March 15, 2019

MEMORANDUM

TO:	The Public Service Commission
FROM:	Robin Arnold, Mike Dalton, Bob Decker, Gary Duncan, Justin Kraske, Jeremiah Langston, Zack Rogala, Will Rosquist, and Neil Templeton
SUBJECT:	SB 331—"The Montana Energy Security Act of 2019"

PURPOSE

This memo provides staff analysis and a recommendation for SB 331, introduced by Sen. Tom Richmond on March 13, 2019. SB 331 replaces SB 278, which was tabled in committee by request of its sponsor, Sen. Richmond, the same day.

BACKGROUND

Following a preamble that addresses the scheduled retirement of Colstrip Units 1 and 2, the significance of baseload power to Montana, and the economic importance of continuing the operation of Colstrip Units 3 and 4 and the 500 kV Colstrip transmission line, two sections comprise the core of the bill:

Section 2

This section mandates that, if a coal-fired generating unit is retired before the end of its expected life, as defined for depreciation purposes, the owning utility's undepreciated investment in the unit, together with any required decommissioning and site remediation costs, must be included by the Commission in the owning utility's rates as a long-term amortization of up to 30 years. (The wording of the bill makes it clear that NorthWestern Energy is the utility referred to in this and subsequent sections.)

Analysis

Though subsequent sections of SB 331 describe the purchase and ratemaking terms of how a future acquisition of increased ownership in Colstrip must occur, Section 2 also applies to Colstrip investments already made. Thus, because NorthWestern already owns 30% of Colstrip Unit 4 (a purchase approved by the Commission in 2008), Section 2 of the bill would remove the Commission's oversight and ratemaking authority on that Colstrip investment at the time of early retirement, thus providing guaranteed security for the utility on that particular asset.

As an example of an estimate of costs that could potentially be passed through to ratepayers under the bill, in the event that Colstrip Unit 4 were retired in 2027, the asset's undepreciated and remediation costs would total $267 million.[1] That amount would equate to a liability of approximately $721 per customer, based on the current number of NorthWestern customers.[2]

SB 331's guarantee of investment security for NorthWestern violates two fundamental principles of public utility ratemaking. First, by removing Commission authority over rates associated with specified utility investments, the bill disrupts the regulatory balance between a public utility, which operates as a monopoly, and the utility's customers, who are captive to that utility. With regard to Colstrip, various plausible scenarios regarding plant operations, retirement dates, decommissioning and remediation costs, and the handling of potential stranded costs may be envisioned for the facility. By guaranteeing the security of NorthWestern's existing investment in Colstrip, SB 331 prevents a deliberative and evidence-based process from determining future electric rates that, for any plausible scenario, would balance utility and customer interests.

Second, SB 331 makes possible a regulatory situation in which the appropriate coupling of risk to reward, and the fair allocation of that risk between the utility and its customers, is dismantled. In adding Colstrip 4 to its regulated rate base in 2008, NorthWestern was awarded a rate of return on the market-based "original cost" as a measure of the economic risk being assumed by the company.[3] However, in guaranteeing security for NorthWestern's Colstrip investment, SB 331 removes a potentially sizable portion of risk assigned to the utility and its stockholders and shift that risk entirely to ratepayers.

Section 3

This section sets parameters for recovery of costs if NorthWestern were to acquire up to an additional 150 MW of Colstrip Unit 4, at a maximum transfer price of $1. The bill states that the transferring utility would remain liable for its share of the ownership costs and liabilities that existed by virtue of its ownership on or before the transfer date, including any required

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[1] If Colstrip Unit 4 were retired in 2027, NorthWestern would have an undepreciated investment balance of approximately $197 million. The Montana Department of Environment Quality ("DEQ") has estimated a cost of $400-$700 million just to clean up the Colstrip ash ponds for units 1-4. Thus, NorthWestern's share could be up to approximately $70 million. Not included in this figure is the $42,639,513.58 of Colstrip expenditures NorthWestern seeks to include in its pending general electric rate case. Dkt. D2018.2.12, NorthWestern Resp. to MEIC-003, Revised Attachment. It is also important to note that this figure only represents known environmental liabilities, which both the DEQ and NorthWestern have indicated likely do not represent the actual costs of remediation.

[2] It should be noted that SB 331 does not itself create the 2027 scenario illustrated here.

[3] In Order 6925f, from Dkt. D2008.6.69, which approved NorthWestern's incorporation of 30% of Colstrip Unit 4 into its regulated rate base, the Commission's judgment that the acquisition served the public interest was based in part on the understanding that the unit would be used and useful for its estimated remaining life span of 34 years. NorthWestern's risk in dedicating the asset to public service was reflected in the 10% return on equity approved by the Commission. SB 331 thus poses this question: If, in approving NorthWestern's original Colstrip acquisition, the Commission had known that the cost risks of early retirement would be shifted *entirely* from NorthWestern to ratepayers, as mandated in Section 2 of SB 331, would the Commission have approved a return on equity of 10%?

decommissioning or site remediation costs. NorthWestern would be allowed full recovery of costs related to the acquisition and ownership up to $40 million over a five-year period; only utility costs beyond $40 million would be subject to regulation by the Commission.

Analysis

Again in this section, SB 331 upends a fundamental regulatory principle by prohibiting the Commission—or anyone else—from ensuring that utility costs are prudently incurred. No state institution would have the authority to balance the ratepayers' need for affordable, safe, and reliable electricity with the utility's need for a reasonable rate of return on its investments.

Section 3 also raises questions about threshold figures and potential unintended consequences of the bill:

- In Section 3(1)(b), it is unclear if the capped costs in accordance with Section 3(1)(a), which are the costs of acquiring and owning an increased share of a coal-fired generating unit, are intended to be limited to future capital investments.

- No rationale is provided in Section 3(b) for setting a cap of $40 million in guaranteed rate recovery for NorthWestern's possible purchase of an additional share of Colstrip. Based on historical data for NorthWestern's portion of capital expenditures and fixed operations and maintenance ("O&M") costs for its current Colstrip holding, staff has estimated that a purchase of an additional 150 MW of Colstrip could entail $58.9 million of O&M costs and $21.6 million in capital expenditures over a five-year period, for a total of $80.5 million.

- In authorizing acquisition of up to 150 MW of baseload coal-fired generating capacity and guaranteeing the full recovery of costs up to $40 million, Section 3 erodes the established practices of resource procurement planning, the identification of least-cost resources, and resource acquisition through competitive bidding, which are all regulatory mechanisms designed to balance utility interests and obligations with customer interests.

- Section 3 neither obligates NorthWestern to purchase additional shares in Colstrip nor alters the mandate for guaranteed cost recovery related to NorthWestern's existing ownership in Colstrip made in Section 2. In the event that NorthWestern does not acquire additional ownership of Colstrip, Section 2 would remain in effect, possibly providing NorthWestern with an incentive to agree to an early retirement of Colstrip Unit 4, as the utility would be guaranteed full recovery of stranded costs and no regulatory oversight.

- Section 3(3)(a) discusses that a transferring utility remains liable for its share of its ownership costs and liabilities. This provision would likely be constitutionally preempted by any environmental superfund liabilities related to Colstrip under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, which requires strict, retroactive, joint and several liability responsibility.

Possible amendments

Staff is aware that several amendments to SB 331 are being discussed. The amendments would modify Section 2 to require recovery of prudently incurred undepreciated investment in the coal-fired generating unit. Section 3 would be modified to authorize the acquisition of interconnected transmission facilities of 500 kilovolts or more, not to exceed book value, and to clarify that the covered costs are capital investments for environmental, regulatory, and safety compliance and reliability, not operational, maintenance, repair or improvement. At this time, it is not clear whether these, or other possible amendments, will be incorporated into the bill.

STAFF RECOMMENDATION

Staff recommends that the Commission oppose SB 331. The bill disrupts the regulatory balance between NorthWestern and its customers by guaranteeing investment returns to the utility while transferring all related risk to ratepayers. SB 331 singles out a particular utility and a particular generation resource, then mandates that a deliberative and evidence-based process may not be used in the allocation of cost responsibility and determination of rates for that resource. Further, SB 331 erodes established fundamental utility ratemaking practices by passing costs directly through to customers without any review of prudency.