



# Energy and Telecommunications Interim Committee

PO BOX 201706  
Helena, MT 59620-1706  
(406) 444-3064  
FAX (406) 444-3036

## 58th Montana Legislature

### SENATE MEMBERS

ROYAL JOHNSON  
DON RYAN  
EMILY STONINGTON  
FRED THOMAS

### HOUSE MEMBERS

DANIEL FUCHS  
DAVE GALLIK  
GARY MATTHEWS  
ALAN OLSON

### COMMITTEE STAFF

MARY VANDENBOSCH, Research Analyst  
TODD EVERTS, Staff Attorney  
REBECCA SATTLER, Secretary

## MEMORANDUM

**To:** Energy and Telecommunications Interim Committee (ETIC) ETIC Members  
**From:** ETIC Staff  
**Date:** September 10, 2003  
**Subject:** Options for Default Supply of Electricity

---

## Introduction

This memorandum provides limited background information about various options related to the default supply of electricity in Montana. The options were identified by individual ETIC members and others. The options described in this memo are not proposals for legislation. They are simply ideas about which the ETIC is seeking additional information. The ETIC has invited a panel, as well as any interested persons, to provide feedback on these options or others during the September 16, 2003 ETIC meeting.

The information provided, the questions raised, and the next steps identified are not comprehensive but are designed to get a discussion started. Staff is seeking committee direction on what steps to take next on this issue before thoroughly evaluating any individual option.

## The Big Picture

Some questions to ponder when considering each of these options are presented below. The first question was presented at the request of an ETIC committee member.

- At what point should the Legislature become involved?
- What are the costs and benefits of an option in comparison with other options, including no action.
- Will rates be lower over the long term with an option, in comparison with other options?
- Are there other benefits such as rate stability or improvement of Montana's economy that make one option better than another? (This question isn't meant to imply that a group of ratepayers should subsidize benefits that accrue to all Montanans or vice versa.)
- Would this option be proposed absent NorthWestern Corporation's poor financial condition? If not, are there other measures related to the financial condition that would be more appropriate for addressing that specific problem?
- How does the option fit into a long-term vision for supply of electricity in Montana?

## Option 1: Higher rate of return/incentives for better default supply service

### Description

Two different approaches are described below:

- a. offer incentives or rewards for better electricity supply procurement; or
- b. allow a higher rate of return for the transmission and distribution utility that provides default supply service, based on an argument that there is an increased risk associated with the default supply responsibility.

### Authority

#### *Option 1a*

Under current law, the default supplier may fully recover prudently incurred electricity supply costs. Section 69-8-403, MCA authorizes performance-based ratemaking if the utility demonstrates that the method complies with the Electric Utility Industry Restructuring and Customer Choice Act. Public Service Commission (PSC) rules (ARM 38.5.8227) require the PSC to evaluate the default supplier's performance in providing default service pursuant to the goals and objectives set forth in the Default Electric Supplier Procurement Guidelines and authorize the PSC to reward the default supplier for superior performance.

#### *Option 1b*

The default supplier could file a rate case that requests a higher rate of return, based on the increased risk associated with the default supply responsibility. The PSC has the authority to establish "just and reasonable rates through established ratemaking principles."

### Question

- Do the incentives authorized under current law provide an adequate incentive for provision of default supply service or better default supply service?

### Other States

Other states have implemented performance-based ratemaking under which rates reflect reliability, quality of service, reduced costs, or rate stability.

### Potential Next Steps

The ETIC could:

- Request that staff provide more detailed information regarding the use of performance-based ratemaking in other states.

- Request that legislation be drafted to amend the law to establish criteria for performance-based ratemaking. (See 69-3-1407, MCA, which authorizes performance-based ratemaking for natural gas utilities.) The law should be further amended to clarify the effect of the various provisions governing rates and cost recovery. The law could be amended to require the PSC to adopt rules governing performance-based ratemaking.
- Do nothing. The default supplier may choose to seek a higher rate of return.
- Other:

## Option 2: Revise provisions of 69-8-201 that affect default supply load

### Description

In testimony presented during the June 13, 2003 meeting of the ETIC, John Fitzpatrick of NorthWestern Energy (NWE) identified several elements of a "perfect storm" that affected NWE. One of the items identified was the increase in electric load as several large choice customers return to default supply. (Because the existing default supply portfolio is not large enough to serve the additional load, incremental market purchases must be made.) A committee member raised the question: Could rates for default supply customers be more stable if the restrictions on choice were revised?

### Background information

HB 509 (2003) placed restrictions on choice for current or potential customers of the default supplier. These restrictions are summarized below.

- Large customers not served by the default supplier on July 1, 2003 are required to purchase electricity from the competitive marketplace, except that:
  - A large customer may make a one-time election to enter into a permanent contract with the default supplier for service on or after July 1, 2004. The customer must notify the PSC in writing no later than December 31, 2003.
  - A new large customer may enter into a contract with the default supplier. The new customer must notify the PSC at least 90 days before delivery of electricity.
  - A large customer that is a public agency may enter into a contract with the default supplier.
  - The total average monthly billing demand for all medium-sized customers that choose a different supplier is limited to 20,000 kilowatts in a calendar year.
  - Small customers may participate in a choice program approved by the PSC. The total average monthly billing demand for all small customers that participate in this program is limited to 10,000 kilowatts in a calendar year.
  - The PSC is required to adopt rules and establish rates and fees to enable customers to have reasonable opportunities to choose an electricity supplier or to receive default supply service, while providing protection for small customers from higher or more unstable default supply service rates than would otherwise result if these choices were not offered.

After the June 2003 meeting, NWE learned that Express Pipeline and Cenex were not going to return to the default supply. However, the PSC interim order on the electricity rate tracker indicated that Energy West customers would be returning to default supply. Furthermore, the League of Cities and Towns and the School Board Association are returning to default supply because of a breach of contract by NorthWestern Energy Marketing.

## Questions

- In light of the requirements of HB 509, is the effect of customer choice on the default supply load going to be a significant factor in default supply rates?
- How does the allowed fluctuation in default supply load under 69-8-201 compare with the fluctuation based on weather conditions and other factors that contribute to uncertainty of price or load?
- What portion of the incremental market purchases are made because of uncertainty about choice and what portion are made as a result of NWE's decisions regarding the default supply portfolio or other factors?
- Would the default supply role be more attractive to other entities or would the default supply service be more financially stable if the law was amended to provide for different restrictions on choice?

## Potential Next Steps

- Inquire into the questions raised above.
- Solicit proposals to make the default supply load more stable.
- Do nothing.
- Other:

## Option 3: PSC orders the default supplier to sell its utility assets

### Description

Montana law would be amended to authorize or require the PSC to order the default supplier to sell its utility assets if the PSC finds that ratepayers are adversely affected by the financial condition of the default supplier.

### Questions

- Can the PSC reach a finding that ratepayers are adversely affected by the financial condition of the default supplier? Another way of putting this question is: should the PSC allow or disallow the recovery of that portion of the cost that results from a default supplier's poor financial condition? Can the PSC identify that portion of the cost? (ETIC staff have not researched this question.)

## Legal Concerns

The legal analysis of this option could be very voluminous; therefore, the legal issues with this option are highlighted below.

- **Interstate Commerce.** Providing a state public service commission with the authority to order a utility that conducts business in multiple states to sell the utility or the utility's assets, may invoke federal constitutional barriers under the Interstate Commerce Clause. Under the United States Constitution, Article I, section 8, the U.S. Congress has complete power over interstate commerce and states may not regulate interstate commerce in a way that interferes with that power.
- **Federal Preemption and Supremacy Clause.** This policy option would likely raise federal preemption and constitutional supremacy clause issues. For example, if a utility owns transmission facilities, the ability of a state public service commission to order a sale of those facilities may be preempted by the Federal Energy Regulatory Commission's regulatory authority over transmission facilities.
- **Taking of Private Property/Due Process.** The taking of private property without just compensation and due process is prohibited under both the Montana and U.S. Constitutions. A state-forced sale of a utility's assets is almost analogous to an eminent domain proceeding. If a forced sale resulted in the utility receiving less compensation than the utility property was worth, a court could determine that a taking of private property has resulted and the court could require the state to adequately compensate the utility. A state decision to force the sale of a utility or a utility's assets would, at the very least, necessitate that the state institute carefully crafted procedures that meet the constitutional requirements of due process (notice, the opportunity to be heard, and an unbiased decision-making entity).
- **Current Law.** The PSC currently has the ability to require a utility to furnish reasonably adequate service and facilities at reasonable and just rates (69-3-201, MCA). Short of ordering a utility to sell the utility or its utility assets, the PSC could order a utility to invest in infrastructure to ensure reliability of the utility system if the utility's financial problems were causing inadequate or unreliable utility service. If a utility's financial problems directly resulted in increased rates, the PSC could prohibit the utility from passing those costs through to ratepayers if the PSC determined that those costs were unreasonable or unjustified. With respect to electricity supply costs, the law (69-8-210(2), MCA) requires the PSC to establish an electricity cost recovery mechanism that allows a default supplier to fully recover *prudently incurred* electricity supply costs. Staff have not investigated what costs can be considered prudently incurred. (The default electric supplier procurement guidelines (ARM 38.5.8201-8227) describe prudence, but do not address issues such as poor credit rating.)

## Potential Next Steps

- Request further investigation of the legal issues raised above.
- Request that a bill be drafted.

- Investigate whether or not the PSC has the authority to disallow costs that result from the poor financial condition of the default supplier.
- Do nothing.
- Other:

**Option 4: Greater assurance for recovery of costs of procurement of electricity**

**Description**

Potential options include:

- Establish a shorter timeline for pre-approval decisions.
- Establish a "bright line" standard for prudence (i.e., a standard correlated to a price index).

**Background Information**

Senate Bill No. 247 established a default electricity supply procurement process, including a process for pre-approval by the PSC, and required the PSC to adopt rules that establish criteria that guide the default electricity supply procurement process. The PSC has adopted administrative rules that establish procurement guidelines for the electric default supplier. Furthermore, the PSC has begun holding roundtables to discuss any additional rules that are necessary to comply with SB 247.

**Potential Next Steps**

- Review the minutes from the hearings on SB 247.
- Request that staff look for examples in other states.
- Request that a bill be drafted.
- Do nothing.
- Other:

**Option 5: Formation of a cooperative to assume some or all default supply functions currently provided by NWE**

**Description**

The option described here is a cooperative that assumes all of the default supply functions currently provided by NWE.

**Authority**

- An electric cooperative may be formed by 5 or more natural persons or two or more cooperatives in the manner provided by Montana law (Title 35, Chapter 18).
- The state does not have the authority to compel formation of a cooperative.
- An electric cooperative may serve:

- any area outside of a city, town, or village with a population of 3,500 or more on or after March 17, 1939;
- an incorporated municipality in which 95% or more of the customers were served by electric cooperative on February 1, 1971;
- a formal rural area annexed by a municipality and subject to 69-5-109; or
- an incorporated municipality that was served by a public utility that sold its distribution facilities within that municipality to an electric cooperative after January 1, 1998.
- Electric cooperatives are exempt from regulation by the PSC and are governed by each cooperative's local board of trustees.
- A cooperative utility may own generation, transmission, and distribution assets.
- Cooperatives are subject to different provisions with respect to choice than NWE.

## Background Information

Montana's cooperatives are customer-owned and locally controlled. According to the National Rural Electric Cooperative Association, the average number of customers served by a cooperative nationwide is 11, 500. The cooperative that serves the largest number of customers in Montana is Flathead Electric Cooperative with approximately 53,000 members.

## Financial Impacts

A letter from Garry R. Thompson, Bonneville Power Administration (BPA), to Todd Everts is attached. In a nutshell, the cooperative could be eligible for the priority firm power rate to the extent that it:

- owns all "necessary physical assets used in the distribution of electricity to its consumers;" and
- serves customers west of the Continental Divide.

The letter includes caveats:

- The BPA may assess additional charges to recover incremental costs that may be incurred by the BPA to supply a new customer.
- The answer is preliminary and subject to change, based on an analysis of the facts as well as potential policy changes.

A cooperative may also be eligible for lower cost financing.

## Potential Next Steps

- Investigate amending the law to authorize the state to initiate the creation of a different entity that is similar to a cooperative, while leaving the current laws governing cooperatives intact.
- Do nothing. By law, cooperatives are formed voluntarily.

Other:

**Option 6: Establish a Montana Power Authority with default supply procurement responsibilities**

**Description**

House Bill No. 474 (2001) created a Montana Power Authority. The bill authorized the Montana Power Authority to:

- purchase electrical energy from wholesale suppliers;
- purchase, construct, and operate electricity generation, transmission, or distribution systems in Montana; and
- enter into joint ventures with a municipality, cooperative, investor-owned utility, and other entities for the purpose of financing the facilities named above;
- sell electricity to any distribution services provider in the state; and
- participate in a regional transmission organization.

The bill required the Montana Power Authority to offer cost-based electrical energy to Montana consumers, including utilities. The Montana Power Authority was authorized to request that the Legislature authorize the issuance of revenue bonds.

**Authority**

House Bill No. 474 was rejected by the electorate. Therefore, there is no statutory authority for the Montana Power Authority.

**Potential Next Steps**

- Request that a bill be drafted to create a Montana Power Authority.
- Do nothing.
- Other:

**Option 7: Make the PSC responsible for procurement of electricity**

**Authority**

The PSC does not have this responsibility under current law.

**Background Information**

In 1999, the PSC issued a rulemaking notice which included an option that established a commission-conducted, annual competitive solicitation process for selecting default suppliers and



determining default service prices. The service quality and reliability characteristics of default service would be established by rule and the commission would select default suppliers based on the lowest bid price.

## Examples in Other States

The report *Electricity Policy Options for Montana*<sup>1</sup>, describes the approach used in Maine:

- The utility commission put out for bid the load of various customer classes.
- Suppliers bid for the privilege of serving the loads.
- The accepted bids are not subject to a contract-by-contract prudence review.
- In Maine, it requires approximately four months for three to four people to review the bids.
- Bidders are bound by force of law to deliver on the bid.
- Bidders do not enter into a contract with the commission.

This is the only example that staff are aware of where a state utility commission is responsible for default supply procurement.

## Potential Next Steps

- Review comments received on the PSC's rule proposal. Ask opponents if their opinion has changed.
- Request that staff provide additional information about the advantages and disadvantages of the Maine program.
- Request that a bill be drafted to require the PSC to procure the default supply. The bill could be based on the Maine model or another approach.
- Do nothing.
- Other:

## Option 8: Create a public/private partnership to purchase the poles and wires

### Description

This memo assumes that "poles and wires" refers to the distribution system. The option, as described, requires a willing buyer and a willing seller.

### Authority

Local government entities that have self-governing powers have the authority to acquire and operate electric and natural gas utilities within and outside the boundaries of the local government unit (see

---

<sup>1</sup>Matthew H. Brown, National Conference of State Legislatures, November 2002. Printed by the Legislative Services Division, Helena, Montana.

Mazurek, Attorney General Opinion, Volume No. 48, Opinion No. 14, June 22, 2000). Local governmental units also have the authority to enter into contracts with private entities to execute the powers granted in law to the local governmental units (7-5-4301, MCA). Local governmental units have the ability to raise revenue (Title 7, Chapters 6 and 7, MCA). With the ability to contract with private entities, raise revenue, and purchase and operate electric and natural gas utilities, local governmental units have the necessary legal authority to establish a public/private partnership to purchase poles and wires.

With the rejection of HB 474 (2001) by the voters in 2002, the legislature would need to provide the necessary legal authority (financing authority and specific statutory direction) for state government to enter into a public/private partnership to purchase poles and wires.

### Potential Next Steps

- Request that a bill be drafted to expand the authority for public entities to enter into a public/private partnership to purchase poles and wires.
- Do nothing.
- Other:

### Option 9: No change in ownership of utility assets or default supplier

This option was included because it reflected the current status when this memo was written. Other options should be compared to the current condition to determine whether those options provide greater net benefits.

### Option 10: NWE sells utility assets to another entity

#### Background Information

This option requires a willing buyer and a willing seller. The City Commission of Great Falls has authorized the preparation of an ordinance to establish an electric utility. The City Manager has reportedly been communicating with electric cooperatives about possible joint ventures.

### Option 11: Remove barriers to owning of generation by the default supplier

Staff did not research this option but included it in the memo because the option has been suggested by several people in various forums recently. There are likely multiple variations. One option is to clearly allow the default supplier to own generation assets and to earn a return on those assets. This allows for an increase in the rate base and possibly a higher rate of return.

CI0425 3253mvjb