Service Date: August 1, 2007

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

IN THE MATTER OF the Joint Application of NorthWestern Corporation and Babcock & Brown Infrastructure Limited, BBI US Holdings Pty Ltd., BBI US Holdings II Corp., and BBI Glacier Corp. for Approval of the Sale and Transfer of NorthWestern Corporation Pursuant to a Merger Agreement	)	UTILITY DIVISION DOCKET NO. D2006.6.82 ORDER NO. 6754e

FINAL ORDER

APPEARANCES

FOR THE APPLICANTS:

NorthWestern Corp.
John Alke, 40 W. Lawrence, Suite A, Helena, Montana 59601

Babcock & Brown Infrastructure Ltd.
Patrick Fleming, 480 E. Park St., Suite 100, Butte MT 59703

FOR THE INTERVENORS:

Montana Consumer Counsel
Robert A. Nelson, Montana Consumer Counsel, 616 Helena Avenue, Room 300, P.O. Box 201703, Helena, Montana 59620-1703

John P. Coyle, 1575 I St. NW, Suite 300, Washington, DC 20005-1175

Human Resource Council–District XI/Renewable Northwest Project/Natural Resources Defense Council
Charles E. Magraw, 501 8th Avenue, Helena, Montana 59601

AARP Montana
Stephen C. Bullock, 30 W. 14th St., Suite 204, Helena MT 59624

Large Customer Group
Donald Quander, 401 N. 31st St., Suite 1500, Billings MT 59101

Heartland Consumers Power District/ South Dakota Public Power, Inc.
Harley Harris, PO Box 1144, Helena MT 59624
Jenny Kaleczyc, PO Box 1144, Helena MT 59624

Colstrip Energy Limited Partnership/Yellowstone Energy Limited Partnership/International Brotherhood of Electrical Workers Local #44
Michael Uda, 44 W. 6th Ave., Suite 200, Helena MT 59624-1185

Ammondson, et al., Retirees/Plaintiffs
Cliff Edwards, 1601 Lewis Ave., Suite 206, Billings MT 59104
Triel Culver, 1601 Lewis Ave., Suite 206, Billings MT 59104

Before:
Greg Jergeson, Chairman
Doug Mood, Vice Chairman
Brad Molnar, Commissioner
Robert H. Raney, Commissioner
Ken Toole, Commissioner

Commission Staff:
Al Brogan, Staff Attorney
Kate Whitney, Utility Division
Eric Eck, Utility Division
Dave Burchett, Utility Division

INTRODUCTION

In this Order the Montana Public Service Commission denies the joint application submitted by NorthWestern Corporation and Babcock & Brown Infrastructure, Ltd., et al. for approval of the sale and transfer of NorthWestern pursuant to a merger agreement.

PROCEDURAL BACKGROUND

1. On June 7, 2006, NorthWestern Corporation d/b/a NorthWestern Energy (NorthWestern or NWE) and Babcock & Brown Infrastructure, Ltd. (BBIL), BBI US Holdings Pty. Ltd., BBI US Holdings II Corp.,, and BBI Glacier Corp. filed a joint application with the Montana Public Service Commission (PSC or Commission) asking that the PSC authorize BBIL's acquisition of NorthWestern under an Agreement and Plan of Merger.

2. A *Notice of Application and Intervention Deadline* was issued by the Commission on June 23, 2006. The Commission subsequently granted intervention to: Montana Consumer Counsel (MCC); AARP Montana (AARP); Colstrip Energy Limited Partnership and

Yellowstone Energy Limited Partnership (CELP/YELP); Human Resource Council District XI/Natural Resources Defense Council/Renewable Northwest Project (District XI/NRDC/RNP); International Brotherhood of Electrical Workers Local #44 (IBEW Local #44); Montana Large Customer Group (LCG); Heartland Consumers Power District and South Dakota Public Power Inc. (Heartland/SDPPI); and the Ammondson, et al. Plaintiffs/Retirees (Ammondson Plaintiffs).

3. On July 20, 2006, the Commission issued a procedural order establishing a schedule for consideration of the application and setting a tentative public hearing date of March 14, 2007, depending on whether any additional issues were identified by PSC staff after receipt of intervenor prefiled testimony. The deadlines in the procedural schedule were suspended by *Notice of Staff Action* issued September 12, 2006, due to pending protective order issues. The procedural schedule was reinstated and amended by *Notice of Staff Action Amending Procedural Schedule* issued October 31, 2006, with the tentative hearing date still scheduled for March 14, 2007. No additional issues were identified by staff.

4. On February 22, 2007, the Commission issued its *Notice of Public Hearing* for the March 14, 2007 hearing. The hearing was held at the PSC offices in Helena from March 14 through March 16, 2007.

5. In addition, 15 public meetings were held by commissioners between February 8 and March 12, 2007, to obtain public comments on the sale proposal in the following towns in NorthWestern Energy's service area: Glasgow, Havre, Lewistown, Great Falls, Hamilton, Missoula, Billings, Bozeman, Butte, Kalispell, Choteau, Conrad, Browning, Cut Bank, and Helena.

6. The Joint Applicants (NorthWestern/BBIL), MCC, District XI/NRDC/RNP, AARP, Heartland/SDPPI, CELP/YELP, and the Ammondson Plaintiffs submitted post-hearing briefs in this docket.

7. At a work session on May 22, 2007, the Commission unanimously voted to direct staff to draft and bring back to the Commission an order discussing all of the issues raised in this docket and denying the joint application.

8. On June 25, 2007, the Joint Applicants submitted a *Joint Petition For Rehearing and To Reopen the Record*. MCC, CELP/YELP, District XI/NRDC/RNP, AARP, IBEW Local #44, Heartland/SDPPI, and the Ammondson Plaintiffs filed responses to the petition.

9. At a work session on July 24, 2007, the Commission voted unanimously not to reopen the record.

PRELIMINARY LEGAL ISSUES

COMMISSION AUTHORITY

Parties' Arguments

10. On April 25, 2006, NorthWestern announced that it had reached a definitive agreement with BBIL under which BBIL would acquire NorthWestern. On June 16, 2006, NorthWestern and BBIL invoked the Commission's jurisdiction and asked the Commission to issue an order consenting to BBIL's acquisition of the common stock of NorthWestern and the assumption of its debt and modifying Order No. 6505e in Docket D2003.8.109 (*Consent Order*). During the subsequent 11 months, NorthWestern and BBIL fully participated in proceedings before the Commission. However, in their Opening Brief, NorthWestern and BBIL challenged the Commission's authority to reject the sale.

11. NorthWestern and BBIL asserted, "The sole issue for decision is what conditions may be appropriately imposed by the Commission upon the sale." Opening Br. at 2. NorthWestern and BBIL argued, "Any objective analysis of the Commission's authority to address mergers and acquisitions will demonstrate that the Commission's authority, at most, is limited to the imposition of conditions to ensure adequate service at just and reasonable rates." Opening Br. at 5. NorthWestern and BBIL based their argument for the Commission's authority on (1) the refusal of the legislature to enact an explicit statute granting authority to control entry into the utility business or to control utility ownership, Opening Br. at 6-7; and (2) a sentence in Order No. 2027 in Docket No. 3647 that "This Commission does not have authority over transfers and sales of utilities." *Re East Side Telephone Company*, 77 PUR NS 87, 91 (Mont. Bd. of R.R. Comm'rs 1948). NorthWestern and BBIL concluded, "the Commission does not have the authority to say no; nor the authority to say it wants a different buyer; nor the authority to adopt a net benefit standard." Opening Br. at 7.

12. The intervenors that addressed the issue of the Commission's authority vigorously disputed NorthWestern and BBIL's arguments and asserted that the Commission has the authority to approve, disapprove, or condition the sale and transfer.

13. AARP stated, "In point of fact, the very authority relied upon by the Applicants for the proposition that the Commission has limited authority underscores that the Commission has a critical role to play. This role includes looking to the character and adequacy of service, the facilities providing that service, and whether the public interest is served." AARP Resp. Br. at 2 (citing *Great Northern Utils. v. Public Serv. Comm'n*, 88 Mont. 180, 204-206, 211, 293 p. 294 (1930)). AARP also pointed out that in Docket D2001.1.5, "the Commission denied an application submitted by NorthWestern and Montana Power Company on the grounds that it was inadequate, rejecting the argument that the [a]pplication is limited to a determination [by the Commission] that "Montana Power's Utility operations, as a division or subsidiary of NorthWestern, will continue to be a fit, willing and able provider of adequate service and facilities at just and reasonable rates." AARP Resp. Br. at 3 (alterations in original, internal quotation marks omitted). AARP concluded, "Accordingly, the Commission and the Court have in the past held that Commission's authority is not as limited as applicants would like to suggest." AARP Resp. Br. at 4.

14. CELP/YELP stated, "It is hard to believe that the MPSC has the authority only to approve but not reject the proposed transaction. . . . The authority to approve the transaction logically presupposes that the MPSC has the authority to reject the transaction through conditions or outright denial after reviewing the record." CELP/YELP Resp. Br. at 3.

15. Heartland/SDPPI focused their brief on "the power of the Commission under Montana law to review the proposed merger and, on the basis of that review, to either withhold approval or impose conditions on any approval that are necessary to protect the public interest." Heartland/SDPPI Resp. Br. at 3. First, Heartland/SDP asserted that NorthWestern and BBIL base their argument on a strawman, the lack of certificates of authority for public utilities. Heartland/SDPPI Resp. Br. at 4. They stated, "What is at issue here is not whether B&B must acquire a certificate prior to commencing operation as a public utility, but rather what obligations and duties attach once it assumes that status." Heartland/SDPPI Resp. Br. at 4. Second, Heartland/SDP argued that NorthWestern and BBIL "misstate the facts when they state that 'the Commission recognized long ago that it actually lacks authority over transfers and sale of utilities.'" Heartland/SDPPI Resp. Br. at 4. Heartland/SDPPI contended that the actual holding in the *East Side* case supports the Commission's authority:

> The actual holding of *Eastside* [sic] was that the Commission ***did*** have authority over the abandonment of service by a public utility. That authority alone is more than sufficient to cover the situation at issue here where, in substance, one set of owners of NWEC seek to "abandon" that ownership in favor of another set of owners.

Heartland/SDPPI Resp. Br. at 4, n.4. Heartland/SDP pointed out that the Commission has asserted authority over change of control transactions for a considerable period. Heartland/SDP argued that NorthWestern and BBIL are precluded from challenging the Commission's authority because (1) NorthWestern did not challenge the Commission's conclusion of law that it possessed authority over transfers of utility assets in Docket D2001.1.5 and (2) "a person who invokes the jurisdiction of an administrative agency is subsequently estopped from challenging the same." Heartland/SDPPI Resp. Br. at 6-10. Heartland/SDPPI also asserted that the Commission's authority extends to those actions necessary to effect its express grant of authority and if the Commission determines that either conditioning or outright disapproval is required to protect the public utility function, the action is within the express grant of authority. Heartland/SDP Resp. Br. at 10-16.

16. District XI/NRDC/RNP encouraged "the Commission not to be swayed by what are, basically, gratuitous comments by the joint applicants about the extent of Commission authority." District XI/NRDC/RNP Resp. Br. at 3. They stated, "At a minimum, however, there is something perverse, having submitted to the jurisdiction of the Commission, for NWE and BBI to cast a cloud over the Commission's authority and suggest that if a positive result (from their perspective) is not forthcoming they are not without legal recourse." District XI/NRDC/RNP Resp. Br. at 3.

17. MCC argued, "The Commission has ample authority to condition approval of the proposed acquisition and deny outright authorization to proceed with it . . . ." MCC Resp. Br. at 6. MCC asserted that the Commission authority to ensure a utility's compliance with its public service obligations has been recognized since at least 1927, citing *Gallatin Natural Gas Co. v. Public Serv. Comm'n*, 79 Mont 269, 289-90, 256 P. 373, 378-79 (1927). MCC Resp. Br. at 6. According to MCC, the Commission's authority to regulate mergers and acquisitions is predicated "both on its duty to enforce the public service obligations of utilities under MCA § 69-3-201, and on its 'full power of supervision, regulation, and control of such public utilities' (MCA § 69-3-102)." MCC Resp. Br. at 6.

18. NorthWestern and BBIL, in their Reply Brief, disputed the intervenors' assertions as to the scope of the Commission's authority. They stated, "Contrary to the assertions of the various Intervenors, the Commission did not receive a broad delegation of unspecified authority under the general language of Mont. Code Ann. § 69-3-102. The reference in that section to the Commission's power of 'supervision, regulation, and control' is expressly limited to the actual provisions of Chapter 3 of Title 69." NorthWestern and BBIL cite *Montana Power Co. v. Public Serv. Comm'n*, 206 Mont. 359, 376, 671 P.2d 604 (1983), for this proposition.

Discussion and Analysis

19. The Commission has consistently exercised authority over mergers, sales, and transfers of utilities and utility property for many years. *See* Docket No. D2001.1.5, Order Nos. 6353 and 6353c (Montana Power Co. to NorthWestern Corp.); Docket No. D98.10.218, Order No. 6103a (PacifiCorp to Flathead Electric Cooperative, Inc.); Docket No. D97.10.191, Order No. 6043b (MCI Communications Corp. to WorldCom, Inc.); Docket No. 97.10.187, Order No. 6025 (Montana-Dakota Utilities Co. to Miller Oil Co.); Docket No. 97.8.140, Order No. 6027 (Lone Mountain Springs Inc. to Big Sky Water and Sewer District No. 363); Docket No. D96.10.169, Order No. 5953 (Communications Network Corp. to WorldCom Network Services, Inc.); Docket No. 93.7.30, Order No. 5731c (GTE Northwest Inc. to Citizens Telecommunications Co. of Montana); Docket No. 93.5.23, Order No. 5712a (US West Communications, Inc. sale of exchanges); Docket No. 92.11.74, Order No. 5688 (KN Energy, Inc. to Montana-Dakota Utilities Co.); Docket No. 92.1.3, Order No. 5616 (Consumers Gas Co. to Town of Sunburst); Docket No. 91.3.4, Order No. 5553 (Midvale Water Service to Victor and Betty Peltier); Docket No. 90.12.93, Order No. 5536c (Butte Water Co. to Silver Bow Water, Inc./MERDI); Docket No. 90.10.64, Order No. 5517 (Redgate Water Co. to Mike and Jackie Pitzen); Docket No. 90.4.26, Order No. 5487 (Granrud Water Co. to Dennis Granrud); Docket No. 87.9.49, Order No. 5298a (Merger of Pacific Power and Light Co. and Utah Power and Light Co.); Docket No. 86.8.55, Order No. 5237 (Pacific Power and Light Co. to Bigfork County Water and Sewer District); Docket No. 86.3.9, Order No. 5205 (Pacific Power and Light Co. to City of Libby); Docket No. 85.5.20, Order No. 5148 (Somers Water Co. to Somers Water District); Docket No. 84.4.12, Order No. 5084a (Burlington Northern Railroad Co.'s water utility

to Sanders County Water District); and Docket No. D82.10.71, Order No. 4472 (Little Chicago Water Co. to Black Eagle Cascade County Water District).

20. NorthWestern and BBIL correctly quote *Re East Side Telephone Company*, 77 PUR NS 87, 91 (Mont. Bd. of R.R. Comm'rs 1948), but ascribe more authority to the statement than it is entitled. The issues in *East Side* were ownership of the company and whether the Commission should order that abandoned service be continued. 77 PUR NS at 89. No issue arose as to the transfer or sale of the utility or utility assets. The statement that "This Commission does not have authority over transfers and sales of utilities" is not necessary to the determination of the issues in *East Side*, and therefore, is dicta. The Commission is not required to give precedential value to dicta. *C.f. Nehring v. LaCounte*, 219 Mont. 462, 471, 712 P.2d 1329, 1335 (1986) (Court not required to give precedential value to dicta.) The statement in *East Side* is at odds with the more recent, but longstanding, practice of the Commission. To the extent that *East Side* stands for the proposition that the Commission lacks jurisdiction over transfers and sales of public utilities, we expressly overrule it.

21. In Montana, administrative agencies have both express authority and implied authority necessary to discharge their express duties and authority.

22. The Commission's duty is to supervise and regulate the operations of public utilities in conformity with Title 69, MCA. § 69-1-102, MCA. The Commission is invested with the full power of supervision, regulation, and control of public utilities. § 69-3-102, MCA. In addition to normally implied powers, the Commission is expressly granted the power to do all things necessary and convenient in the exercise of the powers conferred by Title 69, Chapter 3, excluding judicial powers. § 69-3-103(1), MCA. Sections 69-1-102, 69-3-102 and 69-3-103(1), MCA, are substantially unchanged from their original form enacted in 1913 and manifest the legislature's recognition that given the complexity of the task assigned to the Commission, it was impossible to enumerate every specific power necessary for effective regulation. The legislature has granted the Commission the general powers necessary to perform the task assigned to it.

23. The Commission's authority over sale and transfers of assets or utilities can be inferred from the unique status of public utilities. Public utilities have an obligation to furnish reasonably adequate service and facilities while charging just and reasonable rates. § 69-3-201, MCA. Because of their obligation to serve, public utilities have a special status in the law as entities affected with a public interest. The Court affirmed this special status in *Great Northern*

Utils. Co. v. Public Serv. Comm'n, 88 Mont. 180, 205, 293 P. 294, 298 (1930), quoting Lord Chief Justice Hale: "When 'one devotes his property to a use in which the public has an interest, he in effect grants to the public an interest in that use, and must submit to be controlled by the pubic for the common good to the extent of the interest he has thus created'[.]" The Court also cited from *Munn v. Illinois,* 94 U.S. 113 (1876), "Property becomes clothed with a public interest when used in a manner to make it of public consequence and affect the community at large." *Id.* Logically, a regulated entity that (1) has a duty to provide service, (2) has granted the public an interest in the use of that property, and (3) is affected with a public interest may not sell assets or transfer control of them without the approval of the Commission.

24. The Commission's authority over transfers and sales may be implied from the Commission's authority over complaints. Sections 69-3-321(1)(b) and (c), 324, and 330(3), 501 and 504(1), MCA read as follows:

> **69-3-321. Complaints against public utility – hearing.** (1) The commission shall proceed, with or without notice, to make such investigation as it may deem necessary upon a complaint made against any public utility by any mercantile, agricultural, or manufacturing society or club; by any body politic or municipal organization or association, the same being interested; or by any person, firm, or corporation, provided such person, firm, or corporation is directly affected thereby, that:
>
> (a) . . .
>
> (b) any regulations, measurements, practices, or acts whatsoever affecting or relating to the production, transmission, delivery, or furnishing of heat, light, water, power, or regulated telecommunications service, or any service in connection therewith is in any respect unreasonable, insufficient, or unjustly discriminatory; or
>
> (c) any service is inadequate.
>
> (2) . . . .
>
> **69-3-324. Initiation of action by commission itself.** The commission may at any time, upon its own motion, investigate any of the rates, tolls, charges, rules, practices, and services and after a full hearing as provided in this part may make by order such changes as may be just and reasonable, the same as if a formal complaint had been made.
>
> **69-3-330. Decision by commission.**
>
> (1) . . .
>
> (2) . . .
>
> (3) If the commission finds that any regulation, measurement, practice, act, or service complained of is unjust, unreasonable, insufficient, preferential, unjustly discriminatory, or otherwise in violation of the provisions of this chapter or that

service is inadequate or any reasonable service cannot be obtained, the commission may substitute therefore other regulations, measurements, practices, services, or acts and make such order relating thereto as is just and reasonable.
(4) . . . .

These sections give the Commission jurisdiction to receive a complaint, or to initiate a complaint on its own motion, about the acts or practices of public utilities that affect utility service. Section 69-3-330(3), MCA, specifically gives the Commission authority to respond to such complaints by "substitute[ing] . . .other . . .practices . . . or acts and mak[ing] such order relating thereto as is just and reasonable." The sale and transfer of a utility or of utility assets is obviously an act or practice of a utility company. Therefore, the Commission's jurisdiction to investigate, hold a hearing on, and respond to such action by public utilities is necessarily implied from these statutes.

25. The Commission's authority over transfers and sales may also be implied from the Commission's authority over the issuance of securities. Sections 69-3-501(2) and 504(1), MCA, read as follows:

69-3-501. Regulation of issuance of securities and creation of liens by utilities.
(1) . . .
(2) The public utility, when authorized by order of the commission and not otherwise, may issue stocks and stock certificates and may issue, assume, or guarantee other securities payable at periods of more that 12 months thereafter for the following purposes"
(a) the acquisition of property;
(b) the construction, completion, extension, or improvement of its facilities;
(c) the improvement or maintenance of its service;
(d) the discharge or lawful refunding of its obligations;
(e) the reimbursement of money actually expended for said purposes from income or from other money; or
(f) any other purpose approved by the commission.

69-3-504. Decision on petition. After such hearing and upon such notice as the commission may prescribe, the commission shall enter its written order approving the petition and authorizing the proposed securities transaction unless the commission shall find that:
(1) such transactions are inconsistent with the public interest;
(2) . . .; or
(3) . . . .

These sections give the Commission authority to deny the issuance of stock, stock certificates, or other securities if the transaction is not in the public interest. Nearly all corporate mergers, including the proposed transaction, require the issuance of new stock or stock certificates. Therefore, the Commission's authority to deny a transaction may be implied from its authority to deny the issuance of stock.

26. The Montana Supreme Court has affirmed the general powers of the Commission and has recognized the jurisdiction of the Commission to take appropriate regulatory action under those general powers. In *State ex rel Billings v. Billings Gas Co.*, 55 Mont. 102, 173 P. 799 (1918), the Court stated "A consideration of the statute [Laws 1913, Chapter 52, the Act creating the Public Service Commission and defining its powers] leads to the conclusion that in its enactment the legislature intended to provide a comprehensive and uniform system of regulation and control of public utilities, by a specially created tribunal, through which the state itself exercises its sovereign power." 55 Mont. at 112. The Court later quoted this language favorably in *Great Northern Utilities v. Public Serv. Comm'n*, 88 Mont. at 205, 293 P. at 298.

27. In *Billings Gas Co.* the Court held that the rate approved by the Commission was the lawful rate, not the rate set by the franchise contract between the utility and the City of Billings. The Court did not base its holding on the specific language of the statutes (there was none applicable), but on its reading of legislative intent that the Commission has comprehensive control over public utilities. This holding affirmed that the Commission has general and necessarily implied powers, in addition to its explicit powers.

28. *Great Northern Utilities* definitively established the validity of the exercise of general power by the Commission in the furtherance of adequate service and reasonable rates. The court stated the relevant questions as follows: "Is the Commission clothed with the power to fix minimum or precise rates? If that query be answered in the negative, then our labors are ended, for the Commission is a creature of, owes its being to, and is clothed with such powers as are clearly conferred upon it by the statute." 88 Mont. at 203, 293 P. at 298. No statute expressly authorized the Commission to establish minimum or precise rates. The Court discussed the powers of the Commission at length and stated:

> Legislation affecting public utilities, in its earlier stages, had as its chief purpose the prevention of exorbitant charges being made for the product furnished. As the field covered by these utilities broadened, it became apparent that the public interest extended further than merely fixing the charges; that there was embraced

> as well the character of the service to be rendered, the kind of equipment employed; and that these things, **and others**, are so interdependent that one may not be intelligently regulated and controlled without control being exercised over the others.

88 Mont. 204-05, 293 P. at 298. The Court concluded: "We are of the opinion, therefore, that it was the intention of the legislature to clothe the Commission with the power to fix the precise rate to be charged by the utility for its commodity." 88 Mont. at 218, 293 P. at 303. The Court affirmed the exercise of an implied or general power by the Commission in the furtherance of effective utility regulation.

29. Other cases that support the general and implied authority of the Commission include *Tobacco River Power Co. v. Public Serv. Comm'n*, 109 Mont 521, 98 P.2d 886 (1940); *Cascade County Consumers Ass'n v. Public Serv. Comm'n*, 144 Mont. 169, 394 P.2d 856 (1964); *City of Polson v. Public Serv. Comm'n*, 155 Mont. 464, 473 P.2d 508 (1970); *Montana Consumer Counsel v. Public Serv. Comm'n*, 168 Mont. 180, 541 P. 2d 770 (1975); and *City of Billings v. Public Serv. Comm'n*, 193 Mont 358, 631 P.2d 1195 (1981).

30. Contrary to NorthWestern and BBIL's assertion, *Montana Power Co. v. Public Serv. Comm'n*, 206 Mont. 359, 671 P.2d 604 (1983), did not address the scope of the Commission's implied or general powers. In *Montana Power Co.* the Commission, without notice or hearing, issued an order enjoining the company from taking any action in furtherance of a proposed corporate reorganization. The Court found that issuing an order without notice violated the company's due process rights and that enjoining an action was an exercise of judicial power that was specifically prohibited to the Commission. With respect to the Commission's authority over corporate reorganizations the Court stated:

> The last issue is whether the Commission has subject matter jurisdiction to approve or disapprove the proposed reorganization. We recognize that this question is the central issue in the proceeding taking place before the Commission pursuant to its order of March 1, 1982. We therefore conclude that it would be premature for this Court to attempt to rule on that issue. That issue will not be ripe for our consideration until the decision by the Commission in its own proceeding and subsequent proceedings in the District Court. We therefore do not rule on [this issue].

206 Mont. at 379, 671 P.2d at 615.

31. In addition to the express and implied authority to regulate public utilities, the Commission also has the authority to preserve the benefits of its settlement with NorthWestern and MCC in NorthWestern's bankruptcy. Although NorthWestern may petition the Commission for modification of the settlement (and its implementing order) nothing requires the Commission to consent to a modification.

32. The Commission has the legal, regulatory authority to approve, disapprove, or condition the proposed transaction between NorthWestern and BBIL.

STANDARD OF REVIEW FOR TRANSACTION

33. NorthWestern and BBIL state "the standard of review is whether NorthWestern will continue to provide adequate service and just and reasonable rates." Reply Br. at 21.

34. AARP suggests that the Commission has employed language relating to public interest and public benefit. Heartland/SDPPI imply that the Commission must base its decision on the criteria set out in its written precedents and the *Statement of Factors*.

35. Generally, there are three standards that regulatory commissions employ: the public interest standard, the no-harm to consumers standard, or the net-benefit to consumers standard. In prior orders, the Commission has based its authority on the duty to ensure adequate service at just and reasonable rates, but has not enunciated a specific standard. It may be impossible to enunciate a general standard that is applicable in all cases. For example, if the Commission were faced with the sale of a public utility that was not providing adequate service, it would be appropriate for the Commission to apply a net benefit standard that assured customers would receive adequate service. In another case, a utility may be providing adequate service but just rates for the potential acquirer may be higher than currently charged. In such a situation, it would be appropriate for the Commission to apply a no-harm to consumers standard.

36. For this docket, Commission applies a no-harm to consumers standard.

37. Increased risk of higher rates or inadequate service is a form of harm.

FINDINGS OF FACT

NORTHWESTERN CORP.'S AND BBIL'S JOINT APPLICATION

38. The application provided overviews of NorthWestern (Exh. JA-1, pp. 5-7) and BBIL (Exh. JA-1, pp. 8-10) and asserted that, after NorthWestern conducted an evaluation of its

strategic alternatives and considered final bid proposals, the NorthWestern board of directors determined that a sale of the company to BBIL in accordance with the terms of the merger agreement was the best means of maximizing stockholder value and preserving NorthWestern's ability to provide utility service to its customers.

39. According to the application, although the form of the transaction is a merger, the transaction is actually a transfer from NorthWestern to BBIL of 100 percent of NorthWestern's common stock. The proposed transaction will take the form of a merger of BBI Glacier Corp. (Glacier) with and into NorthWestern with NorthWestern surviving the merger as a wholly owned indirect subsidiary of BBIL. Generally, owners of NorthWestern common stock will receive $37 per share of stock owned on the effective date of the merger. BBIL will assume NorthWestern's existing debt. NorthWestern will no longer be listed on NASDAQ but NorthWestern will still have publicly traded debt that requires the filing of financial disclosure reports with the U.S. Securities and Exchange Commission (SEC). According to the application, the only changes to NorthWestern will be the identity of its stockholders and ownership under a holding company structure.

40. The applicants stated the application was filed in accordance with the terms of the July 2004 *Stipulation and Settlement Agreement* among NorthWestern, the Montana Consumer Counsel (MCC) and the Commission associated with NorthWestern's emergence from bankruptcy, as well as the terms of the PSC's *Consent Order* in Docket D2003.8.109.

41. The applicants requested the Commission find that NorthWestern has complied with the *Consent Order* provisions and consent to BBIL's acquisition of NorthWestern under the merger agreement, or, in the alternative, determine after hearing in a contested case proceeding that NorthWestern has complied with the terms of the *Consent Order*, consent to BBIL's acquisition of NorthWestern under the merger agreement, and modify the *Consent Order* as necessary to implement the merger agreement.

42. A copy of the merger agreement between NorthWestern and BBIL is included with the application. Exh. JA-1, Appendix 1. The proposed agreement calls for BBIL, through the merger of Glacier into and with NorthWestern, to acquire 100 percent of the outstanding shares of NorthWestern, subject to regulatory and NorthWestern shareholder approvals, for $37.00 per share in an all cash transaction, which values NorthWestern at approximately $2.2

billion. BBIL will pay approximately $1.5 billion, including closing costs, and $736 million of existing NorthWestern debt will remain in place.

APPLICANTS' PREFILED DIRECT TESTIMONY

Prefiled direct testimony of Michael J. Hanson (NorthWestern)

43. According to Mr. Hanson, the key objective of the proposed transaction is for NorthWestern to continue to provide adequate service at stable, reasonable rates without the distraction and uncertainty of investors with short-term monetary goals. Mr. Hanson added that BBIL's capital resources will allow NorthWestern to pursue infrastructure development and other growth opportunities in Montana such as generation and transmission.

44. Mr. Hanson described NorthWestern and its utility operations in South Dakota, Nebraska and Montana. NorthWestern's regulated electric utility operations in Montana consist of over 7,000 miles of transmission lines and 20,300 miles of overhead and underground distribution lines to approximately 316,000 customers in 187 communities. NorthWestern also serves as the default electricity supplier for 310,000 residential and commercial customers. On the natural gas side, NWE purchases, stores, transports and distributes natural gas to Montana customers. NWE's regulated natural gas system in the state consists of a distribution system of approximately 3,700 miles of underground pipelines and a transmission system of more than 2000 miles of pipelines. NWE is the default supplier for its natural gas customers in Montana.

45. Mr. Hanson said that, since emerging from bankruptcy in November 2004, NorthWestern has accomplished much to increase its financial stability, as evidenced by quarterly increases in net income, paying debt down to below a 50 percent debt/equity ratio, strong operating cash flows and liquidity, reduced interest expense, improved credit ratings on debt, the disposition of the large majority of its non-utility assets and the resolution of many lawsuits.

46. According to Mr. Hanson, although NorthWestern's corporate headquarters is located in Sioux Falls, South Dakota, the majority of the utility's activities and key utility operational management operate out of Montana. He cited as examples the location in Butte of most of NorthWestern's primary administrative support personnel functions, the System Operations and Control Center, the majority of its energy supply, transmission and distribution operations personnel, and regulatory and government affairs personnel and functions. Mr.

Hanson noted that two of the five members of NorthWestern's Energy Supply Board are located in Montana.

47. Mr. Hanson pointed to energy supply as the greatest challenge facing NorthWestern and claimed BBIL understands the situation and supports NorthWestern's efforts to address it. Mr. Hanson said that, with BBIL's support, NorthWestern is in a position to explore all options including the possibility of equity ownership in rate-based generation.

48. Mr. Hanson provided background and information about NorthWestern's strategic review process that resulted in the proposed transaction with BBIL. He said NorthWestern's board of directors ordered a thorough review of the strategic alternatives, including continuing as a stand-alone company, a financial restructuring, various merger scenarios, and sale of the company. After analyzing the alternatives and final proposals, the board determined that a sale was the best means of maximizing stockholder value and preserving NWE's ability to provide adequate service at reasonable rates. Mr. Hanson stated that all bidders for the company were advised to focus on the terms of the bankruptcy settlement agreement, the Consent Order by which the Commission approved the settlement agreement, and the provisions of the Commission's October 2004 *Statement of Factors For Evaluating Proposals To Acquire NorthWestern Energy*. Mr. Hanson said the NorthWestern board decided BBIL's offer provided the best value for all of its customers, employees, regulators and stockholders. Mr. Hanson asserted BBIL will be a long-term owner that is experienced in core utility assets and infrastructure, which is preferable to an owner focused on short term returns, particularly if new investment is required.

49. Mr. Hanson described the proposed transaction as a merger of BBI Glacier Corp., a wholly owned indirect subsidiary of BBIL, with and into NorthWestern with NorthWestern surviving the merger as a wholly owned indirect subsidiary of BBIL and BBI Glacier Corp. ceasing to exist. Details regarding the effect of the merger on NorthWestern's shareholders were provided. Exh. JA-2, pp. 12-14.

50. Under current ownership or the ownership of BBIL, Mr. Hanson stated that NorthWestern will comply with the terms of the bankruptcy stipulation and Consent Order.

Prefiled direct testimony of Michael M. Garland (BBIL)

51. Mr. Garland is the president and member of the board of directors of BBI US Holdings II Corp. (Holdings II) and BBI Glacier Corp. He explained that BBIL, together with Babcock & Brown Infrastructure Trust (BBIT), form Babcock & Brown Infrastructure (BBI). BBI is a utility infrastructure company based in Sydney, Australia, that is listed on the Australian Stock Exchange and has a current enterprise value of approximately $4.9 billion. BBI owns companies in electricity transmission and distribution, gas transmission and distribution, transport infrastructure, and has ownership interest in thermal and renewable power generation. According to Mr. Garland, BBI's energy sector is managed by utility executives with an average of over 25 years experience in the electric and gas transmission and distribution businesses. Mr. Garland said that each operating BBI company is managed locally.

52. Mr. Garland explained that the proposed post-merger structure will involve two BBIL-subsidiary holding companies. He said companies such as BBIL that operate in multiple jurisdictions often form two holding companies to segregate investments, limit the reach of unforeseen liabilities and enable efficient tax structuring. This structure, according to Mr. Garland, enables expansion of the local entity independent of other parent operations and investments and allows BBIL to ring-fence each business, sheltering each from the risks and obligations related to other BBIL businesses. Following the proposed BBIL/NorthWestern merger, the following BBIL companies would constitute the organizational structure:

- BBI US Holdings Pty Ltd. (Holdings Pty) - a wholly-owned Australian direct subsidiary of BBIL that was formed to hold the equity interests of Holdings II.

- BBI US Holdings II Corp. (Holdings II) - a Delaware corporation, a wholly-owned subsidiary of Holdings Pty formed to hold the equity interests in Glacier and, following completion of the acquisition, NorthWestern.

- BBI Glacier Corp. (Glacier) - a Delaware corporation, a wholly-owned indirect subsidiary of BBIL, a special purpose company formed to merge with and into NorthWestern. Glacier is a direct subsidiary of Holdings II, which is in turn a wholly-owned subsidiary of Holdings Pty.

53. Mr. Garland asserted BBIL's commitment to meet the ring-fencing expectations of the Commission and said BBIL will not pledge its interest in NorthWestern to secure financing of other ventures.

54. Mr. Garland described BBIL as an experienced utility infrastructure owner with a conservative approach that owns and operates its assets on a long-term and financially stable basis. He said BBIL's interest in NorthWestern stems from the quality of NWE's assets, its stable existing customer base and its steady growth opportunities, as well as its similarity to BBIL-owned Powerco, a New Zealand electric and gas transmission and distribution company.

55. According to Mr. Garland, the total amount of funds necessary to complete the merger is $2.228 billion, of which $736 million represents existing NorthWestern debt and the remaining approximately $1.492 billion will be funded through a combination of equity contributions by BBIL and debt financing. He explained that approximately $987 million is expected to be provided by BBIL from existing cash and from equity issuances in capital markets. BBIL's market capitalization is about $1.7 billion, he said. Mr. Garland noted that Moody's Investor Services has informed BBI that, if the transaction is completed and the financial and operating projections are realized, BBI's post-merger investment grade rating (Baa3 stable) will likely be retained.

56. As for the required debt financing, Mr. Garland said BBI has obtained commitments in the amount of $505 million for an acquisition bridge financing facility to be provided to Holdings II that is non-recourse to NorthWestern. According to Mr. Garland, the loan will be repaid out of dividends paid by NorthWestern to Holdings II, and it will not be secured in any way by NorthWestern or its assets.

57. Mr. Garland said BBIL assumes little or no refinancing of existing NorthWestern corporate debt will be required to consummate the merger. He noted that NorthWestern's $225 million worth of Senior Secured Bonds has a change of control feature that would be triggered if the bonds are not investment grade as rated by Standard & Poor's and Moody's when the change of control occurs. However, BBIL believes NorthWestern will achieve an investment-grade rating because of those rating agencies' positive announcements in April 2006 regarding NorthWestern's credit rating. Regarding the revolver facility, which also has a change of control trigger, Mr. Garland said BBIL and NorthWestern will work with the lenders to maintain the existing facility.

58. According to Mr. Garland, each of BBIL's companies makes appropriate capital expenditures related to maintenance, replacement, enhancement of existing infrastructure or growth opportunities. He said BBIL is able to access capital markets to supplement NWE's cash

flow when necessary. He provided a list of various BBIL companies' capital expenditure commitments for fiscal year 2006. Exh. JA-3, pp. 10-11. NWE local management will bring to the NorthWestern board for approval investment proposals requiring discretionary and growth capital expenditures.

59. Mr. Garland said BBIL considered the bankruptcy stipulation and PSC Consent Order when it made its bid for NorthWestern and that the transaction will substantially comply with them. He said that, although the agreement and order refer to a parent company and NorthWestern will be a wholly-owned BBIL subsidiary under the structure of the proposed transaction, NorthWestern will still operate as a utility company similarly to what it now does as a parent company. In addition, he said, BBIL ring-fences each of its assets and would do the same with NorthWestern.

60. Mr. Garland asserted BBIL satisfies a preponderance of the elements as set forth in the Commission's Statement of Factors as follows:

a. <u>Financial strength and capability</u>. Mr. Garland claimed that BBIL is an investment grade infrastructure owner and a long-term investor in businesses that provide stable, consistent cash flow. According to Mr. Garland, BBIL does not intend to recover any acquisition premium it is paying for NorthWestern from ratepayers; BBIL will maintain the ring-fencing protections of the settlement agreement and consent order; BBIL will maintain existing employee levels for two years and benefit plans for at least two years, and subject to certain conditions, three years; and BBIL will maintain the current funding commitment to NorthWestern's pension plan.

b. <u>Energy supply</u>. According to Mr. Garland, BBIL's energy sector managers average 25+ years experience in electricity generation and electric and gas distribution. He said BBIL will work with NWE to acquire appropriate and balanced supply under the PSC's guidelines and complete the electric default supply portfolio.

c. <u>Infrastructure</u>. Mr. Garland said BBIL will work with NWE to fully implement the Liberty Consulting infrastructure audit recommendations.

d. <u>Demonstrable Montana focus</u>. Mr. Garland said BBIL will retain local management and staff in Montana; focus on local jobs and investment in Montana; continue NorthWestern's current customer and community programs, existing energy assistance and charitable giving programs; and meet conservation and renewable energy commitments.

e. Utility focus. According to Mr. Garland, BBIL agrees with NWE's approach to maintain focus on distributing gas and electricity to its customers in a regulated environment.

f. Customer focus. Mr. Garland said NWE's commitment to meeting the PSC's customer service expectations will not change.

g. Energy utility management experience. Mr. Garland said BBIL is an experienced owner/operator of regulated energy utilities and reiterated the related experience of BBIL's senior energy sector management. He asserted that BBIL's experience will provide NWE additional resources to better serve Montana customers. Mr. Garland listed and described BBIL's energy sector assets (Powerco in New Zealand, IEG in the United Kingdom and elsewhere, Cross Sound Cable in New York, 50 percent of Ecogen Power in Australia, and 50 percent of Redbank Power Station in Australia).

h. Effective functioning in the Montana constitutional, statutory, and regulatory framework. Mr. Garland reiterated BBIL's experience operating in regulated environments.

61. According to Mr. Garland, there will be very little, if any, difference in NorthWestern's daily operations if the transaction is approved. BBIL will keep NorthWestern's current management in place and supports NorthWestern's current business plan. In addition, he said, BBIL intends to create long-term value by continual investment in NWE's infrastructure. Mr. Garland testified that BBIL will assist NorthWestern in continuing to improve its financial strength and access to financial markets and will provide NorthWestern with enhanced access to capital to fund organic growth as appropriate to ensure stable ratings and reduce long-term debt costs. He said BBIL's resources and experience could be helpful as NWE works to improve the energy supply situation in Montana.

INTERVENOR PREFILED TESTIMONY

Response testimony of John W. Wilson (MCC)

62. Dr. Wilson, testifying on behalf of MCC, concluded that the proposed acquisition will adversely affect NWE's ability to provide adequate service at reasonable rates and that, as proposed, it would provide few benefits to Montana customers. He recommended that, if the PSC authorizes the acquisition of NorthWestern by BBIL, certain minimum conditions should apply.

63. Dr. Wilson noted that, although Mr. Hanson touted BBIL's financial resources, BBIL's market capitalization of $1.7 billion makes it only a bit financially larger than NorthWestern and there is no evidence that BBIL's parent Babcock & Brown will contribute to NorthWestern's ability to provide utility service. With respect to capital expenditures, Dr. Wilson observed that BBIL's acquisition model only provides for a 2 percent annual increment and that, according to the model, BBIL will not retain earnings for capital expansion or contingencies, but rather will consider and finance those requirements as they arise.

64. Dr. Wilson claimed that BBIL plans to support its proposed $2.2. billion acquisition of NorthWestern, which has a $1.4 billion rate base, by substantially increasing NWE's equity distributions. According to Dr. Wilson, NorthWestern's 2006 Long Range Forecast projected equity payouts to stockholders totaling $203 million for the period 2007-2010 in contrast to BBIL's plans to increase NorthWestern's equity payouts to its investors to $660 million over the same period. Dr. Wilson asserted that BBIL plans that NorthWestern will employ four "unusual" practices in order to fund the increased equity distributions: (1) retention of the acquisition premium of $700 million in its utility capital structure to justify utility borrowing of $180 million for equity distributions and return on equity amounts; (2) use of $300 million worth of depreciation over the next 15 years to fund equity payouts rather than new capital expenditures; (3) a BBIL-projected increase in rate of return on NorthWestern's equity-funded rate base to 30 percent by 2023, leveling off between 25 percent and 30 percent through 2046; and, (4) over-recovery in NorthWestern's rates of more than $200 million of tax expenses.

65. Dr. Wilson based most of his conclusions about BBIL's plans for NorthWestern on his analysis of the results of BBIL's acquisition model, a tool that Dr. Wilson said was used by BBIL to evaluate the acquisition of NorthWestern and to arrange financing for it. Dr. Wilson

asserted the acquisition model provides the best indication of BBIL's expectations and intentions as the prospective owner of NorthWestern. He categorized the conclusions he reached from his review of the model into two groups as described below.

66. First, Dr. Wilson reached conclusions related to the model's projection that NorthWestern's debt will increase from $736 million at the end of 2006 to $1.854 billion by the end of 2009 because of large NorthWestern capital expenditures and corporate borrowings in the 2007-09 period, mostly for new transmission investments in the Montana-Idaho line and the 500-Kv Colstrip-NW upgrade. Besides assuming $900 million in capital expenditures to fund the two transmission projects, Dr. Wilson claimed BBIL's model also includes $153.8 million to fund the planned Colstrip 4 lease buyout and $90 million to fund what Dr. Wilson termed an unwarranted equity payout. Dr. Wilson said NorthWestern's equity, excluding acquisition adjustment goodwill, is projected to decline over the same period from $732 million to $531 million.

67. Second, Dr. Wilson reached conclusions related to what he asserted is BBIL's business practice of paying out 100 percent of cash flow as management fees or dividends, which Dr. Wilson said is contrary to the customary U.S. utility practice of distributing an average of 60-70 percent of net earnings (a smaller subset of cash flow). According to Dr. Wilson, BBIL expects cash flow from NorthWestern operations to be about 150 percent to 200 percent of net earnings. As a result, he argued, adequacy of NWE service is at risk because BBIL will over-distribute NorthWestern earnings instead of funding and maintaining sufficient reserves.

68. A comparison by Dr. Wilson of the projected equity distributions in NWE's January 2006 Long Range Management Forecast for 2007-2010 with those in the BBIL acquisition model for the same time period showed projected distribution amounts from NWE to BBI "holdco" that range from more than twice the NWE-projected distributions to more than four times the NWE-projected distributions. MCC-3, p. 14.

69. According to Dr. Wilson, BBIL's model shows BBIL initially funds the projected equity payouts by including in rates tax expenses that exceed actual tax payments ("phantom taxes") and later by high and unrealistic earnings projections. In addition, Dr. Wilson claimed BBIL's forecasts keep the $700 million acquisition premium in the utility's capital structure. He argued the inclusion explains in part how BBIL will support its $2.2 billion capitalization while increasing NorthWestern's forecasted equity distribution, when NorthWestern has only $1.4

billion worth of net plant and equipment. He added that the improper inclusion results in unwarranted NorthWestern debt-funded equity distributions in 2008 and 2010 ($90 million in borrowing each of those years) by which BBIL "holdco" repays a portion of the debt it plans to issue in 2007 to finance the acquisition premium. Dr. Wilson disputed what he said was BBIL's justification for the extraordinary equity distributions as being needed to achieve a 50/50 debt/equity capital structure by arguing that, if the acquisition premium is excluded from NorthWestern's capital structure, equity declines to a level less than 5 percent due to the very high equity payouts.

70. Dr. Wilson expressed concern that the $900 million of new debt BBIL's acquisition model assumes will be invested in the two transmission projects could become a burden for Montana ratepayers. He said BBIL's assumptions about transmission markets and revenues are overly optimistic and, if they do not pan out, ratepayers rather than investors could be at risk. He said regulatory safeguards should be in place to protect against asset depletion at the NorthWestern level because BBIL's forecasts for a sustained level of equity payouts that exceed 150 percent of after-tax earnings for the period 2007-2016 and that exceed 140 percent through 2023 are significantly out of line when compared to the NorthWestern-forecasted payout of 63 percent of earnings and the 63 percent average forecast by Value Line for comparable electric utilities.

71. According to Dr. Wilson, NorthWestern's debt is projected to increase from $736 million in 2007 to $1.854 billion in 2009 due to debt funding of the planned transmission projects, the planned Colstrip 4 lease buyout, and the $90 million equity payout to BBI Holdco to pay off part of BBIL's debt for the original equity acquisition premium. He argued that BBIL's planned debt financing will result in an unacceptable leveraged capital structure, which he said would violate the bankruptcy settlement agreement that required NorthWestern's consolidated total book equity/consolidated total capitalization to never be less than 40 percent. Dr. Wilson claimed that at the NorthWestern utility level, excluding acquisition premiums, leverage is worse. Dr. Wilson provided details and tables related to the projected consolidated and NorthWestern-level capital structures. Exh. MCC-3, pp. 20-25.

72. Dr. Wilson said he requested from BBIL a run of the BBIL acquisition model excluding the inputs and assumptions related to the interstate transmission projects. The requested model run showed that, even without those projects, equity payouts by NWE still

significantly exceed 100 percent of total earnings and long-run earnings projections remain excessive and unrealistic. (The charts that comprise Exh. MCC-3, Attachment JW-1, depict projected NorthWestern cash distributions to equity owners under several different assumptions.) Notably, according to Dr. Wilson, equity payouts over the next 15 years greatly exceed total earnings and are much greater than NorthWestern's 2006 equity distribution forecast of under 65 percent as well as distributions projected for comparable utilities. Dr. Wilson claimed payouts of this size are unrealistic, unsustainable and would adversely affect NorthWestern's ability to provide adequate service at reasonable rates.

73. According to Dr. Wilson, BBIL plans to more than double NorthWestern's current level of equity payouts through 2023 by paying out 100 percent of earnings each year, plus issuing "advances to shareholders" that average an additional 40 percent of earnings. Dr. Wilson disputed the accuracy of BBIL's discovery responses to the PSC that implied there would be no change in NorthWestern's current dividend policy.

74. Dr. Wilson said BBIL intends for ratepayers to subsidize the acquisition premium paid by BBIL to acquire NorthWestern. He claimed BBIL will include the acquisition premium in the ratemaking equation in order to justify NorthWestern utility level earnings by including the premium in the equity component of the utility's capital structure. He also argued that, contrary to BBIL's claim that it must issue $90 million in NorthWestern opco-level debt in 2008 and in 2010 in order to maintain a 50/50 equity-to-debt ratio, that debt issuance would only be necessary if acquisition premiums are included in NorthWestern's equity balance.

75. Dr. Wilson also asserted that BBIL's model assumes NorthWestern's post-merger plant investment and capital expenditures will be at levels considerably lower than and out of step with those of comparable utilities. He claimed BBIL projects NorthWestern capital expenditures about equal to equity payouts over time, while Value Line projects capital expenditures for comparable utilities at about 2.5 times equity payouts. Dr. Wilson provided a summary of projected capital expenditures for comparable companies. Exh. MCC-3, Attachment JW-4.

76. Additional concerns expressed by Dr. Wilson include: that BBIL's model expects returns on equity that are unrealistic (Exhibit MCC-3, Attachment JW-3); that BBIL's plan to fund the equity payout to BBI Holdco includes reflecting in rates more income tax expenses than are actually paid ("phantom taxes"); and that BBIL's use of "phantom taxes" is questionable

because it is unclear whether the underlying assumptions related to net operating loss carry forwards are consistent with information submitted by NorthWestern in PSC Docket D2006.10.141 as well as BBIL's failure to recognize there will likely be regulatory questions in a subsequent rate proceeding about the appropriateness of rates that include large increments for tax costs that have not actually been paid.

77. According to Dr. Wilson, the proposed acquisition does not satisfy the objectives of the bankruptcy settlement agreement and the related PSC *Consent Order* or the PSC's October 2004 *Statement of Factors*. He said the proposed acquisition will result in noncompliance with ¶ C.3.a of the *Consent Order*, which sets a 40 percent floor on the equity component of the consolidated capital structure for NorthWestern and its affiliates. He noted this is one of the ring-fencing provisions that is meant to insulate the utility from the risks of non-utility ventures. Dr. Wilson added that overleveraged utilities generally incur higher debt costs, which could result in higher utility rates and/or service quality deterioration.

78. Dr. Wilson contended that BBIL addressed the *Statement of Factors* rhetorically, not substantively.

79. Dr. Wilson recommended that, if the PSC approves the acquisition, the approval should be subject to the following conditions at a minimum:

a. No recovery in retail rates, directly or indirectly, of any portion of the $700 million acquisition premium unless it is expressly authorized by the PSC after demonstration by the company of benefits to Montana ratepayers.

b. No deferral of any of the transaction and transition costs incurred by BBIL and NorthWestern as a regulatory asset for future rate recovery. Costs must be borne exclusively by shareholders.

c. No distribution in any year in excess of 100 percent of net earnings from utility operations from NorthWestern to its owners, affiliates, or affiliates' shareholders, either directly or indirectly, without prior PSC approval.

d. Financing for any capital projects for purposes other than providing service to NorthWestern's retail utility customers must be non-recourse to NorthWestern and its customers.

e. Continuation of the structural and financial measures, intercorporate and affiliate transactions requirements, reporting and disclosure requirements, and infrastructure audit compliance requirements from the *Consent Order*, with these modifications:

1) Revise the definition of the term "Parent Company" as necessary throughout ¶ C.1 and ¶ C.2 to ensure NorthWestern controls the public utility assets.

2) Amend ¶ C.3.a to reflect a meaningful post-acquisition basis for determining consolidated book equity and consolidated total capitalization and the financial reporting requirements to which the corporate structure will be subject.

f. A requirement that NorthWestern submit rate informational filings with the PSC every 2 years in accordance with ¶ B.1 of the *Consent Order* for 10 years after the merger.

g. A requirement that financial disclosure documents filed by BBIL in the Australian Stock Exchange or the Australian Securities and Investments Commission be publicly filed at the same time with the PSC.

80. Dr. Wilson additionally recommended that any Commission approval make clear that: (1) funds for the new debt issuances must be raised through project financing that depends solely on project revenues with no recourse to ratepayers; (2) approval of the acquisition does not mean endorsement of BBIL's projected equity payouts and, in fact, they seem excessive, outside industry norms, and unlikely to receive future regulatory approval; (3) NorthWestern's rate of return on rate base will be computed based on a capital structure that excludes acquisition premiums or any type of "goodwill" that exceed net plant value and neither NorthWestern or its owners will recover from ratepayers, directly or indirectly, any acquisition premiums; and (4) the Commission reaffirms the *Consent Order's* provisions that require that neither the consolidated capital structure nor NorthWestern's capital structure fall below 40 percent and that sufficient earnings must be retained to meet potential capital investment needs and to support investment grade ratings at the operating company and consolidated levels.

<u>Response testimony of Ann Gravatt (District XI/NRDC/RNP)</u>

81. Ms. Gravatt applauded the development of the Judith Gap wind project, but indicated that the potential of renewable resources in Montana has yet to be realized. According to Ms. Gravatt, BBIL or any new owner of NorthWestern must expand the development of Montana's robust renewable resources and address any issues that are impeding that

development. She said it is possible that changes in law will be enacted that will allow NorthWestern to own and rate base generation. This would require the new owner to make critical and long-lasting decisions about the mix of energy resources and their associated environmental and economic impacts.

82. According to Ms. Gravatt, new ownership of NorthWestern will have to quickly come to grips with the reality that continued business-as-usual reliance on conventional fossil fuel generation is no longer a viable option for utilities now that the financial and environmental risks of global warming are front and center.

83. Ms. Gravatt said that with the completion of the Judith Gap wind project, Montana has about 145 MWs of wind power operating, as compared to over 800 MWs of wind in Washington and around 440 MWs in Oregon, both states with moderate wind resource compared to Montana. She said neighboring states have also recently developed wind power projects, such as Wyoming with just under 290 MW and North Dakota with about 125 MWs and more on the way. Ms. Gravatt is concerned that NorthWestern will proceed haltingly towards additional wind or other renewable energy acquisitions. She argued Montana citizens should not have to wait to get the benefits of reduced risk, economic development, and clean air from its homegrown resources.

84. Ms. Gravatt said she expects the applicants, particularly given BBIL's wind power experience, to increase NorthWestern's investment in new renewables. At the very least, NorthWestern must obviously meet the target created by the statutory Renewable Energy Standards, which require 15 percent of NorthWestern's load must be met with new renewables by 2015. Given that NorthWestern already has about 7 percent with Judith Gap, she said the additional increments of 10 percent by 2010 and 15 percent by 2015 are modest targets, allowing NorthWestern plenty of time to gain operating experience with Judith Gap while starting to explore the addition of other renewables to its resource mix.

85. Ms. Gravatt acknowledged there are challenges associated with the deployment of wind energy on a large scale, such as the usual start-up issues associated with any new resource. The wind's variability at Judith Gap, particularly on an intra-hour basis, has presented more of an issue than anticipated. She said some of the difficulties at the Judith Gap project had nothing to do with the wind. She claimed a lack of communication between NWE default supply, NWE transmission, and Invenergy, the project's owner and operator, at least in the initial months of the

project, was clearly not helpful. It was not appropriate for NWE to take over a year after the project was approved by the PSC to get the meteorological towers up and transmitting data, according to Ms. Gravatt.

86. She said NorthWestern and BBIL should commit to study and ultimately solve any wind integration issues and to explore with others transmission opportunities to access additional renewable resources in Montana. She viewed as essential NorthWestern's continued involvement in the Northwest Wind Integration Action Plan, convened by the Northwest Power and Conservation Council and the Bonneville Power Administration in August 2006. This group has discussed cooperative strategies, such as area control error (ACE) sharing, standardized regulating resource products, and regional wind forecasting, that could help control area operators manage the variability in their systems.

87. Ms. Gravatt said she is encouraged by BBIL's experience with wind power resources and expects, with BBIL's guidance, NorthWestern should continue to study its system and the wind resources available to determine how to integrate additional wind and renewable resources. With further analysis, NorthWestern will know what sort of additional products, if any – such as load following, regulating or additional transmission – are needed to acquire additional wind or other renewable resources. BBIL's expertise could also be valuable in addressing transmission limitations both inside and outside of Montana.

88. Regarding demand side management (DSM) programs, Ms. Gravatt said NWE has acknowledged the need to expand them in order to give customers access to all cost-effective savings. She said the new owner of NorthWestern must be fully committed to these efforts. According to Ms. Gravatt, NWE should aggressively acquire all cost-effective efficiency on its system and devote sufficient resources, including staff, to the task. Ms. Gravatt questioned whether the lost revenue recovery mechanism is the best possible method of removing the disincentive to utility investments in conservation and achieving fairness for the utility and ratepayer. She said NWE should perform an updated and expanded estimate of the amount of cost-effective demand side resource on the system. She also favors accelerating the acquisition of the resource.

89. Ms. Gravatt asserted that increasing energy costs have imposed significant burdens on Montana's low-income population. She said NorthWestern and any new owner must be aware of the company's continuing obligation to assist low-income customers.

90. Ms. Gravatt stated that BBIL appears to have taken no corporate position on global warming and coal plants. She said BBIL has touted its experience with coal resources and its willingness to bring that experience to develop more coal resources in Montana. In suggesting the possibility of new coal plants in Montana, BBIL made no mention of carbon and global warming. Ms. Gravatt expects BBIL to reconsider its position on coal development in light of the urgent challenge of global warming, and will oppose any plans by NorthWestern to acquire additional conventional coal resources. She claimed that long-term utility commitments to conventional coal-fired generation are imprudent, given that federal legislation controlling carbon is inevitable and imminent in her opinion. She added that several CEOs of the nation's largest utilities now publicly advocate federal controls on carbon.

Response testimony of Thomas Power (District XI/NRDC/RNP)

91. Dr. Power's testimony focused exclusively on the need to locate full control of NorthWestern's Montana operations in Montana and not in Sioux Falls, South Dakota. Dr. Power listed 10 conclusions that the analysis in his testimony supports. Exh. HRC-1, pp. 1-2.

92. In conclusions 9 and 10, Dr. Power recommended that the Commission should condition its approval of the proposed BBIL purchase of NorthWestern on either the movement of NorthWestern's corporate headquarters to Montana or the establishment of a truly independent, stand-alone, Montana company. This is a reasonable condition, Dr. Power said, and pointed out that NorthWestern and BBIL have already entered into an agreement with the South Dakota Public Utilities Commission to keep the corporate offices in South Dakota for three years. He said the Montana PSC should insist that either the corporate offices move to Montana at the end of that time period or that a stand-alone Montana company be established now.

93. Dr. Power noted that in its *Statement of Factors*, the Commission indicated the need for any NorthWestern buyer to have a demonstrable Montana focus. The Commission at that time indicated that the sale of the South Dakota and Nebraska operations would accomplish a Montana focus.

94. Dr. Power noted that the difference between working with NWE and with its predecessor, Montana Power Company (MPC), in an advisory capacity has been dramatic. In the MPC era all of the management functions, including the top leadership, were located

centrally in Montana. With NorthWestern's takeover of the non-generating assets of MPC, decision-making within the utility is segmented and confused, according to Dr. Power. Dr. Power said NorthWestern employees in Butte appear to have limited authority and seem to be regularly surprised by decisions made by officers in Sioux Falls. He claimed systematic decision-making has seemed to collapse into an erratic stop-start process that paralyzed decision-making for a time and then produced "emergencies" where decisions had to be made very quickly. He said the long and erratic course of obtaining long-term resources to support default supply provides a good example. He recalled that the Montana First Megawatts facility was in the mix, out of the mix, mysteriously back in the mix again, and then, just as mysteriously, permanently disappeared from the mix altogether.

95. According to Dr. Power, the separation of corporate offices in Sioux Falls and operational offices in Butte have had a negative impact on NWE's ability to make use of its advisory committees. He said the NorthWestern executives making some of the key decisions were never present and, sometimes, even the Montana personnel were not present because they were back in Sioux Falls. He claimed there was regular conflict between some of the Sioux Falls representatives and the advisory committee because those in Sioux Falls did not understand the role of the committee, Montana regulation, or committee members' past involvement with the utility. Dr. Power said the net result of the division of authority was that the advisory committees could not be effectively engaged in assisting NorthWestern in its decision-making in a timely and productive manner.

96. Dr. Power asserted the range of issues that NorthWestern has brought to advisory committees has narrowed considerably. The only partially-functioning committee currently operating focuses exclusively on some of the default supply issues, while in the past there had been advisory committees dealing with low-income, universal systems benefits (USB), natural gas supply strategies, rate design, qualifying facilities, distributed energy policy (net metering, transmission and distribution cost savings, etc.), and legislative proposals. NorthWestern is making decisions on these important issues without the assistance of any advisory committee involvement, according to Dr. Power.

97. Dr. Power described the role of advisory committees as helping the utility test its ideas in a frank and critical setting so that the utility can improve its decisions. NWE's inability to participate productively in that process is worrisome, he said.

98. Dr. Power made clear that he does not believe that the entire corporation is dysfunctional. He said NorthWestern has managed and maintained the transmission and distribution systems well. NorthWestern has also played a very productive role on a variety of other fronts: (1) it has invested in favorably-priced, wind generation that mitigates the price risk associated with future carbon regulation and has been engaged in efforts to understand and manage integrating wind into the electric grid; (2) it has expanded its efficiency and demand side management programs (although Dr. Power said there is more cost effective DSM available to be pursued and it could be pursued on a more aggressive schedule); (3) it defended the USB program and all of its authorized public purposes while endeavoring to strike an appropriate funding balance among the various programs; and (4) it has supported, overall, low income programs during a period of rising market prices for energy focusing not only on low income discounts but also ongoing low income weatherization. Dr. Power said that in most areas NorthWestern has served Montana customers well since it took over the MPC non-generating assets, but that does not mean no further changes are needed within NorthWestern to protect the long-run interests of its Montana customers.

99. Dr. Power claimed that in the past NorthWestern demonstrated that it agreed with the Commission's statement that "management of the utility is most effective when located where the company has the majority of its business." Dr. Power noted that from its founding in 1923 until 1997 the corporate headquarters of NorthWestern was located in Huron, South Dakota, not Sioux Falls. Huron is located in the center of NorthWestern's South Dakota service territory, while Sioux Falls is not even in NorthWestern's utility service territory. According to Dr. Power, prior to NorthWestern launching its ill-fated diversification-through-acquisition venture, it recognized the importance of locating its corporate headquarters in Huron in the center of its service territory. He said, however, that in 1997 NorthWestern's management decided to move the corporate offices to the Sioux Falls, the fastest growing of South Dakota's metropolitan areas. According to Dr. Power, the Sioux Falls corporate headquarters made sense only when NorthWestern was focused on becoming a non-utility business with holdings across the nation. Dr. Power said that, given the catastrophic failure of NorthWestern's diversification ventures, the reason for the Sioux Falls headquarters has been lost and is a remnant of a misguided business venture. Given that NorthWestern is once again primarily a regulated utility,

Dr. Power argued its corporate offices ought to be located in Montana where the bulk of its utility activities are located.

100. Dr. Power contended that, in terms of relative importance of NorthWestern's three separate service territories, Montana dominates South Dakota and Nebraska. Montana is the source of approximately 90 percent of NWE's before tax profits. Montana has close to 90 percent of electric energy sales, 84 percent of electric customers, 75 percent of the employees, and two-thirds of natural gas customers and sales. Montana is now the business center of the NorthWestern Corporation, according to Dr. Power.

101. Dr. Power argued the geographic distribution of NorthWestern's corporate officers is completely out of balance with the geographic distribution of business activity, profit potential, risk, employees, and customers. He said there are 15 corporate officers, with 11 of them located in the Sioux Falls corporate headquarters. The Montana corporate officers include four vice-presidents (wholesale operations, retail operations, government and regulatory affairs, and administrative services). NorthWestern has set up an Energy Supply Board that has five members on it. Two of those, Pat Corcoran and David Gates, work in Butte. The other three members of the Energy Supply Board are based in Sioux Falls.

102. Dr. Power recommended the Commission condition any approval of the BBIL-NorthWestern merger on BBIL's agreement to, within a relatively short period of time such as three years, move NorthWestern's corporate offices to Montana. He argued that NorthWestern needs to know Montana well -- its customers, its regulators, its government officials, and other stakeholders. He said the company has to have its pulse on changing conditions, emerging trends, developing public opinion, and new opportunities and that it cannot do that from a distant corporate headquarters.

103. Dr. Power suggested a three-year period over which corporate leadership would relocate to Montana to avoid the disruption that would ensue from abruptly trying to change the geographic location of corporate headquarters.

104. Alternatively, Dr., Power said NorthWestern could be broken into two autonomous pieces: the South Dakota-Nebraska operations and the Montana operations. After all, according to Dr. Power, NorthWestern Public Service Company successfully served its South Dakota and Nebraska customers for almost 80 years before the Montana operations were added to the corporate mix. Dr. Power suggested the NorthWestern Public Service Company could be

resurrected as an independent company owned by BBIL, and the Montana Power Company name could be resurrected in Montana for an independent company also owned by BBIL.

Prefiled response testimony of Barbara Alexander (AARP)

105. Ms. Alexander stated that the purpose her testimony was to address the risks and potential impacts of this transaction on NWE's limited income or payment-troubled customers and to propose conditions that the Commission should adopt if the transaction is approved. The terms "limited income" and "payment troubled" are explained on page 3 of her testimony.

106. Ms. Alexander proposed that the Commission impose the following six conditions associated with any approval of this transaction:

a. Implementation of a permanent increase in NWE's low income discounts and in the participation rate for the discount program. She recommended that the natural gas discount be increased to at least 30 percent for the winter period (November through April) and the electric discount be increased to 25 percent on a year-round basis. These increased discounts should be funded through current USB rates imposed on all customers, but if those rates are insufficient to maintain the program as participation in the discount increases, the increased funding should be provided by BBIL as a merger benefit at least until NWE files its next rate case or three years, whichever is longer.

b. Adoption by NWE of new eligibility guidelines for the low income discount program. The discount should be available to any customer who is participating in the Low Income Energy Assistance Program (LIEAP), as well as other means-tested state financial assistance programs that reflect the 150-180 percent of federal poverty level. These programs include Food Stamps, Medicaid, Temporary Assistance for Needy Families, Special Supplemental Assistance for Women, Infants and Children, Social Security Disability and other limited income drug prescription programs available in Montana, particularly for seniors. Customers who are already enrolled in these financial assistance programs should be automatically eligible for the NWE discount program. NWE should solicit these customers to enroll through coordinated mailings with other Montana assistance program administrators and allow these customers to orally self-declare eligibility and provide proof of program participation within a reasonable time period.

c. An increase of NWE's contribution to the weatherization program in Montana. Any increase should reflect recommendations from the weatherization administrator and the local delivery system for this program, based on their ability to absorb these additional funds and spend them efficiently in any program year.

d. Require that NWE evaluate its USB-funded programs in sufficient detail to determine the effectiveness of these programs and identify potential areas of reform on a regular basis. Ms. Alexander said this will require, with respect to limited income programs, that the utility evaluate the impact of the program on the ability of participating customers to make regular monthly payments, enter into and keep payment agreements, avoid disconnection of service, and reduce the use of the utility's customer care and calling center expenses. She said NWE should be required to track and report routine credit and collection information for all its residential customers, as well as the subset of limited income customers participating in the discount programs. NWE should be required to report annually to the PSC on the operations of its gas and electric USB programs, as well as submit the required credit and collection information that would allow the Commission and the public to determine the status of NWE's limited and payment troubled customers.

e. Require that NorthWestern make its Home Heating Assistance Program more accessible to Montana customers. Ms. Alexander said the program should continue to be funded by NorthWestern and BBIL shareholders until NorthWestern files its next rate case or three years, whichever is longer, as a merger benefit. The program should be made available to any NWE customer with a household income of 185 percent of poverty or less. NWE should conduct outreach efforts to encourage potentially eligible customers to apply for this program and not rely strictly on enrollment activities associated with LIEAP or Energy Share, although those enrollment methods should continue. Rather than targeting all the funds strictly as a heating benefit available to NWE's natural gas or electric heating customers, a lesser grant (in the amount of $100-$150) should be available to Montana electric customers who do not heat with electricity, but who encounter hardship in paying their NWE electric bill due to high heating costs for other fuels.

f. Require that NWE’s call center performance improve so that an average of 80 percent of the calls are answered by a representative within 30 seconds. Ms. Alexander said NWE should be required to achieve this level of performance within 6 months of the approval of the merger. If NWE does not achieve and maintain this level of performance on an annual basis, BBIL should fund a customer credit to NWE’s Montana customers in the amount of $1 million for each percentage below the 80 percent annual average performance that is achieved. According to information detailed in Ms. Alexander’s testimony (see page 24), a review of various service performance indicators for 2004 and 2005 showed a high level of performance for most service metrics, except for the customer call center. Ms. Alexander said NWE’s results for “calls answered within 30 seconds” in 2004 and 2005 were at 71.4 percent and 57.4 percent, respectively. She argued the degradation in call center performance from 2004 to 2005 is particularly disturbing.

107. Ms. Alexander said the NorthWestern/BBIL application lacked specificity with respect to the impact of the merger on NWE’s limited income or payment troubled residential customers. Ms. Alexander is concerned that customers will bear significant risks associated with the transfer of ownership to an Australian-based investment vehicle that is answerable to shareholders for a stock listed in Australia. She contended the lack of any specific and enforceable service commitments is disturbing because the urge to generate the return on the substantial investment that will be made by BBIL to acquire NorthWestern may result in pressure to cut costs and reduce expenses, thus adversely impacting customer service and service reliability and the ability of limited income and payment troubled customers to maintain utility service.

108. According to Ms. Alexander, customer service activities such as customer call center performance and timely and accurate billing are at risk when a utility with historically good service quality is subjected to pressures to assure adequate profits to absentee landlords. She said fixed-income, limited-income and payment troubled customers rely on access to customer call centers to negotiate payment arrangements, respond to disconnection notices, and enroll in various limited-income programs. The receipt of timely and accurate bills with a well understood and efficient collection routine is crucial to such customers’ ability to manage their

monthly payments and seek financial assistance which is typically triggered on the receipt of an accurate disconnection notice.

Other Intervenors

109. Heartland/SDPPI, the Large Customer Group, and CELP/YELP submitted statements in which they advised the Commission and other parties that they waived their rights to submit initial prefiled testimony but reserved all other rights of general intervention as well as the right to seek relief from PSC orders concerning issues raised by the PSC or any party.

Written public comments

110. In addition to oral comments received at public hearings around the state, the Commission received written comments from 54 individuals and entities. Forty-one of the written comments opposed the sale. Five of the written comments supported the sale. The remaining eight written comments dealt with a variety of other issues.

111. Most opponents did not support the ownership of NorthWestern Corporation by a foreign corporation. The supporters thought that BBIL would provide capital to NorthWestern, and would help to provide a more stable energy future for Montana customers.

APPLICANTS' REBUTTAL TESTIMONY

Prefiled rebuttal testimony of Michael Hanson (NorthWestern)

112. Mr. Hanson stated that none of the intervenors argued for disapproval of the sale, but rather each intervenor recommended conditions on the sale.

113. Mr. Hanson suggested that the Commission focus on what he said were certain key points of the application. He said NWE is a financially capable utility and that the best interests of the company, customers and regulators are served by ownership by a long-term investor like BBIL that is focused on the utility business and its long-term financial health, rather than by the current ownership by short-term investors that are interested solely in maximizing their gains. He reiterated that, because NWE will remain the operating utility, the sale and merger transaction will be seamless to customers and cause no disruption in ongoing utility operations such as supply procurement. According to Mr. Hanson, BBIL's ownership will mean

NWE has access to capital for maintenance, growth, expansion and infrastructure projects at possibly lower costs than NWE could obtain as a stand-alone utility. He said investments in expansion projects requiring additional capital would require approval, as they now do, by a board of directors, and added that BBIL has a direct interest in ensuring its operating companies get the necessary capital to maintain and expand their infrastructure.

114. According to Mr. Hanson, NWE is developing a long-term asset management plan, including expenditure forecasts, that initially will cover 10 years, but is planned to be extended to a 15-year horizon. He noted that all of BBIL's operating companies have similar asset management plans.

115. Mr. Hanson responded to each of Dr. Wilson's recommended sale conditions as follows:

116. Prohibition of recovery of acquisition premium in rates. Mr. Hanson responded that the applicants have unequivocally affirmed as much.

117. Prohibition on transaction and transition costs recovered in rates. Mr. Hanson responded that the applicants have clearly stated they will not seek rate recovery of these costs.

118. Current stipulation/settlement agreement and ring fencing. Mr. Hanson responded that: (1) the applicants have made clear they will abide by the terms of the agreement after the merger, and note the definition of "Parent" will need to be revised; (2) revision will be required to the agreement's requirement that every board member but one must be independent; and, (3) the ring-fencing provisions and Montana law will continue to provide the PSC with authority to regulate NorthWestern, including rates, utility financing, debt and equity levels.

119. Periodic rate informational filings. Mr. Hanson responded with a proposal that, instead of these filings being required every two years for the next ten years as recommended by Dr. Wilson, they be required to be filed every three years for the next six years.

120. Filings of public financial disclosure documents with the PSC. According to Mr. Hanson, BBIL will agree to notify the Commission when its public financial disclosure documents are being filed in Australia and provide links to the appropriate websites. NorthWestern's financial disclosure documents will be available on the SEC's website.

121. Project financing non-recourse to NorthWestern. Mr. Hanson responded that NorthWestern, to the extent it undertakes capital projects that are not secured by conventional utility assets, will finance those projects by non-recourse project financing.

122. In response to Dr. Power's testimony, Mr. Hanson argued that the location of decision-making individuals is not important when day-to-day business communications are routinely accomplished by email, telephone, and video conferencing. He said these tools facilitate prompt and thorough decision making. Mr. Hanson noted that when decisions must be made that exceed the Montana-located executives' authority, they must seek approval from the CEO or board of directors. Mr. Hanson acknowledged that NorthWestern struggled to adapt to the role of default supplier, but added that even Dr. Power recognized NorthWestern has made substantial progress by nearly completing its supply portfolio while continuing to provide reliable utility service. Mr. Hanson said Dr. Power's criticisms are not related to the proposed change in ownership which is the subject of this proceeding. According to Mr. Hanson, the proposed Montana Advisory Committee (discussed in Patrick Corcoran's rebuttal testimony) should result in improvements in NorthWestern's decision-making processes.

123. Mr. Hanson disagreed with the recommendations for sale conditions made by intervenor witnesses Barbara Alexander and Ann Gravatt. He said NorthWestern has demonstrated leadership and social responsibility regarding renewables, energy conservation and low-income issues, and is committed to continuing that leadership. For that reason, Mr. Hanson argued it is inappropriate and unnecessary to condition the sale as recommended by Ms. Alexander and Ms. Gravatt.

<u>Prefiled rebuttal testimony of Patrick Corcoran (NorthWestern)</u>

124. Mr. Corcoran said that, as part of NorthWestern's efforts to improve its Montana focus and make NorthWestern more responsive to Montana concerns, the company proposes to form a Montana Advisory Committee of external stakeholders representing major customer segments or utility interest groups. The new committee would be comprised of the members of the existing electric default supply Technical Advisory Committee (TAC), with the addition of representatives from AARP, Large Customers, Montana Chamber of Commerce and Montana League of Cities & Towns.

125. In response to Ms. Gravatt's testimony, Mr. Corcoran said NorthWestern will continue to focus on renewable resources and energy conservation, but that those issues are appropriately discussed and considered in other forums and are not the subjects of this proceeding.

126. Mr. Corcoran responded to Ms. Alexander's testimony by first reiterating NorthWestern's commitment to supporting the needs of its low-income customers. He stated that USB programs and funding are not at risk as a result of the proposed sale. Regarding the six sale conditions recommended by Ms. Alexander, Mr. Corcoran argued the first four conditions (increase low-income discount, expand discount eligibility, increase NWE's contribution to weatherization, and require NWE to evaluate and report on its USB-funded programs) are not appropriate subjects for this docket. He said her condition #5 (reform NorthWestern's Challenge Grant) is inappropriate because AARP's approach will actually discourage this type of program, which is a voluntary shareholder-funded activity begun at NorthWestern's own initiative. Mr. Corcoran contended that Ms. Alexander's proposed sale condition #6 (require NWE to improve its call center answering performance to 80 percent of calls answered within 30 seconds, with a financial penalty to be funded by BBIL if the performance metric is not met) is based on an anomalous high-level review of a single call center performance measure and seems to be an attempt to leverage the sale to secure the proposed penalty. Mr. Corcoran added that NWE's call center performance is one of the criteria considered by PA Consulting Group when determining which utilities' should be awarded its ServiceOne™ award, which NWE has been awarded for the past three years.

<u>Prefiled rebuttal testimony of Steven Boulton (BBIL)</u>

127. Mr. Boulton, the CEO of BBIL, rebutted MCC witness Dr. Wilson's testimony. According to Mr. Boulton, because the intervenors, including MCC, have indicated NorthWestern is providing adequate service at reasonable rates, the only relevant issue in this proceeding is whether NorthWestern will be adversely affected by BBIL's acquisition of it.

128. According to Mr. Boulton, NorthWestern will operate in the same manner after the sale as it does now, except that its shareholder will be one long-term investor. He said BBIL intends to keep NorthWestern in its present form, but as an operating company within a holding company. The rate base, its capitalization, and tariffed services will not be affected by BBIL's acquisition of the company; in fact, they cannot change without the Commission's approval.

129. Mr. Boulton argued that NorthWestern's financial condition should improve after the merger. Nothing about the operation of the company will change, he said, except that with

BBIL ownership, NorthWestern will be able to invest in larger growth projects that provide the opportunity to earn an adequate rate of return.

130. Mr. Boulton pointed out that BBIL has already committed to the Commission and to the other regulatory commissions involved that the acquisition premium and any transaction costs will not be recovered in rates, that public financial disclosure documents will be available to regulators, and that NorthWestern's or BBIL's capital projects that are not secured by conventional utility assets will be financed by non-recourse project financing. BBIL has also made clear that NWE will continue to be subject to the terms of the bankruptcy settlement agreement with changes made to the agreement to revise: the definition of "Parent" to apply to NorthWestern; the board composition to recognize the new board as an internal board, not a public one; and the informational rate filing requirement to require such filings at least every three years over the next six years.

131. Mr. Boulton disputed Dr. Wilson's recommendations resulting from his analysis of BBIL's acquisition model, which Mr. Boulton said was solely intended as an evaluation tool of the NorthWestern acquisition for BBIL management. He contended the model was not designed to serve as an operating model or business plan for NorthWestern. Under BBIL ownership, he said, NorthWestern will develop its own business plan, consistent with BBIL's strategy of empowering local management to run the business. Mr. Boulton criticized Dr. Wilson for focusing his analysis of the proposed acquisition exclusively on the BBIL acquisition model and using it for a purpose for which it was not designed. Mr. Boulton asserted that a key assumption of NorthWestern and BBIL is NorthWestern will use revenues to first pay all operating expenses, including interest and debt service, cash taxes, and prudent and necessary capital expenses, and retains sufficient working capital and cash to fund the day-to-day operating requirements, before any returns are made to the owner.

132. Mr. Boulton stated that, contrary to Dr. Wilson's assertions, BBIL has no intention to extract excessive cash distributions from NorthWestern. He argued that the Commission can ensure NWE's financial viability by: (1) regulation of NWE's rates, including establishment of the capital structure; (2) PSC approval of debt issuances secured by NWE's utility assets in Montana; (3) PSC review of annual regulatory reports, NorthWestern's SEC filings and reports, and the PSC's ability to conduct investigations if concerns arise; and, (4)

monitoring NWE's continued implementation of the Liberty Audit recommendations and, possibly, the proposed NWE 10-year asset management plan.

133. Regarding Dr. Wilson's specific recommendations, Mr. Boulton responded as follows:

a. Prohibition of recovery of acquisition premium in rates. Mr. Boulton responded that NorthWestern and BBIL, in the answer to MCC Data Request MCC-13(b), clearly indicated they do not intend to recover the premium to book in rates. He added that NWE would not be able to do so anyway unless it first obtained PSC approval to include it in rate base or treat it as an amortization expense.

b. Prohibition on transaction and transition costs recovered in rates. Mr. Boulton responded that NorthWestern and BBIL, in the answer to MCC Data Request MCC-063, clearly indicated these costs are being expensed as they occur and tracked in the company's financial statements, and will not be included in future rate filings. He added that NorthWestern would not be able to recover these costs in rates anyway unless it first obtained PSC approval in a rate filing.

c. Project financing non-recourse to NorthWestern. Mr. Boulton responded that NorthWestern and BBIL clearly indicated in the application that they will not issue Montana utility debt, pledge Montana utility assets, or provide loans, guarantees, etc. related to Montana regulated utility assets, except in accordance with Montana law and PSC rules. He noted that the Commission regulates the issuances of securities, including pledges of utility property. He said that, although the acquisition model's assumptions may include some related to future debt issuance as the company grows, any issuance other than non-recourse borrowings is a modeling exercise without effect unless and until the PSC authorizes such debt.

d. Current stipulation/settlement agreement and ring fencing, and recommendations for revisions to Ordering ¶ C.3 of the agreement. Mr. Boulton responded the applicants have made clear they will abide by the terms of the agreement after the merger, and noted the definition of "Parent" will need to be revised and revision will be needed to the agreement's requirement that every board member but one must be independent. He argued there is no need to revise Ordering ¶¶ C.3.b & c as recommended by Dr. Wilson because those provisions will remain in place and unchanged. He disputed the need to change Order ¶ C.3.a because the existing definition of consolidated book equity and consolidated total capitalization is consistent with Generally Accepted Accounting Principles while Dr. Wilson's concerns are unwarranted and inconsistent with industry practice.

e. Periodic rate informational filings. Mr. Boulton responded with a proposal that, instead of these filings being required every two years for the next ten years as recommended by Dr. Wilson, they be required to be filed triennially once or twice.

f. Filings of public financial disclosure documents with the PSC. According to Mr. Boulton, BBIL will agree to notify the Commission when its public financial disclosure documents are being filed in Australia and provide links to the appropriate websites.

g. Prohibition on payment of dividends above 100 percent of net income in any year without prior PSC approval. Mr. Boulton argued this condition is inappropriate for these reasons: (1) it appears to apply to all of NorthWestern when the Montana PSC has no jurisdiction over NWE's regulated operations in other states or over NorthWestern's unregulated operations; (2) it usurps the legal authority of NorthWestern's board of directors and could conflict with the board's fiduciary responsibilities and with laws governing dividend payments; (3) it is unnecessary, given the PSC's authority over rates, debt issuance, ability to investigate and audit, and the required rate informational filings; (4) it ignores the fact that consolidated income taxes may be paid by the holding company and not NWE as the operating company, necessitating distributions from NorthWestern to Holdco as the taxpayer for the consolidated group; (5) it fails to take into account that, just because a company may choose to pay more in dividends than its book net income in a year does not mean it is impaired from providing adequate service; and, (6) NWE's proposed long-term asset management plan will demonstrate NorthWestern's commitment to infrastructure investment.

134. Mr. Boulton contended that Dr. Wilson's analysis of BBIL's financial projections contains material flaws that are the result of his misapplication of the acquisition model and from what appears to be his selective use of data to justify erroneous conclusions. In conclusion, Mr. Boulton stated that the information provided in the application, direct and rebuttal testimony, and discovery responses all add up to a convincing demonstration of BBIL's suitability as a purchaser of NorthWestern.

Prefiled rebuttal testimony of Jonathon Sellar (BBIL)

135. Mr. Sellar, BBIL's chief financial officer, rebutted Dr. Wilson's testimony, particularly the conclusions drawn by Dr. Wilson from his analysis of BBIL's acquisition model. According to Mr. Sellar, Dr. Wilson inappropriately applied the acquisition model to the public utility ratemaking process and then claimed it showed how the post-merger NorthWestern will operate.

136. Mr. Sellar stated that the purpose of the model was to evaluate the effect of the transaction on the BBI stockholder; therefore, BBIL included the premium to book in the model so that it would accurately reflect BBI's economic investment. He reiterated that BBIL has no intention of recovering the acquisition premium in rates.

137. According to Mr. Sellar, Dr. Wilson's claim that NorthWestern will increase its equity payouts for the period 2007-2010 to $660 million from the $203 million projected by NorthWestern in its 2006 Long Range Forecast is not correct. Mr. Sellar contended that the net distributions assumed by BBIL and NorthWestern during this period are about equal because the model shows not only $660 million in distributions, but $405 million in reinvestment of equity capital by BBIL, which results in a net distribution of $255 million.

138. Mr. Sellar responded to Dr. Wilson's four major concerns, which, according to Mr. Sellar, are all related to a misuse of the model:

a. NorthWestern intends to retain for ratemaking the premium to book offered by BBIL. Mr. Sellar responded that this concern is misplaced because the Commission determines regulated rate base and the equity and debt components of it. He said that NorthWestern's current regulated capital structure is about 50/50 debt to equity and that, while the equity component will increase as total rate base increases, the debt component can only increase if the PSC authorizes it. He asserted that for Montana ratemaking purposes, the equity component of rate base will likely increase over time, not decrease.

b. NorthWestern intends to invest annually less than its annual depreciation expense. Mr. Sellar responded that Dr. Wilson's comparison of forecast capital expenditure to a GAAP depreciation charge is not relevant or reasonable. He said that if Dr. Wilson's analysis of capital expenditure as a percentage of GAAP depreciation were extended over the entire 40-year life of the BBIL model rather than to just the first 15 years used by Dr.

Wilson, then capital expenditures exceed GAAP depreciation expense. He argued that Dr. Wilson's analysis was faulty because he included in depreciation expense the Colstrip 4 lease buyout cost, but did not include that capital cost when he calculated capital expenditures -- a difference that makes up more than half of Dr. Wilson's "shortfall," according to Mr. Sellar. Further adjustments for remaining GAAP depreciable life of the assets, and inclusion of all depreciation and capital expenditures through the end of 2023, result in a capital expenditure amount well in excess of book depreciation (by $258 million), argued Mr. Sellar.

c. <u>BBIL projects a 25- to 30-percent return on its investment by 2023</u>. Mr. Sellar claimed that BBIL's total internal rate of return in regard to the overall consolidated NorthWestern transaction over the 40-year evaluation term is 11.9 percent. With respect to regulated Montana gas and electric rate base return on investment, Mr. Sellar contended the BBIL model projects a return on the electric business of 7.5 percent and a return on the gas business of 7.7 percent over the 17-year evaluation period referenced by Dr. Wilson. Regarding Dr. Wilson's calculation of a rate of return on equity-funded rate base (RREFRB), Mr. Sellar argued that Dr. Wilson's use of consolidated numbers distorts the results. Mr. Sellar said that when he used Dr. Wilson's methodology to calculate RREFRB metric for each of the Montana utilities, the resulting ratios through 2023 for the Montana electric assets was 7.5 percent and 7.7 percent for the gas assets.

d. <u>BBIL proposes to recover "phantom taxes" from ratepayers</u>. Mr. Sellar responded that the availability of NOLs carry forward to NorthWestern is irrelevant to this proceeding. He explained the NOLs were generated by the write-off of some of NorthWestern's unregulated businesses and the investments that resulted in the NOLs were never included in rate base and are not related to NWE's regulated Montana utility. He said the use of the NOLs will result in higher available cash flow during this period after all other needs are met.

139. Mr. Sellar disputed Dr. Wilson's conclusion that, as a result of the two new transmission projects planned by NorthWestern and supported by BBIL, NorthWestern debt will increase from $736 million in 2006 to $1.854 billion at the end of 2009, while equity will decline from $732 million to $531 million. According to Mr. Sellar, the financing of the larger of two transmission projects, as well as the cost of the Colstrip 4 lease buyout if that occurs, will be

fully non-recourse to NWE and not included in rate base. He added that Dr. Wilson should have pointed out that in 2010, BBIL's plans call for a $400 million injection of equity capital into these projects to repay short-term, non-recourse construction debt and achieve a 50/50 debt/equity capitalization for the largest of the projects and an approximately 50/50 debt/equity capitalization on a consolidated NorthWestern basis.

140. According to Mr. Sellar, Dr. Wilson's contention that BBIL plans excessive equity distributions that are outside of industry norms is incorrect. Mr. Sellar said that if the BBIL projections are adjusted to make them actually comparable to other utilities and if Dr. Wilson's list of comparable utilities is revised and expanded to include utilities similar to NorthWestern with primarily regulated assets, BBIL's projections are consistent with the historical distributions of that utility group. Exh. JA-7, pp. 12-13, and attachment JS-1.

141. Mr. Sellar argued that Dr. Wilson's concern that BBI Holdco financial statements indicate an ongoing balance of less than 3 days of revenues is another result of his misapplication of the BBIL acquisition model, which was not designed to model NorthWestern's working capital management. Mr. Sellar said that, post-merger, BBIL expects NorthWestern to continue to manage its working capital as it does today and that only excess cash not needed to manage its liquidity would be distributed up to BBIL on a quarterly basis.

142. Mr. Sellar concluded by reiterating that BBIL has no intention of extracting excessive distributions from NorthWestern, but rather BBIL intends to be a long-term investor with an interest in ensuring NorthWestern remains a financially strong, customer-focused utility.

COMMISSION ANALYSIS AND DECISION

143. The overriding issue in the docket is whether the proposed transaction poses a threat to NorthWestern's financial health and, therefore, harm or risk of harm to Montana customers. The Commission finds that it does and explains its reasons below.

Recovery of the acquisition premium

144. It is a long held regulatory principle of this Commission that the value of plant in rate base is determined by original cost less depreciation. Original cost of utility property is determined when the asset is first dedicated to public service. The action of selling a utility,

absent any compelling reason, is not sufficient to allow an adjustment in rate base to reflect acquisition costs.

145. In this case, BBIL will pay a premium of approximately $700 million over NorthWestern’s book value to acquire the company. In addition, the Joint Applicants will incur an estimated $88 million in transaction costs. No prudent business owner would make such a sizeable investment unless it could recover its costs. The obvious question is: how does BBIL plan to recover the acquisition premium?

146. BBIL witness Mr. Garland testified that BBI will recover the acquisition premium from dividends paid by NorthWestern to Holdings II. TR Vol. 2, p. 40. Mr. Garland explained in a discovery response that: “BBI believes the free cash flow (operating cash flow after debt service and maintenance capital expenditures) will be sufficient to amortize its purchase price.” RDR PSC-17(e).

147. Although BBI emphasized at every available opportunity that it would not seek to recover the acquisition premium and transaction costs from customers (see, for example, JA-3, p. 12; JA-4, p. 9; JA-7, p. 3; RDR PSC-017-e; TR Vol. 2, p. 40), the evidence in the record leads to the opposite conclusion. Ratepayers, as the source of NorthWestern’s revenues, will foot the bill. As Dr. Wilson testified at hearing:

> There is only one place that cash flow comes from. Cash flow comes from ratepayers. Now, there may be some borrowing to provide for cash flow, but ultimately the ratepayers have to pay for the borrowing. So all of the money comes from the revenues of the company. Most of that from utility rates. Some of it, some of the revenues are going to come from revenues that are produced by Colstrip. Some of it's going to come from revenues that are produced by the transmission investments, but there's only one place that the cash flow comes from. That's from revenues and the basic revenue pot is utility ratepayers.
> TR Vol. 2, p. 168.

Equity impairment

148. Dr. Wilson’s testimony concerning BBIL’s financial plans for NorthWestern and the deterioration of NorthWestern’s equity capital that would occur under BBIL ownership is compelling. Using BBIL’s acquisition model as a road map of its intentions, Dr. Wilson showed that BBIL plans to extract equity from NorthWestern in several ways. First and foremost, BBIL assumes NorthWestern will consistently pay out dividends to its new owner in excess of NorthWestern’s net earnings. While U.S. utilities typically pay out 60 to 70 percent of net

earnings in dividends, BBIL's acquisition model calls for in excess of 100 percent of net earnings to be paid out annually by NorthWestern through the year 2023. Exh. MCC-3, p. 13 and pp. 16-17. Mr. Sellar's attempt to counter Dr. Wilson's exhibit that depicted comparable U.S. utilities' dividend payout ratios in the range of 70 percent fell flat when Mr. Sellar's own competing exhibit that showed an average 91-percent payout ratio among selected comparable utilities was revealed under cross examination to have been calculated using a "averaging of the averages" method that was clearly biased to support BBIL's high-payout argument. TR, Vol. 3, pp. 180-185.

149. In normal utility operations, retained earnings provide a vital source of financial strength for capital investment and as reserves that are available during unexpected financial strains. Regularly paying out dividends in excess of net earnings by a utility is inappropriate and risky because having insufficient reserves on hand could adversely affect the utility's ability to provide adequate service. Under BBIL ownership, NorthWestern, without retained earnings of its own after meeting its operating costs and required capital expenditures, would have to seek approval from the BBIL board for any additional capital needs or investments. BBIL assured the Commission that funding for necessary or advisable investments would be forthcoming. RDR MCC-088. However, it is apparent that NorthWestern's capital requests would be subject to the discretion of a BBI-controlled board with just one independent director that would be weighing the merits of capital requests from BBIL's numerous operating subsidiaries and would be subject also to BBIL's future financial capability.

150. BBIL's projected equity distributions from NorthWestern exceed by far the 63-percent level of dividends NorthWestern planned for distribution in its January 2006 Long Range Management Forecast for the same time period. Exh. MCC-3, p. 17. In that forecast, NorthWestern projected $205 million in dividends for the period 2006-2010. The BBIL model projects $660 million in dividends for the same period. TR Vol. 3, pp. 22-23.

151. The plan to upstream all of NorthWestern's available cash flow to its parent stands in stark contrast to NorthWestern's practice since emerging from bankruptcy of working to strengthen its financial posture by using earnings to pay down debt. As a result of that practice, NorthWestern's current debt/equity ratio is around 50/50 when one includes in equity the existing $435 million of goodwill on the books, and around 70/30 when the existing goodwill is excluded from the equity calculation. TR Vol.1, p. 54. The Commission considers 40 percent

equity, excluding goodwill, in a utility's capital structure to be barely sufficient and would much prefer to see at least 50 percent equity. It is reasonable to expect NorthWestern would achieve in the near term at least the barely adequate 40-percent equity level if the utility were to continue its present course.

152. However, under BBIL's plan no earnings will be retained at the utility level after operating expenses and required capital expenditures are paid. BBIL does not intend to reserve funds at the utility level. RDR PSC-045. In fact, when the $700 million BBIL acquisition premium is added to NorthWestern's balance sheet as a goodwill component to NorthWestern's equity, as it will be under the proposed transaction, the equity side of the utility's capital structure will be artificially inflated by the goodwill amounts, so much so that BBIL intends for NorthWestern to take on debt to balance its debt/equity ratio. BBIL's model projects borrowing by NorthWestern through 2009 for two large interstate transmission investments, the buyout of the Colstrip 4 lease, and even for an equity payout. Taken together, these will increase the utility's debt from about $736 million at the time of acquisition to $1.8 billion by the end of 2009. Exh. MCC-3, pp. 21-22. If goodwill is excluded from the equity calculation, NorthWestern's equity will decline under BBI ownership from $732 million at acquisition to $531 million by year-end 2009. Exh. MCC-3, pp. 21-22. BBIL's model projects NorthWestern's consolidated capital structure (including goodwill) at year-end 2009 to be 27 percent equity/73 percent debt. NorthWestern's "real" equity (which excludes goodwill) will be reduced to a mere 22 percent. Exh. MCC-3, p. 22. By the year 2023 equity could be close to a mere 17 percent. Exh. MCC-3, p. 24. If the model is run excluding the two new transmission projects, the results still show equity payouts that exceed net earnings and an unacceptable, though less dramatic, reduction in the level of NorthWestern's equity capital. Exh. MCC-3, Att. JW-1, pp. 1-2.

BBIL's track record

153. MCC's claim that under BBIL ownership NorthWestern would consistently pay out dividends in excess of net earnings was supported not only by the acquisition model but also by evidence that excessive dividending is BBIL's established practice with at least one existing utility-related subsidiary. Mr. Boulton acknowledged at hearing that the "Consolidated Changes in Equity" pages of the Powerco 2006 annual report showed Powerco paid out dividends in

excess of net profits for the past two years and that Powerco's equity balance dropped commensurately over the same period. Exh. MCC-8; TR Vol. 3, pp. 18-21.

154. The record indicates that BBIL does not consider a ratio of equity distribution to net earnings of 91 percent to be excessive. RDR MCC-101; TR Vol. 3, p. 121-122. The Commission disagrees and accepts MCC's assessment that a dividend payout ratio of around 70 percent is normal among comparable utilities.

155. Although Mr. Garland testified that BBIL considered a 50/50 debt-to-equity ratio to be appropriate for NorthWestern at the operating company level and a 60/40 ratio at the consolidated level as required by the bankruptcy stipulation (TR Vol. 2, p. 42), there is record evidence that BBIL's existing operating subsidiaries are leveraged ("geared" is the Australian term) at levels the Commission would consider high for a regulated utility. BBI's 2006 annual report included a chart titled "Current Gearing Status" that showed BBI and its six subsidiaries are leveraged in the range of 59 to 90 percent. The utility-related operating subsidiaries, Powerco and IEG, are leveraged at 66 and 67 percent, respectively, which means their equity levels are just 34 and 33 percent, respectively. RDR PSC-29(b); TR Vol. 2, p. 21.

156. Given BBIL's dividend expectations and practices and the highly leveraged capital structures that BBIL has implemented at its existing operating subsidiaries, as well as the financial projections in the acquisition model, it is evident that BBIL's proposed ownership of NorthWestern presents the likelihood that NorthWestern's capital structure will deteriorate and become unacceptably leveraged. This would reverse the prudent course toward financial recovery that NorthWestern has taken since emerging from bankruptcy in 2004. An overleveraged utility would experience increased costs of business. A weak capital structure would have a negative effect on NorthWestern's bond rating, which would increase NorthWestern's costs to borrow money. The Commission has welcomed the improvement in NorthWestern's bond ratings since the company emerged from bankruptcy and expects that trend to continue. Any change that will handicap an improved bond rating is not acceptable to this Commission.

<u>Significance of acquisition model</u>

157. BBIL's rebuttal of MCC's testimony failed to overcome the concern that the transaction poses harm or the risk of harm to Montana ratepayers. Regarding the acquisition

model upon which Dr. Wilson's testimony was largely based, BBIL witnesses Mr. Boulton and Mr. Sellar downplayed its significance, arguing it was not an operations or business plan for NorthWestern, but rather an evaluation tool used by BBIL as it considered the acquisition. Mr. Boulton said the model would be set aside once the transaction was consummated. Exh. JA-4, p. 6; TR Vol. 3, p. 110. They claimed MCC had used the model data selectively and inappropriately. Exh. JA-4, p. 7.

158. But contrary to BBIL's representations, the record demonstrates the acquisition model was a significant factor in the BBIL decision to acquire NorthWestern and was relied upon as well by Moody's in its rating assessment review. The model's purpose was clearly stated by Mercer Finance & Risk Consulting, the firm hired by BBI to conduct an audit of the model:

> The objective of the Model is to generate projected cash flow available for debt service, debt service requirements, taxation, cash flow available to equity, equity return analysis and debt cover ratios on the basis of assumptions made and input data provided by the Client...
> RDR PSC-017(a)

159. BBI decided to submit an offer for NorthWestern based on analysis that was presented to the BBIL and Babcock & Brown Investor Services boards in April 2006. RDR PSC-018(d). The boards' minutes of April 7 refer to just two documents that were presented as the boards considered whether to go forward with the acquisition: the March 30, 2006 Capital Approval Request and the "Project Big" slide presentation dated April 7, 2006. RDR PSC-017(b). The Capital Approval Request included the following statement: "The investment has been evaluated based on a number of economic parameters, however, the current bid amount is based primarily on a 40 year financial model of the Company ...." RDR PSC-017(d). "Valuation metrics," "economic sensitivities," and various rate-of-return scenarios derived from the model figured prominently in the board meeting slide presentation. RDR PSC-017(d).

160. It is evident from the extensive discussions that representatives of Moody's conducted with BBI concerning various aspects of the financial model and from the resulting Moody's ratings assessment for BBIL's debt issuance for the NorthWestern acquisition that the ratings agency relied heavily on the financial model in its review of the transaction. Exhibits MCC-9 [Confidential] & MCC-10 [Confidential]; RDR MCC-025 [Confidential]; TR Vol. 3, pp. 169-177 [Confidential].

161. At hearing Mr. Garland said the financial model provided the ratings agency with "a reasonable expectation of what is going to happen," and "give[s] them a reasonable estimate of the capability of NorthWestern and the BBI entities, in this case, to pay its debt," and agreed with MCC counsel that a financial model would provide Moody's with BBI's best effort to forecast earnings over 40 years. TR Vol. 1, pp. 188-189.

162. Dr. Wilson provided an index of the specific sources for the financial projections and numbers he cited in his testimony, most of which came from the BBIL financial model. Exh. MCC-4. There was no dispute that the numerical values referenced by Dr. Wilson in his testimony were accurate.

163. In response to BBIL's argument that Dr. Wilson had been selective in his use of the model, Dr. Wilson acknowledged his testimony was selectively based on the initial 17 years of model results rather than the entire 40 years reflected in the model. He explained he did so for two reasons. First, the BBI model assumes excessive dividends through the year 2023 will be funded by NorthWestern paying out amounts well in excess of earnings. However, beginning in 2024, the model shows the high payout levels continue without exceeding earnings, but only because the model assumes NorthWestern's annual rate of return on equity will increase to 30 to 40 percent, which is extremely unlikely in Dr. Wilson's opinion. Second, Dr. Wilson argued a 30- to 40-year forecast is too long a time period to be reliable in any event. TR, Vol. 2, p. 140.

164. The Commission agrees with Dr. Wilson's assessment that the model is "the clearest and most detailed indication that we have of BBI's expectations and intentions ... ." Exh. MCC-3, pp. 8-9.

<u>Regulatory oversight</u>

165. BBIL and NorthWestern argued that the Commission's regulatory authority and oversight, in combination with the bankruptcy stipulation's financial and structural protections, would prevent the unacceptable equity deterioration that MCC claimed would occur under BBIL ownership. However, as the Commission learned through its experience with NorthWestern's bankruptcy and as aptly put by MCC counsel John Coyle in his opening statement at hearing, "... bad decisions made in the boardroom don't often show up on the balance sheet of the regulatory agency until it's too late to save customers from the problems that its decisions cause." TR Vol. 1, p. 28.

166. The bankruptcy stipulation has been effective in nurturing the financial health of NorthWestern as it recovers from bankruptcy. Its terms protect the regulated utility and ratepayers from the kinds of corporate misadventures with unregulated affiliates that led to the company's bankruptcy in the first place. However, the stipulation's provisions were developed with the current corporate structure of NorthWestern in mind. The parties to the stipulation did not anticipate a change in ownership such as that proposed by BBIL that would result in NorthWestern becoming a holding company subsidiary or include the provisions necessary to protect ratepayers from the possibility in that event of a corporate parent extracting excessive dividends from the regulated utility subsidiary. In that kind of organizational structure, appropriate ring fencing would include a restriction on dividends to prohibit all of the utility's cash from being upstreamed to the holding company parent, or to paraphrase MCC, installing a ring fence around NorthWestern that includes a roof as well as walls. MCC Resp. Brief, p. 28. As Dr. Wilson noted at hearing, "If they can take all the cash and upstream it, your ring fencing limitations are fairly hollow." TR, Vol. 2, p. 171.

<u>Proposed condition to restrict dividends</u>

167. To their credit, the Joint Applicants accepted the majority of MCC's proposed conditions, albeit with some suggested revisions. However, their steadfast opposition throughout the proceeding to MCC's proposed condition that would require prior Commission approval of dividend payments in excess of 100 percent of net earnings served to confirm the contention that BBIL's intent is to extract excessive equity from NorthWestern in order to recover the acquisition premium. BBIL's argument that its acquisition model was just a theoretical exercise and not a real plan makes its reluctance to accept any restrictions on dividend payouts in excess of 100 percent of net earnings all the more puzzling and troubling. If indeed BBIL has no intention for NorthWestern to pay out excessive dividends, it is difficult to understand why BBIL would not accept the proposed MCC condition to restrict its ability to do so. BBIL's protests that a company-wide dividend restriction oversteps the bounds of the Commission's jurisdiction, is unnecessary in light of the PSC's regulatory authority, ignores the need for NorthWestern distributions to Holdco for tax payment, and incorrectly implies that inadequate service will result if NorthWestern's dividends exceed net income seem inexplicable when the proposed

condition was not even an outright prohibition against the dividend practice but simply a requirement for prior Commission approval each time.

168. Perhaps recognizing belatedly the seriousness of the equity deterioration concern raised by MCC, the Joint Applicants proposed in their final brief a minimum 40-percent common equity ratio condition and the exclusion from NorthWestern's balance sheet the goodwill amount resulting from the acquisition premium paid by BBIL. JA Reply Brief, p. 8. That proposal was a step forward by the Joint Applicants but even at that late date they continued to resist the MCC dividend restriction condition. In addition, even though Mr. Hanson agreed at hearing to accept a condition that the existing $435 million in goodwill on NorthWestern's books be excluded for ratemaking (TR Vol. I, pp. 234-235), the Joint Applicants did not repeat that offer to exclude the $435 million as well as the BBIL acquisition premium in their reply brief. (The Commission notes its agreement with Mr. Hanson that the current amount of $435 million of goodwill on NorthWestern's financial statements will be excluded from any future determination of the amount of equity in the capital structure because the Commission does not allow the recovery of acquisition adjustments in any form for ratemaking absent a showing of good cause.)

Statement of Factors analysis

169. The *Statement of Factors* was developed by the 2004 Commission to provide prospective purchasers of NorthWestern, which had just emerged from bankruptcy when the *Statement* was issued, with guidance regarding the elements and characteristics that would comprise a superior acquisition proposal, in the PSC's judgment. The Commission specifically said the *Statement* was not intended to prejudge any issues that might arise in a sale proceeding or to bind future commissioners. The factors listed in the *Statement* remain relevant to the Commission's evaluation of the proposed sale, given that NorthWestern used them to assess the acquisition proposals it solicited and that intervenors applied them to BBIL's proposal.

170. BBIL said all the right things in response to the *Statement of Factors*. But for the most part, those statements of good intentions were not supported with substantive and binding commitments to meet the factors' expectations. In fairness, it is not possible to know with certainty what future post-acquisition actions BBIL or any prospective purchaser might take that would tip the scale one way or the other regarding many of the factors.

171. The first of the eight evaluation factors, which is the financial strength and capability of the acquirer, is arguably the most important. The *Statement* lists explicit preferences for an acquirer that is a financially stable, investment grade utility with no expectation of recovering any acquisition premium in rates and that will commit to continuing the post-bankruptcy ring fencing provisions, funding the pension plan, and long-term ownership. BBIL fails to satisfy this factor because, as discussed in this Order, the Commission concludes that BBIL's financial plans for NorthWestern as depicted in its acquisition model belie BBIL's statements that it has no intention of recovering the acquisition premium in rates.

172. Energy Utility Management Experience and Montana Focus are the only two factors that the Joint Applicants successfully demonstrated. Regarding utility management experience, BBIL owns and operates energy distribution and transmission assets worldwide and, until recently, held stakes in two generation assets. Some of BBIL's energy sector managers, notably those who worked at Powerco, have significant experience in a somewhat relevant utility business to add to the experience and expertise of NorthWestern's current managers, who would continue to manage the utility.

173. Regarding a demonstrable Montana Focus, the Joint Applicants reversed their initial position that no additional Montana focus was necessary. Laudably, they committed in their opening brief that NorthWestern would either move its corporate headquarters to Montana after three years or establish a separate Montana regulated operations business entity. Opening Br., p. 38.

174. The remainder of the factors were generally addressed with statements of good intentions but lacked binding, substantive commitments.

<u>Intervenors' recommendations and proposed conditions</u>

175. Intervenors in the case recommended various courses of action to the Commission. District XI/NRDC/RNP took no position in its response brief, but had advocated in Dr. Power's testimony that NorthWestern improve its Montana focus in recognition of the fact that most of the utility's business is in Montana. NorthWestern responded in its initial post-hearing brief that it would in three years either move its corporate headquarters to Montana or, alternatively, establish a separate Montana regulated operations entity. The Commission's denial of this application does not diminish the importance of NorthWestern's evolution into a

Montana-focused utility. The Commission encourages NorthWestern to follow through on its commitment and proceed to either establish a Montana corporate headquarters or a separate Montana regulated operations entity.

176. Heartland/SDPPI took no position. CELP/YELP submitted no testimony in the docket, but recommended denial of the application in their response brief. MCC, AARP, and the Ammondson Plaintiffs recommended approval but only with various conditions.

177. Had the application been approved the Commission would have rejected AARP's and the Ammondson Plaintiffs' proposed conditions. Four of the six AARP conditions related to USB or other existing programs and the appropriate venue for addressing them would be when there is a fully developed record in a general rate case. There is not a fully developed record regarding those items in this docket. The Fuel Fund and Challenge Grant Program was established voluntarily by NorthWestern to assist customers who were facing significant rate increases due to the extremely volatile natural gas market. AARP's proposed condition that would have required shareholders to fund an expanded program is not reasonable. With respect to the penalties proposed for failing to meet the annual average answer time of 80 percent of calls answered within 30 seconds, the proposed penalties are excessive and unreasonable, and would not have been approved by the Commission. NorthWestern pointed out that the call center is staffed to handle normal call traffic. However, at times of widespread weather-related outages, the call center statistics will be adversely affected.

178. Regarding the Ammondson Plaintiffs' proposed condition to require NorthWestern and BBIL to set aside separate funds to pay the $21.5 million state court judgment recently won by the Ammondson Plaintiffs, the Commission responds that it does not have statutory authority to enforce judgments from court cases. At hearing Mr. Hanson testified that NorthWestern would pay the judgment if upheld by the appellate court. TR Vol. 1, pp. 94-95. There is no evidence on the record that NorthWestern will be unable to pay the ultimate judgment found to be appropriate by the court. Finally, the Ammondson Plaintiffs admit in their post-hearing brief that NorthWestern has posted a $25,800,000 *supersedeas* bond with the state court. Ammondson Plaintiffs' Resp. Br., p. 3.

179. The MCC-proposed conditions were right on the mark in their attempt to ensure the continued ability of NorthWestern to provide adequate service at reasonable rates if the Commission approved the transaction. But the Commission by this Order denies the application.

The Joint Applicants chose to submit an application that was short on substance and long on promises. It is neither the Commission's responsibility nor preference to try to "fix" its serious deficiencies and mitigate the harm the proposed transaction poses to ratepayers by adopting conditions to approval. Furthermore, even if the Commission was so inclined, the Commission has no confidence that conditions that would cover all contingencies and risks presented by BBIL ownership could be crafted or effectively enforced.

<u>Status quo vs. BBIL ownership</u>

180. The Commission prefers the model of a stand-alone NorthWestern continuing to improve its financial outlook to the prospect of a BBIL-owned NorthWestern that is making excessive equity distributions to its owner, retaining insufficient earnings at the utility level, and experiencing a deteriorating capital structure – all to the detriment of the utility and Montana customers.

181. Mr. Hanson testified at hearing that NorthWestern is now a financially stable utility that has access to capital markets and is improving its credit ratings, including receiving an investment grade rating on secured debt from Fitch. TR Vol. 1, pp. 101-102. He said that NorthWestern was financially capable on its own of making the investments in the transmission projects and Colstrip 4 that BBIL planned to make if it acquired NorthWestern. TR Vol. 1, p. 114.

182. Mr. Hanson argued that, if the application is denied, the Commission should not expect that NorthWestern will remain a stand-alone utility for long. He claimed that, even though the large stockholders who wanted a NorthWestern sale have sold all or most of their shares, a large percentage of shares are currently held by hedge funds or "merger arbitragers" who bought stock after the sale announcement in anticipation of a short-term return. In Mr. Hanson's opinion, these short-term owners will pressure NorthWestern to find a way to recover their investments if this merger is denied. TR Vol. 1, p. 104-106 and p. 150.

183. Even if Mr. Hanson's prediction is correct that NorthWestern will not remain a stand-alone utility for long if the sale to BBIL is denied, that possibility does not have any bearing one way or the other on the merits of the proposed acquisition at issue in this proceeding.

CONCLUSIONS OF LAW

1. All findings of fact that are properly conclusions of law are incorporated herein and adopted as such.

2. The Commission has provided adequate public notice of all proceedings, and an opportunity to be heard to all interested parties in this docket. § 69-3-104, MCA.

3. The Commission supervises, regulates, and controls public utilities pursuant to Title 69, Chapter 3, MCA. § 69-3-102, MCA.

4. The Commission has authority to do all things necessary and convenient in the exercise of the powers granted to it and to regulate the mode and manner of all investigations and hearings before it. § 69-3-103, MCA.

5. Public utilities are required to provide reasonably adequate service and facilities at just and reasonable rates. § 69-3-201, MCA.

6. Pursuant to its authority, the Commission has jurisdiction over and must approve any sale or transfer of a public utility, its assets or utility obligations in order to assure generally that utility customers will receive adequate service and facilities, that utility rates will not increase as a result of the sale or transfer, and that the acquiring entity is fit, willing, and able to assume the service responsibilities of a public utility.

7. The Commission must deny authorization for any securities transaction if the transaction is inconsistent with the public interest. § 69-3-504, MCA.

8. NorthWestern is a public utility subject to the jurisdiction of the Commission.

ORDER

The Commission denies the joint application of NorthWestern Corporation and BBIL, BBI US Holdings Pty Ltd., BBI US Holdings II Corp., and BBI Glacier Corp. for approval of the sale and transfer of NorthWestern Corp. pursuant to a merger agreement because the proposed transaction presents the risk of harm to NorthWestern's financial integrity and to Montana customers of NorthWestern and also denies authorization for the issuance of securities to complete the proposed transaction because such issuance is inconsistent with the public interest.

DONE AND DATED this 31st day of July 2007 by a vote of 5 to 0.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

GREG JERGESON, Chairman

DOUG MOOD, Vice-Chairman

ROBERT H. RANEY, Commissioner

BRAD MOLNAR, Commissioner

KEN TOOLE, Commissioner

ATTEST:

Connie Jones
Commission Secretary

(SEAL)

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