL MEMBERS PRESENT

**REP. MONICA LINDEEN, Chair**
**REP. DOUG MOOD**
**REP. PAUL CLARK**
**SEN. WALTER McNUTT**
**REP. DON HEDGES**
**SEN. KEN TOOLE**
**MS. ELLEN PORTER**

## STAFF MEMBERS PRESENT

**MR. TODD EVERTS**

## AGENDA

**Attachment 1**

## SUBCOMMITTEE ACTION

- Approved September meeting minutes

## I CALL TO ORDER

**REP. LINDEEN** called the meeting to order. This would be mostly an informational meeting.

## II STATUS OF SUPPLY SYSTEM IN MONTANA AND THE PACIFIC NORTHWEST

**John Hines, North West Power Planning Council**, presented a power point presentation, see **Exhibit 1**. In March, the second worst runoff was recorded, therefore, the hydro generation produced about 4,000 megawatts less than normal. Average loads continue to grow by 220 megawatts per year. There has been very little new generation developed. The Northwest Power Planning Council (NPPC) predicts that the region faces a 24% probability of not being able to meet its needs at some level by the winter of 2003.

Since March, the loads are down and new generation and hydro conditions are both increasing. There has been a 20% decrease in loads as compared to this time last year. Seventy percent of this is due to large industry closures. Thirty percent of the decrease is coming from the smaller consumers.

He offered a summary of the region's power supply. Reliability of the power system has increased substantially. Energy prices have fallen since March. Last week the Mid Columbia spot prices were around $25 per megawatt. There is 1,650 megawatts of new generation expected this year and 1,250 megawatts expected in 2002.

Montana exports at least 48% of generation out-of-state. However, a large portion of generation is owned by out-of-state, regulated utilities and therefore can't be allocated to Montana customers.

He talked about the implications for Montana Power Comapnay's (MPC) default supply portfolio. MPC has three separate issues currently before the Public Service Commission (PSC): settlement of stranded costs, approval of the transmission and distribution sale, and approval of the default supply portfolio. The portfolio must be approved after the sale settlement. The goals of the portfolio according to MPC are the lowest rates to the customer; economic development in Montana; increased generation in the Western United States; and the creation of new competitors in Montana.

**SEN. TOOLE** said that the goals section of **Mr. Hines'** presentation said that there wasn't predictability or reliability in price, and asked if the EQC should be looking at those types of issues. **Mr. Hines** said that those are all important considerations, but they are almost secondary. When you decide what path you want to follow, then you can ensure reliability through contractual mechanisms. **SEN. TOOLE** asked what the longer term contract prices are now. **Mr. Hines** said that he hadn't seen any five-year contracts recently. Those are hard numbers to find because most of those prices are from bilateral contracts that are somewhat confidential. **SEN. TOOLE** asked if the prices were higher than 25 to 27. **Mr. Hines** said that they may be a little higher, in the mid to low 30's. **SEN. TOOLE** asked, regarding the price commitments that came in the MPC portfolio, what were they talking about. **Mr. Hines** said that there are only a couple of those that are publically available. PPL is at 31.75 for five years. **SEN. TOOLE** asked about market sensitivity, is it more sensitive now because of recent difficulties. **Mr. Hines** said that the wholesale market has evolved over the last two or three years. It is not a competitive market yet. The Federal Energy Regulatory Commission (FERC) still has price caps imposed in the Pacific Northwest, which shows that it is not a well operating market. In the past there wasn't really a market at all, so there would only be a slight change when there was a significant weather event, for example. Now there is more fluidity in the market and there is more price response to changes in supply or demand. **SEN. TOOLE** asked if that would continue in regional markets.

Mr. Hines thought that it would.

**SEN. McNUTT** asked if there are other factors, such as the Enron problem, that could be involved in a price spike. **Mr. Hines** said that he hasn't seen much effect from Enron, but certainly, any time a large amount of generation goes down for whatever reason the market will react to that. Because Enron was more of a brokerage than a generator, he doesn't feel that there will be a huge repercussion from them. Mr. Hines' understanding was that much of the

power that Enron was selling to Montana was above the current market price. **SEN. McNUTT** asked how much of the portfolio is unit contingent. **Mr. Hines** didn't know.

**SEN. TOOLE** asked if it was much of an issue that the distribution utility will be conducting affiliated transactions with its own generation. **Mr. Hines** said that was an existing concern when SB 390 was passed. There was concern about self-dealing within the company to advantage itself financially. If Northwestern goes forward with development of generation and becomes the owner of the distribution system, there needs to be something in place so that there isn't the incentive to self-deal.

**REP. CLARK** asked what the criteria for assessment the PSC would use to evaluate the default package. **Mr. Hines** said that the legislation is very remiss in not putting forward some strict criteria by which the PSC should judge a portfolio. The PSC will be looking to intervening parties for guidance as to what criteria they should apply. In the application, MPC said what they would like to hear from the PSC to tell them whether the PSC thinks this is the acceptable criteria. The goals that were shown came from MPC. In testimony MPC said that they included new generation, which may be higher cost. **REP. CLARK** asked if MPC is presenting both the package and the guidelines to evaluate the package. **Mr. Hines** said that they are not presenting the guidelines, but MPC did say that this is what they feel the package should include. Now PSC has to tell MPC what criteria they want to use to evaluate the package. The MPC package included economic improvement. The PSC will have to decide if that is appropriate.

## III THE STATUS ON MONTANA'S ENERGY DEMAND, SUPPLY, AND EFFICIENCY

**Paul Cartwright, Department of Environmental Quality (DEQ)**, referred to **Exhibit 2**. There are about 5,200 megawatts of capacity in the state. In 1999, the average generation in Montana was 3,200 megawatts. The average load in 2000 was 1,800 megawatts.

Montana's load is about 2% of the entire western load. Our sales are about 6% of California's sales. It is important to realize that what happens elsewhere affects Montana.

There are 45 generating facilities in Montana. The largest is Coal Strip Units 1-4, with 1,800 megawatts of capability. Libby Dam has 600 megawatts of capability. Some of MPC's qualifying facilities make up the smallest generators. The majority of Montana generators use coal and hydro for their fuel.

The sales have climbed about 50% over the last 20 years. The greatest climb has been in the 1990's. The commercial sector has had the most growth, but the residential has grown steadily. Over the two decades there hasn't been much industrial growth.

The average load for a residential customer is 810 kwph per month, but that varies quiet a bit depending on the customer's circumstances. Commercial loads are about 4,200 kwph per month. The large industrial loads are all over the place.

There are reams of press releases that have come out about new generation. Some, but not all, are real. If the generation is for real, an inter-connection study must be done, there may be a contract with a purchaser, or the facility may have applied for an environmental permit. MPC has received 21 requests for inter-connection studies. Most of those are separate facilities;

some are the same facility trying different angles. To get an inter-connection study, $10,000 of earnest money is required. There are three permits with DEQ right now for air quality.

The real price of electricity was pretty flat over the last decade, however that will change. If the real price goes up, it can be expected that people will use less electricity. About 2/3 of the load in Montana hasn't seen any price increase to speak of. Most of the large industrials have not seen a significant increase in cost. Other aspects, such as milder temperatures in the winter, may affect the sales. Efficiency is constantly improving, and therefore has the potential to lower sales.

The state efficiency programs are mostly aimed at improving the efficiency of public buildings, both state and local. The state does mandate some efficiency program. Also, some building codes may help efficiency. The other state mandated program is the Universal Systems Benefit Program (USBP). This was part of the restructuring of the electricity industry. The obligation of utilities in 2000 was about 13.6 million dollars, which was less that 2% of total revenues. Of that, about half was spent on investments that otherwise wouldn't have happened. The other half was distributed among low income customers, Energy Share, and others.

**SEN. TOOLE** asked if there are other jurisdictions that have adopted minimum conservation standards (MCS). **Mr. Cartwright** said that Washington and Oregon have adopted MCS. **SEN. TOOLE** asked about generator name plate and capacity for summer and winter. **Mr. Cartwright** said that name plate is set at the factory. In the field it will perform differently. The capability is what it can do if it was running full blast. It is not uncommon to have the capability be greater than the name plate. **SEN. TOOLE** asked if Columbia Falls Aluminum Company goes down, is that power available or does it go into the Bonneville Power Administration (BPA) system. **Mr. Cartwright** said that they don't know that Columbia Falls Aluminum Company is going to go down. If it did, he believes that BPA's Montana load is roughly equivalent to BPA's critical water generation. If any BPA power went out of state, it would be a fairly small amount. Their load has actually been greater than the amount generated over the last few years.

**REP. CLARK** asked if Mr. Cartwright could see this leading to a water rights issue, in order to allow for more water to go through the generators. **Mr. Cartwright** said that DEQ doesn't work with water rights. He doesn't think that would happen. There is only so much flexibility in how much water can be moved through. Some rivers have more flexibility than others.

**REP. LINDEEN** asked if there are current state forecasts. **Mr. Cartwright** said that there are not. MPC also doesn't have an official forecast. **REP. LINDEEN** asked if MPC or the state had done forecasts in the past. **Mr. Cartwright** said that the state had not done forecasting. MPC used to. Deregulation has been hard on numbers. Right now the state has no requirements on generators or marketers to make any information public. **REP. LINDEEN** asked how a potential generator would make a good business decision about whether or not they will be able to sell the generation. **Mr. Cartwright** replied that they have their own best guesses. As we have seen over the last month or so, maybe the potential generators don't have good models.

**Mr. Cartwright** offered supplemental information, see **Exhibits 3 and 4**.

## IV THE STATUS OF THE TRANSMISSION SYSTEM IN MONTANA AND THE PACIFIC NORTHWEST

**Larry Nordell, DEQ**, referred to **Exhibit 5**. He said that the transmission grid and how Montana fits into it is important because the western United States constitutes a single market for electricity. The entire western inter-connection is one integrated, synchronous transmission network. The generators all go up and down simultaneously. We are also part of a single western market because federal actions have opened up the wholesale market. Most of the new generation is being built by independent generating companies. FERC has allowed most of those companies to sell at market rates rather than regulated rates. FERC Order 888 ordered that the transmission grid be opened to transactions by parties other than the owners, under the same terms and conditions that the transmission owners use. Montana is part of the western market because as of July 2002, the PP&L buy-back contract will expire and Montana will become integrally part of the western market.

The wholesale market consists of a mix of participants. Some utilities own their own generation, serving native loads. Other utilities rely on long-term contracts. There is a day-ahead market with major trading hubs. The California PX was a major part of the market, but is now defunct.

Prices generally track across the western grid with minor differences. When prices spiked in California, they were also spiking in the northwest. The only barrier to there being a single price across the western United States are transmission bottlenecks.

There is a big difference between the physics of the transmission system and the way it's managed. When you send power from one point to another, that power will tend to flow over all available paths. One transaction incrementally affects other flows in the western grid. There are thousands of transactions happening simultaneously. If you model the system, the transactions don't matter. What matters is where the generators are, how much they are generating and where the loads are, how much they are consuming. With that information, who is buying from which generator is irrelevant. The management is very different. In order to send energy from one part of the system to another, a contractual right to send that power is needed. If the generator owns its own transmission, then it is not an issue. If a generator wants to send power across utility boundaries, a contract path is needed.

The capacity of the system is limited. There are thermal limits in how much power can be pushed through a wire. With a complicated network, the thermal limits of the system shouldn't be reached because it is not reliable. There is a variety of protocols that have been developed over the years to judge what the reliability limits are. Different paths have been broken down and given path limits, which are well below the thermal limits of the system.

FERC requires the utilities that own the rights post what is available for sale on an OASIS, which is an open access information system. Little to no available transmission capability is posted, but there may be non-firm capacity there.

There is an ongoing conflict between the issue of reliability and the desire to use the system for commercial purposes. The engineers who are in charge of reliability have an interest in making the system as reliable as possible. Reliability comes by keeping capacity redundant, which means that there is capacity that is physically there, but can't be used for commercial purposes.

There are three major paths going from Montana to the west coast. The major path is called Montana Northwest, which is the line going west out of Garrison. They link to another rated path called west of Hat Wai, which is comprised of four major lines leaving Spokane for the west coast. The rating on Montana Northwest is 2,200 megawatts and the rating on west of Hat Wai is 2,800. The two other paths out of Montana are Montana Southeast, out of Yellow Tail, and Montana Idaho, which runs south from Garrison. Both of those lines are 300 megawatts each.

A non-firm capacity is available most of the time, but it is a challenge to use it. You can make sales with a non-firm capacity, if you know that you are going to get on all but 8% of the time, but you have to make some arrangements for those hours when you can't get on. You can't buy the non-firm access in advance, although there has been some discussion at BPA about setting up a non-firm tariff. Mr. Nordell sees this as a market niche that no one has filled yet.

All of this is going to change because FERC has ordered the utilities to turn their transmission systems over to regional transmission organizations (RTO). There have been discussions underway for two or three years now to set up an RTO. Montana would be part of RTO West. Its boundaries would go from the Pacific Northwest, including Montana, Idaho, Utah and most of Wyoming. California ISO is in the process of turning itself into an RTO. There is also an RTO under formation in the Desert Southwest. The areas of RTO discussions have focused on governance, management, and tariffs.

Is new transmission needed? In the scenario where only natural gas generators were built, there is very little new construction of transmission needed for the next five to ten years. There was about one to two billion dollars in transmission that seemed to be needed. Under a scenario where different fuels, such as coal and wind, were used for new generation, there was about 9 billion dollars in transmission needed, including major new lines going west from Montana. He would conclude that if we are going to build significant new generation in Montana, we will need to have more transmission capacity. One of the major issues with new transmission construction is risk allocation siting, which deals with who picks up the costs versus who picks up the benefit. Siting is also a big issue; it is a difficult issue. There is a lot of public interest in the siting of lines, this interest can make the issue very contentious. It is a big challenge to ensure that the right lines are built in the right place at the right time.

**REP. CLARK** asked how susceptible the existing transmission lines are as far as reliability. **Mr. Nordell** said that the lines are public and visible. He doesn't think that there is any way to guard them from sabotage. In the past they have been vulnerable to vandalism. The system is planned for individual outages. The problem is that when there is a transmission system outage, it takes out huge numbers of people. You could protect against sabotage by building more redundancy into the system, but that is very expensive.

**REP. MOOD** said that BPA seemed to be confident that they could upgrade the transmission by upgrading the transmission lines rather than having to build new lines. **Mr. Nordell** said that you can gain capacity by raising the voltage on the line, but the current capacity goes up by the square of the voltage. If you change a 230 kv line to a 500 kv line, the capacity will increase by four times. Whether the path capacity would increase the full amount is unsure. There are other cases where bottlenecks could be improved at low cost. **REP. MOOD** asked for the reason that the WSCC rule that limits use of parallel right-of-ways is in place. **Mr. Nordell** said that the reasoning was that there could be events that could take out both lines in a corridor.

**REP. HEDGES** asked how it will work if the subscription user is going to pay for new lines. **Mr. Nordell** said that what is envisioned in the subscription model is that anybody could propose a new line, either power users or a new generator. If you paid for the line, you would get the rights created by the construction of that line.

**REP. LINDEEN** asked how the costs that are now covered by the wheeling charge would be recovered if that charge is done away with. **Mr. Nordell** said that if you take all of the financial transactions for the last year, MPC had a certain revenue requirement to recover its transmission. Part of that was paid by MPC customers, part was recovered by wheeling charges where other people were using MPC's system. Under the RTO calculation there would be annual transfer payments from the other entities using the transmission system. Once the transfer payments were set up, generators and customers would be free to make transactions anywhere on the RTO system without making any further wheeling payments. **REP. LINDEEN** asked about the congestion management proposal, would it cause a decrease in the reliability of the system.

**Mr. Nordell** said that there shouldn't be any decrease in reliability.

For supplemental information, see **Exhibits 6 and 7**.

## V THE BASICS OF ELECTRICITY PRICING SUPPLY AND DEMAND

**Larry Nordell, DEQ**, said that the regulatory compact that arose over the year basically said that the states will regulate the price at which electricity is sold. It will be priced at average cost and producers will be able to make a return on their investment, but not from a monopoly profit.

At some point, all utilities built their own generation. If someone else wanted to build generation, the utilities could simply refuse to buy it, even if it was cheaper. In 1978, Congress passed the Public Utility Regulatory Policy Act (PURPA), which required that certain qualifying facilities (QF) could sell to regulated utilities at rates to be set by the PSC. The Commissions were to set those prices at the cost that would be avoided by the utilities. MPC signed long-term contracts with the QF's under the PURPA rates. MPC is now stuck with contracts for about 100 megawatts of power at rates that will escalate over 25 to 30 year contracts.

Wholesale markets have now been opened up. It started with PURPA and the Electric Policy and Conservation Act and FERC Order 888. This lead to a deregulated wholesale market. FERC retained the right to step in, and have used that right reluctantly.

Demand for electricity is not elastic, which means that the demand goes down slightly when the price goes up greatly. If supplies are tight, the supply curve is also very steep. In California, there was enough reduction in supplies, and increasing loads in the southwest, that the supply curve went vertical. When prices went up, they were not reflected in retail prices, therefore the consumers didn't see the prices increasing and they kept consuming the same amount. This was a totally dysfunctional market. On the supply side, the prices had an immediate effect. The companies selling into the market made record profits. There were hordes of potential new developers. One the demand side, there was a market that was in the process of deregulation. Most of the consumers are still served by regulated utilities. The only portion of the market that was subject to market prices and was capable of adjusting was the industrial customers who had gone to choice. The industrials in California were mostly under long-term contracts and

therefore better protected than the utilities. The utilities were driven towards bankruptcy and shut downs occurred.

In Montana there was a demand reduction and some temporary generation. In addition, there were some buy-backs. For example, BPA was selling electricity to its customers with rates in the 20- 23 mil range and it was buying power on the market for up to 100 times that. Any load reduction that they could get was going to save BPA from having to buy expensive power on the market. BPA was able to pay Columbia Falls Aluminum Company (CFAC) enough to shut down so that CFAC could pay its bills and still be better off than it would have been if it was running. There are buy-back programs like that in other areas of the west.

Estimates for the northwest were that industrial curtailments and temporary generation brought in approximately a 500 megawatt savings. Irrigation buy-backs, Idaho Power and some other utilities saved about 300 megawatts. BPA bought back about 2,500 megawatts from its industrial customers. The regional total was about 4,000 megawatts of demand side responses. The problem was that these didn't come in a timely manner. Once the demand response began kicking in, prices came back down. Part of that was from plants coming back on line. The demand side response was a key factor in bringing supply and demand back into balance.

There are several causes for why we got where we were. The market design was a big mistake; the California market design didn't allow utilities to hedge against price instability. When the spot market went crazy, the utilities were driven into bankruptcy. The second cause is that there was no price signal to consumers and therefore a very limited demand-side response. The end response is crucial to a properly functioning market. The consumers have to be allowed to respond to price signals. Ideas such as real-time metering may help the response. Another option is retail deregulation. Another method are demand exchange, or buy-back programs, but they have to be designed in advance and they have to be made price sensitive. There are also load management and conservation programs, that if brought in a timely manner may serve as a market response.

Prices serve as a signal for what the value of a commodity is. Regulated prices are a benefit to the consumers, but there may be buy-back opportunities lost.

**SEN. TOOLE** asked about the demand side being slow to respond in California, but the supply side being quick to respond. There was a lot of talk about new generation, was that the only supply response? **Mr. Nordell** said that the response was that there was a lot of money to be made by investing in the industry. The result would be an increase in long-term supply, but it takes several years to bring that into effect. The temporary generation was also a supply response, which came in more quickly. **SEN. TOOLE** asked if there are situations where the supply response has the same lag that the demand response has. **Mr. Nordell** said that the demand response will lag until the price signal gets through. **SEN. TOOLE** asked what sense does it make for a state or jurisdiction that is at the low end of prices to enter a system where all the states are going to be melding. Would the expectation be a lower price? **Mr. Nordell** said that the benefits of competition are more than simply looking at equilibrating prices across the region. The effect on price by bringing in competitive markets is that prices everywhere should be driven down to the long-term marginal cost of production. He doesn't think that we have seen the outcome of what prices will do in the long run. The other benefit of competition is the forces towards innovation, which will have effects on quality, level of service, etc. **SEN. TOOLE** asked where Mr. Nordell sees a role for public intervention in this construct. **Mr. Nordell** said that risk

shifting is an appropriate place. That is an area where the public has an interest. There would also be an interest in issues of low income assistance, etc. The generation sector is quite capable of being market operated, but there is going to be a role for anti-trust action and issues market ventilation.

**REP. CLARK** asked what happens in the market to produce the condition of a seller who sells at a given price because they can, yet at the same time they realize that they are going to destroy the purchasers. **Mr. Nordell** said that in California the prices were set by the PX. The PX was trying to mimic a static supply and demand curve and they set up rules, which in retrospect were nuts. He doesn't think that it was a matter of people saying that they are going to charge that rate because they can. People might have been holding plants off the market to drive prices up, but the extent of the damage was more a product of how the market was designed. **REP. CLARK** asked if the generators had to answer to the PX as to what price they sole the energy at.

**Mr. Nordell** said that the generators submitted bids for what price they would bring different plants into service for. This was done on a day-ahead basis. **REP. CLARK** asked if there wasn't much willingness on the part of the generators to bring the plant to bid at a lower price in order to protect the consumer. **Mr. Nordell** said that some plants were bid at lower prices and those were the plants that were first chosen, but it is the most expensive one that determined the price on the market. **Mr. Cartwright** said that the people in the DEQ will concede that you can't have markets without government, someone to enforce the structure. The debate isn't government intervention versus free market, it is where and what kind of government intervention.

**REP. MOOD** said that he had it described to him that the PX determined the price it would pay by waiting to a certain point in time and the last price that came in at that point in time was the price that they paid. **Mr. Nordell** said that his understanding was that on a day-ahead basis people bid in what it would take to run each generating plant. **REP. MOOD** said that BPA had said that if they could eliminate the regulations they could sell electricity on a cost basis of 1.1 cent. If the cost of electricity is going to drive public policy, doesn't it make sense for the government to eliminate the regulations, including the Endangered Species Act requirements, that drive the price of electricity up. **Mr. Nordell** declined to answer.

**REP. HEDGES** said that 7,000 megawatts came on line in the last year. Several plants were reopened and built 3,500 megawatts of new generation. Supply and demand seems to be working.

**MS. PORTER** said that she agreed with REP. MOOD's assessment of what BPA had said and of the way that the PX set its prices.

**SEN. TOOLE** commented that the response on the supply side is not immediate. It has the same lag characteristic that is found on the demand side. He asked if Montana ratepayers, through the sale of the generation system to PPL, allow the opportunities through these past market spikes to flow to PPL ratepayers rather than MPC ratepayers. **Mr. Nordell** said that it was the power that Montanans were consuming that offered the opportunity for a buy-back. **SEN. TOOLE** asked if Mr. Nordell would agree that there was a lost opportunity because of deregulation that PPL took the profits from excess off system sales, that in the previous environment would have come back to Montana ratepayers. Have we already missed those

opportunities and did that loss occur because of deregulation? **Mr. Nordell** said that at the time that the sale was made, PPL made a bid based on its expectations of the future, along with other bidders. MPC compared the bids and chose PPL. At the time it looked like a good decision. **SEN. TOOLE** asked if Montana ratepayers missed an opportunity because of deregulation and the sale of the generation assets missed the opportunities from the revenues that were sold into those high markets. **Mr. Nordell** said that with the sale of the assets, the income or loss from those transactions went to PPL instead of Montana. As it turned out, it was a profit.

**REP. MOOD** asked if there is a reasonable expectation that without SB 390 being in place, Montana ratepayers would currently and in the recent past have paid more for electricity than they currently are. **Mr. Nordell** said that was correct. SB 390 imposed a rate freeze starting in 1998.

**REP. CLARK** asked what percentage of the energy that MPC was dealing with was actually purchased from other sources and what percentage was self generated. **Gary Willis, MPC**, said that they had peaks around the 1,400 megawatts, but their own generation was around 1,000 megawatts. During peak months MPC purchased around 30%, but the opposite was true in the summer. **REP. CLARK** asked if the percentage that was purchased was purchased on the open market and at market prices. **Mr. Willis** said that was correct.

**MS. PORTER** asked if HB 474 is the only thing allowing the large customers to fall back to the default supplier. **Mr. Nordell** said that the people who had contracts with Enron have had to go to other suppliers. **MS. PORTER** asked if HB 474 is repealed, will the large customers be able to default back to MPC. **Mr. Willis** said they would not.

## VI THE TIE BETWEEN NATURAL GAS AND ELECTRICITY

**Jeff Blend, DEQ**, referred to **Exhibit 8**. Natural gas is an important piece of the puzzle, which affects Montana as well as the United States. There was a big price spike in natural gas prices at the beginning of 2001. That spike coincided with California's electricity price spikes. More than ever before, natural gas markets and electricity markets are more closely tied than they have ever been. Montana is part of a huge North American market, so whatever happens in other parts of the country, directly affect us. We are not isolated.

There are several natural gas producing areas in North America. Currently, most of the US consumption, which is now at record levels, is supplied domestically. About 15% of the natural gas the US consumes comes from Canada.

In Montana there are two major natural gas utilities and a few other small ones. The two major ones are MPC and the Montana Dakotas Utility (MDU). MPC's system connects in with Canada's system and some pipelines going down to the Rocky Mountain West. Currently, Montana receives the majority of its gas from Canada. Because of that, Montana's prices follow Alberta's AECOC index. Alberta's index basically follows the larger indexes in North America. The Henry Hubb Index in southern Louisiana is the biggest natural gas price index in the United States.

The delivered price of natural gas is what consumers pay in their bills. That consists of the price of gas or the well-head price, transmission fees, delivery fees, and other fees such as storage fees. Montana's prices essentially track prices in the greater United States.

Pipeline capacity has continued to increase over the last ten years. This allows Alberta to supply more natural gas to the United States.

Because of the inter-tie between natural gas and electricity markets, there may be increasing price volatility in the price of gas. Extreme events will likely affect both the gas and electricity markets simultaneously. This could lead to increased investment in alternative energy generation.

Natural gas fired electrical generation is probably the cheapest method right now to generate electricity and may be for some time in the future. Almost all of the proposed generation is natural gas fired.

If we continue as is, the demand for natural gas in Montana will probably go up about 1% annually, according to utility projections. However, there are things happening in the state, for example the Northwestern plant in Great Falls and the Silver Bow generation plant. If the Silver Bow plant comes on line, it will increase Montana's natural gas demand by 50%. It probably won't have much effect as far as price.

**SEN. TOOLE** asked about transportation costs for gas. **Mr. Blend** said that generally, the further away you are from a natural gas producing hub, the more you pay in transmission fees. He would, however, assume that is not true in all cases.

**Paul Gould, NARCO *,** said that it is generally true that the further away you are, the more you pay. Those are all regulated rates and tariffs by the federal government. **SEN. TOOLE** asked if he knew the how much the increment of the transportation cost is compared to the actual cost of the commodity. **Mr. Gould** said that there comes a point where it gets over 2,000 miles and the transportation cost is actually more that the product itself.

**SEN. McNUTT** asked if we can draw the conclusion that if we build more generation and electric prices come down, will gas prices also come down. **Mr. Blend** said that natural gas to some extent is going to determine the price of electricity at gas fired plants because, once the plant is built, one of the greatest costs is the fuel to run the plant. At the same time, electricity can affect the price of natural gas. In isolation, if you build more generation, and there are less instances where there is a shortage, then the price will probably stay low.

## VII TRANSITION ADVISORY COMMITTEE UPDATE

**Jeff Martin, TAC staff**, gave an update of where the Transition Advisory Committee (TAC) is at. They spent considerable time looking at the power pool in the June meeting and the allocation of the energy. They also looked at the changes in the spot market. The price has dropped considerably since the end of the Session. In the August meeting, many large industrial companies came in to talk about their contractual agreements. TAC also had Rep. Lee talk about the rationale for putting HB 474 to voter approval. Staff will be looking at the legal implications of the repeal of HB 474. In October TAC attended a wind energy conference in Big Sky and heard a presentation from NCSL about restructuring and policy implications. Enron also

spoke about how power marketing works. At the December meeting TAC looked on the work plan of what the committee is going to do in addition to the statutory duties. They created a USBP Subcommittee, and a Transmission Subcommittee. If HB 474 is rejected by the electorate, the USBP program will terminate in 2003 rather than 2005. The original legislation in SB 390 requires TAC to look at the programs and come up with recommendations by July 1, 2002.

There is a conference call scheduled for December 11, 2001, to talk with NCSL about having them come and take an objective look at restructuring in Montana. Hopefully they will evaluate Montana's system based on what the law is and what developments have occurred in the market. One of the issue that will be focused on is transmission.

Another statutory requirement of TAC is to look at the elements that make up a competitive market. With the transition period being extended, this may be an academic exercise, but still worthwhile. It will lay the framework for the Legislature to use, if and when a competitive market evolves.

TAC will also be looking at the portfolio supply arrangement put forth by MPC. One of the things that was mentioned today was long-term contracts and whether the portion of the portfolio that is made up of long-term contracts may somehow impede the transition to competition. It would be beneficial for the Committee to look at what the impact is of long-term contracts in the transition.

TAC will look at the development of new energy generation in the state. One of the common themes that has been developing is "bragowatts" versus serious proposals for new generation. Perhaps having financial institutions come in to offer their input about the types of things that they look at in financing new generation projects would be beneficial. The effect of TAC's incentives and financial incentives for new generation will be considered.

Another item that TAC will be looking at is the Tier II stranded costs issue. The PSC review of the sale of the transmission and distribution assets to Northwestern and the portfolio will be looked at to determine if there is a link in those areas.

Other issues that TAC will deal with include net metering, real-time metering, technical corrections to legislation, and coordination with the EQC.

**REP. LINDEEN** asked when TAC was created. **Mr. Martin** said that it was created in SB 390 in 1997. **REP. LINDEEN** asked why they decided to create TAC when EQC already had the authority to do all of it. **Mr. Martin** said that there was a report recommended that there be a committee with oversight responsibilities if the state adopted the competitive model for the supply of electricity. **MR. EVERTS** said that the issue was raised on whether the EQC was an appropriate entity for this, but at the time this was such a huge issue, which went beyond what the EQC could realistically do given its other statutory responsibilities. The policy makers felt that it was important to have a specific committee on top of these issues. The policy makers wanted a committee entirely devoted to this one subject area.

**REP. HEDGES** asked if HB 474 had an effective date. **Mr. Martin** said that if it is approved by the electorate, at the time it is rejected, we would immediately revert back to law prior to HB 474.

**SEN. TOOLE** asked if TAC is looking at the various levels of wholesale market, large industrial, and small customer. **Mr. Martin** replied that they are looking at two markets: wholesale and retail. The wholesale market is moving in fits and starts. There isn't much of a retail market at the small customer level at this point in time. He feels that the competitive market includes both the retail and wholesale markets. **SEN. TOOLE** said that TAC has been looking at the transition to competition and what needs to happen to make that transition, based on the assumption that competition is the goal. He is concerned that at some point the question of whether competition is going to arrive or not, will have to be answered and is the effort to get to competition so risky that we shouldn't be going in that direction? Is TAC going to be looking at those questions? **MR. EVERTS** said that TAC has a specific charge within the statutes to see whether competition is developing. They are going to have to face that issue at some point in time. **SEN. TOOLE** asked when. **MR. EVERTS** said that the timing on that is open-ended through the transition period. **Mr. Martin** said that presumably that would happen before the Committee is terminated. This will actually be the first effort of the Committee to evaluate the criteria of judging whether a competitive market has emerged or is going to emerge.

## VIII REVIEW OF THE DRAFT OUTLINE FOR THE ENERGY LAW HANDBOOK

**MR. EVERTS** said that the Subcommittee has received a lot of information and they are getting to a threshold point where they will have to decide what to do with the information. One of the ways that the Subcommittee has decided to respond is to develop an Energy Law Handbook. He referred to a draft table of contents of the handbook, see **Exhibit 9**. The work plan also promises a full draft for the February meeting. He needs to get any feedback regarding the table of contents.

**REP. MOOD** said that he didn't see the difference between public utility law and cooperative utility law included in the contents. He thinks that a worthwhile addition would be to give and understanding between those two entities and the estimated number of customers that is affected by those different entities.

**SEN. TOOLE** said that he is concerned that energy law is a moving target. He worries that the more of that that is included in the handbook, the less valuable the handbook becomes. If we look back in five years at cooperatives and restructured environments, there will be a lot of change. He also thought that a discussion should be included in Chapter 7 about principles that are involved in making the decisions, such as the cost of risk and the fact that who is assuming risk often has a lot to do with how much is being paid. He would also add a discussion of external costs and the whole concept of externalities and how those are born and paid for. In the conserving energy portion it is important to talk about how conservation is paid for.

**REP. CLARK** said that a baseline is needed for restructuring that would show where we started from and the difference between a regulated and a deregulated schematic. In other words, where were we, what changed, and where are we now. Understanding this is important in trying to understand the current laws.

**REP. HEDGES** asked if there is a section in the handbook that will cover the philosophy in terms of a balance of power sources, such as solar energy, fuel cell energy, wind powered energy, etc. **MR. EVERTS** said that the handbooks reflect what is currently in law. If there is a mandate out there for a balance in the energy policy statement for the state of Montana, that will be reflected in the handbook. They are designed to educate the public about what is there in

terms of laws and policy. If there isn't anything there in terms of specifics, then it probably wouldn't end up in this type of handbook. **REP. HEDGES** said that we have invested millions of dollars in incentives to promote alternative energy sources, through USBP we have spent hundreds of thousands of dollars in research. He would say that Montana is at least inferring a policy of alternative energy sources, if not literally mandating it. **MR. EVERTS** said that the USBP law will be touched on in the handbook. There is also another publication that is coming out of this Subcommittee, which is the State of the State Report that will deal with what is actually happening out on the ground in terms of sources and the relative percentages to each other. This is the legal handbook, what ever the Subcommittee directs be put in, can be put in.

**SEN. TOOLE** said that if it is a legal thing, there isn't much space for talking about issues surrounding conservation. He thinks that it is core to the statement of policy that is already in statute. **MR. EVERTS** said that the Subcommittee has the ability to shape what the handbook looks like. Basically, what the handbooks have attempted to do in the past is take a very complex subject of law, put it into plain language and explain to legislators and the general public what exists in terms of law. The handbooks have been very successful in this. These things are non-intimidating; they are small and short. They offer the chance to get a basic understanding of what the law is. These handbooks are updated every interim to reflect what is happening in the law. **SEN. TOOLE** said that the more explaining about why these things are in law makes the handbook more valuable. It is important to do that, especially in areas that are more complicated. **MR. EVERTS** said that there are a lot of different reasons why a piece of legislation is adopted. If we start getting into projecting what those reasons were, we will find that people have different perceptions for the reasons. It is in the eye of the beholder.

**MS. PORTER** said that the simpler we can keep it the better. People will always have their own opinions and can do additional research if they want to get into the why and the interpretations. She would be concerned about making it too overwhelming to read.

**SEN. TOOLE** said that he doesn't want to end up with a list of statutes without any context or some type of unifying thing about what is going on. **MR. EVERTS** said that there are some things that you have to do for people to understand what the law does. You have to get into some of the physics and a general understanding of what electricity is and how it is transmitted.

**REP. LINDEEN** said that the examples that she has read were simple, but did have some historical aspect to it. It had to in order for it to make sense.

**MR. EVERTS** said that the Subcommittee will have a chance in February, May, and July to further discuss this. The draft will go out for public comment for a whole month in June.

**REP. CLARK** asked if there could be schematic to follow the flow of money and show the difference between a regulated and deregulated structure included. **MR. EVERTS** said that there are some creative things that can be done.

## IX REVIEW OF DRAFT OF BENCHMARK DATES AND TIME LINE FOR MAJOR ENERGY ISSUES AND DECISIONS

**MR. EVERTS** referred to **Exhibit 10**. This memo was due to the Subcommittee's request for an inventory of all of the dates, lawsuits, initiatives, etc. This is a significant tool for the Subcommittee to use for the remainder of the interim to know what is going on. The memo is

split into 13 areas. The first is statutory due dates that have a bearing for electric industry restructuring and natural gas restructuring. The transition to customer choice was extended to 2007. This has a bearing on a number of things, including the portfolio. The function of this section is to make the members aware that there are a number of statutory due dates. An example he gave was that the rate moratorium us scheduled to come off on June 30, 2002.

The next item is the sale between MPC and Northwestern. Under that he has outlined the procedural schedule that the PSC has adopted for resolving their role in this issue. The memo also includes information on the default supply portfolio, a docket that is before the PSC dealing with transition costs, status of state permitting on generation projects. There is very little information on tax incentives, but it is something that the Subcommittee wanted to monitor. The status of current lawsuits is included, as well as the status of electricity and natural gas prices and more.

He referred to **Exhibit 11**, which is a time line of all events before the PSC since the inception of the 1997 restructuring law. This is very helpful in terms of all the actions that the PSC has taken to-date. **Exhibit 12** is a chronology of events that is reprinted from Stephen Maly's report called "Shock of the New." **Exhibit 13** is a summary of the power supply arrangements that large industrial customers have entered into. This is before the Enron situation.

**SEN. TOOLE** asked about the sale to Northwestern and the recent fall of MPC stock. Has TAC discussed this? **MR. EVERTS** said that it wasn't discussed much at the last TAC meeting. The PSC obviously expedited the normal course of events, it was clear at that point that the sale was still on. There is a lot of pressure to get a resolution from the PSC. There is the possibility of a settlement between the parties, the large industrials, the Consumer Counsel. Northwestern and MPC have been talking about settlement. **E.J. Redding, Northwestern**, said that talks are currently in progress. There is no talk of pulling out of the sale as of today.

## X REVIEW OF THE SUBCOMMITTEE WORK PLAN AND DISCUSS THE FEBRUARY SUBCOMMITTEE AGENDA

**MR. EVERTS** referred to the work plan, **Exhibit 14**. The Subcommittee is on schedule for completing the tasks it assigned itself in the workplan.

## XI OTHER BUSINESS

**ACTION:** September minutes were approved.

## XII ADJOURN

There being no further business, the meeting was adjourned.