April 5, 2021

MEMORANDUM

TO: The Public Service Commission

FROM: Robin Arnold, Bob Decker, Michael Dalton, Gary Duncan, Lucas Hamilton, Zack Rogala, Will Rosquist, and Neil Templeton

SUBJECT: Sen. Cuffe's Amendment to SB 379, "Generally Revise Coal-Fired Generation Laws"

PURPOSE

This memo summarizes the Senate Energy and Telecommunications amendment to SB 379 and provides recommendations from staff.

SUMMARY AND ANALYSIS

SB 379 amendment

SB 379.001.002, requested by Senator Mike Cuffe, allows the Public Service Commission ("Commission") to approve a utility acquisition of an additional share in coal-fired generating units if the utility is already a joint owner. If the Commission allows an acquisition, it must allow the utility to fully recover the remaining undepreciated book value (otherwise known as "stranded investment" if the generating unit is retired early) and its share of applicable legal obligations for decommissioning and remediation for the additional ownership interest. The Commission would also be required to allow the utility to receive a rate of return for the new acquisition that is based on the book value of the existing ownership interest prorated by size in megawatts. The amendment removes language related to NorthWestern's recovery of remaining undepreciated book value and share of decommissioning and remediation costs for its existing share of Colstrip, and instead requires full recovery of undepreciated book share, decommissioning, and remediation costs related to any additional share acquired after the effective date of the bill.

The amendment makes no changes in Sections 2 through 7 of SB 379. The utility would be required to pay a $500 fee to the Commission when it applies for full-cost recovery; the utility would be required to continue operating the coal-fired units until the Commission issues an order in a contested case proceeding finding the closure is in the public interest; and a rebuttable presumption would state that full recovery of replacement power costs attributable to outages, reduced generation, operations, or maintenance and repair at coal-fired generating units is prudent.

Staff Analysis

Senator Cuffe's amendment takes a small step toward retaining regulatory oversight with the Commission. The wording of the bill is difficult to interpret in places, however, if staff's reading of the amended bill is accurate, significant concerns remain. The following analysis addresses

the amended language in the bill. While not included here, much of staff's analysis from its previous memorandum on SB 379 still applies to the amended bill.

- New Section 1(1)(a): This states that the Commission "may allow" a regulated electric utility to acquire an additional equity interest (or lease, or power purchase agreement ("PPA")) in a coal-fired unit after the effective date of this act.
    - The Commission already possesses the authority to pre-approve the acquisition of new resources, whether equity interests, leases, or PPAs. Why is new code needed?
    - Does this in effect make it more difficult for the Commission to approve the acquisition of an additional interest, as the Commission would be required to allow the terms set out in Sections 1(1)(b) and 1(2), as well as any outage costs as required in New Sections 3 and 4?
    - The phrase "enter into a lease or power purchase agreement to lease or purchase one or more coal-fired generating units" is somewhat unclear. PPAs typically are used to purchase the output of a unit, however, Section 1 refers to additional ownership costs.

- New Section 1(1)(b): This states that if the Commission allows a utility to acquire more of a coal unit (or lease, or PPA), the Commission <u>shall</u> fulfill the requirements of 1(1)(b)(i) and 1(1)(b)(ii) [emphasis added].
    - New Section 1(1)(a) assigns authority to approve acquisition to the Commission, but New Section 1(1)(b) requires the Commission to allow the utility to obtain full recovery of "remaining undepreciated book value" for the acquisition and the utility's share of decommissioning and remediation costs related to the acquisition.
        - The terms of cost recovery are central factors determined by the Commission as part of the Commission's decision to allow an acquisition. In SB 379, the terms are mandated by statute and prevent the Commission from considering the inputs that necessarily underlie a just and reasonable outcome.
        - Under traditional utility ratemaking, a utility is provided a reasonable opportunity to recover prudent investments, not a full guarantee (as seems to be implied by lines 7 and 8).
        - Traditional regulation allows utility investors to receive a both a "return on" and a "return of" their investment, which are normally valued at either original cost or market value. Originally, SB 379 was silent regarding depreciation of additional ownership interests. The amended language requires recovery of the undepreciated book value for additional shares, which potentially requires ratepayers to pay for depreciation of the value calculated according to the book value of the existing ownership interest prorated by size in megawatts, rather than recovery of the amount actually paid to acquire the additional interest.

        - This section again assigns the identified costs entirely to ratepayers.

- New Section 1(2): This mandates the Commission to allow a rate of return on an additional equity interest (or lease, or PPA), and it bases that ROR on the book value of the utility's existing ownership interest in the coal generation unit.
    - Once again, a major factor in the Commission's decision on acquisition is mandated (although a precise value of rate-of return ("ROR") is not established).
    - Why should a rate of return <u>not</u> be tied to the purchase price or book value of the acquired equity interest?
        - The text in this section is difficult to interpret, rendering the bill's intent and subsequent ramifications equally difficult to identify. If the bill's intent is to establish the value of a new acquisition as equal to the book value of NorthWestern's existing ownership of Colstrip, the staff sees no reason for making such a linkage. If the bill's text is intending to equate the ROR values of existing and acquired ownership shares, staff notes that economic factors that inform the determination of ROR (interest rates, expected useful life, evaluation of risk, market conditions, *et al*) vary over time, sometimes significantly. In the case of Colstrip Unit 4, NorthWestern purchased its existing share in 2008. SB 379 seems to require that the ROR for a new acquisition, presumably made in 2021 or later, must equal the ROR of a 2008 transaction. In this scenario, it is difficult to imagine how or why a state regulatory body would forego a case-by-case analysis to apply a valuation determined for an acquisition occurring 10 years earlier.
    - SB 379's mandate of an ROR for a PPA appears to run counter to the Commission's longstanding practice of reimbursing prudent PPA costs through tracker or cost-adjustment mechanisms on a cost-only basis. Utilities have traditionally earned returns on owned assets, but not on PPAs.
    - The bill language still appears to conflate valuation with rate of return. Prorating existing book value by MWs establishes a value for the asset but does not establish a rate of return on that value.
    - Staff is concerned that "existing ownership interest" is not well defined. Staff assumes that this applies to NorthWestern's existing interest in Colstrip (222 MW), but perhaps this should be properly defined.

- New Sections 2 through 7: No amendments to these sections. Staff advice remains in line with previous memorandum on SB 379.