

March 19, 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: SB 379, “Generally Revise Coal-Fired Generation Laws”

PURPOSE

This memo summarizes SB 379 and provides recommendations from staff.

SUMMARY AND RECOMMENDATION

SB 379 (Referred to Senate Energy and Telecommunications)

SB 379, requested by Senator Steve Fitzpatrick, encourages the continued operation of coal-fired generating units. It would require the Public Service Commission (“Commission”) to allow a utility to fully recover the remaining undepreciated book value of its existing share of a joint-owned coal-fired unit. It would require the Commission to allow a utility to fully recover the cost of applicable legal obligations for decommissioning and remediation for units it owned prior to the bill’s effective date as well as units (or shares thereof) acquired after the effective date. It would also require the Commission to allow a rate of return on an additional equity interest, lease, or power purchase agreement acquired for a coal-fired generating unit that it already jointly owns.

SB 379 requires that a rate of return for any additional acquisition of a Colstrip share must be based on “the value attributed to the additional interest, lease, or power purchase agreement calculated to equal the book value of the existing ownership interest prorated by size in megawatts.” 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.

The bill creates a rebuttable presumption 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***

SB 379 applies to the existing Colstrip share owned by NorthWestern Energy (“NorthWestern”), as well as any acquisition by NorthWestern of additional shares. While the intent of the bill may be to tie the recovery of costs for existing shares to the acquisition of additional shares, the bill as written could be interpreted to allow the automatic recovery of existing share costs without any additional acquisition. Thus, because NorthWestern already owns 30% of Colstrip Unit 4 (a

purchase approved by the Commission in 2008), the bill would largely remove the Commission's oversight and ratemaking authority on that Colstrip investment, providing a near-guarantee of cost recovery for the utility on that particular asset if it were retired early while shielding management and shareholders from accountability. Staff struggles to understand several provisions in the bill and, as a result, has concerns that the bill could result in undesirable and/or unintended consequences.

Potential cost scenarios resulting from NorthWestern's existing share of Colstrip and additional Colstrip acquisitions, together with several regulatory concerns, are considered below.

### *Potential Costs*

#### 1. Existing NorthWestern Colstrip Share

SB 379 could potentially impose significant customer impacts for NorthWestern's existing share of Colstrip. For example, if Colstrip Unit 4 were retired in 2027, NorthWestern's undepreciated book and remediation costs would total \$267 million.<sup>1</sup> Under the bill, NorthWestern would be permitted to recover approximately \$721 per customer in stranded costs, based on the current number of NorthWestern customers.<sup>2</sup>

SB 379 could also result in increased customer rates for costs associated with the operation of Colstrip. Section 3 of the bill creates a rebuttable presumption that replacement outage costs for Colstrip are in the public interest. On this subject, staff notes that the Commission has disallowed costs for Colstrip-related outage replacement costs twice: once in 2016 for \$8.2 million, and more recently in October 2020 for \$5.7 million. In both instances, the Commission determined that NorthWestern failed to take prudent steps in its supervision of operations at the Colstrip plant.

SB 379 upends a fundamental regulatory principle by impeding the Commission—or anyone else—from ensuring that NorthWestern's Colstrip costs are prudently incurred. The bill includes a definition of "prudency" that would make it difficult for parties to prove that any action taken by the utility was not prudent (the term *prudent utility practice* "is not limited to the

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<sup>1</sup> 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 to clean up the Colstrip ash ponds for units 1-4. Thus, NorthWestern's share could be up to an approximate \$70 million. 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 at Colstrip.

<sup>2</sup> It should be noted that SB 379 does not itself create the 2027 scenario illustrated here. A hypothetical 2027 date is used because it represents a date that other Colstrip owners have used for accelerated depreciation schedules.

optimum practice, but rather to a spectrum of possible practices, methods or acts.”).<sup>3</sup> Weaker incentives for the utility to ensure reliable and efficient operations could contribute to higher costs for customers that, under the bill, are presumed to be prudent.

## 2. Additional NorthWestern Colstrip Acquisitions

Automatic recovery of future Colstrip acquisitions by NorthWestern, as envisioned by SB 379, raise substantial concerns.

SB 379 allows the utility, when acquiring an additional share of Colstrip, to receive a rate of return on the acquisition equal to the book value of the existing ownership interest prorated by size in megawatts. This language raises some questions, such as whether the “existing ownership interest” is the book value of the current owner or of NorthWestern’s ownership interest.<sup>4</sup> Assuming the latter example, i.e., that it represents NorthWestern’s book value of its existing Colstrip share, the book value of additional Colstrip acquisitions would be approximately \$1.5 million per MW.<sup>5</sup> Staff interprets the language of the proposed statute such that the value of obtaining an additional interest in a lease or a purchase power agreement is to be calculated by multiplying the MW acquired by the \$1.5 million per MW. If staff’s interpretation is correct, the bill could produce troubling results.

An example of a problematic outcome may be drawn from NorthWestern’s recent Colstrip Unit 4 acquisition docket, in which NorthWestern proposed to acquire an additional 185 MW from Puget Sound Energy for one dollar (\$1). In that case, the starting net book value was also \$1, resulting in essentially zero investment related revenue requirement for NorthWestern Energy customers. Under SB 379, however, the starting net book amount would have been \$283 million (185 MW × \$1.5 million/MW). Therefore, even if NorthWestern were still to acquire the additional share for \$1, the new acquisition would be valued as a \$283 million investment on which shareholders would be able to earn a 9.65% return. This fictional “investment” of \$283 million would have an associated annual revenue requirement of \$38 million, or approximately \$100/year for each NorthWestern Energy customer, with an assumed retirement of Colstrip in 2042.

The ratepayer impact of NorthWestern’s purchase of any of the existing Colstrip ownership interests, based on the above example’s book value of \$1.5 million/MW, is reflected in the table below.

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<sup>3</sup> SB 379, New Section 3 (2)(b).

<sup>4</sup> It is also unclear what “size in megawatts” means. Staff assumes that it refers to the nameplate capacity.

<sup>5</sup> Based on the book value (plant cost less accumulated depreciation) of NorthWestern’s 30% share, which is \$340 million ( $\$340,000,000 \div 222 \text{ MWs} = \$1,531,531/\text{MW}$ ).

CU3/CU4 Owner	MW	Cost
PSE	370	\$ 555,000,000
PGE	296	\$ 444,000,000
Avista	222	\$ 333,000,000
PacifiCorp	148	\$ 222,000,000
Talen	222	\$ 333,000,000
Total		\$ 1,887,000,000

Taken to the extreme, the net book value of the total remaining 1,258 MW of both CU3 and CU4 would be approximately \$1.9 billion, with an annual revenue requirement of almost \$260 million. This would equate to a cost of more than \$700/year for each NorthWestern customer. SB 379 divorces the valuation of utility investments from the actual dollars invested by shareholders and violates established ratemaking, accounting, and statutory requirements for rate base valuation.<sup>6</sup>

It is also unclear how depreciation would be treated by passage of SB 379 and how depreciation (or lack thereof) may interact with the guaranteed recovery of stranded costs. The example provided above assumes that the additional acquisitions would be depreciated over 21 years until 2042. However, because the language in the bill is vague, there is a potential that an additional acquisition would not be depreciated and would remain at the initial book value for the life of the plant, which would grossly inflate any stranded investment that investors would be entitled to recover.

### *Regulatory Concerns*

In addition to the tangible ratepayer impacts, SB 379 presents serious regulatory concerns:

- SB 379's guarantee of investment security for NorthWestern violates two fundamental principles of public utility ratemaking. First, by removing Commission authority over rates associated with specific 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

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<sup>6</sup> Mont. Code Ann. § 69-3-109 states that "The commission may, in its discretion, investigate and ascertain the value of the property of each public utility actually used and useful for the convenience of the public. The commission is not bound to accept or use any particular value in determining rates. However, if any value is used, the value may not exceed the original cost of the property, except that the commission may include all or some of an acquisition adjustment for certain property purchased by a public utility in the purchasing utility's rate base if the transfer of the property to the purchasing utility is in the public interest."

potential stranded costs may be envisioned for the facility. By providing guaranteed security of NorthWestern's existing investment in Colstrip, the bill prevents a deliberative and evidence-based process from determining future electric rates that, for any plausible scenario, strive to balance utility and customer interests.

- SB 379 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 customers--is dismantled. In making its investment in Colstrip 4 in 2008, NorthWestern was awarded a rate of return on the investment as a measure of the economic risk being assumed by the company.<sup>7</sup> However, in guaranteeing security for NorthWestern's Colstrip investment, SB 379 removes the burden of risk assigned to the utility and its stockholders and leaves the investment risk entirely with ratepayers. The utility and its stockholders are relieved of any accountability for the utility's economic analyses and representations of future benefits of the investment.
- New Section 2(2) of SB 379 indicates that a utility "shall continue to operate the coal-fired generating units until the commission issues an order finding that closure of the units is in the public interest." This permits the possibility of either premature or overdue retirement dates. On one hand, parties would have the right to petition for early closure of any coal-fired power plant purchased under this provision, regardless of the remaining unrecovered or undepreciated rate base. On the other hand, the Commission could require the plant to continue to operate even if it were no longer economically efficient. The burden of determining when a generating plant should be retired would be shifted to the Commission, with the utility made whole no matter what the Commission decided.
- Section 3 of SB 379, which creates the rebuttable presumption for recovery of replacement outage costs, presents a number of regulatory concerns. It shifts the burden of proof to any challenging party to rebut the prudence of costs, rather than requiring the utility to prove that its costs were reasonable. In effect, this assumes that all replacement power costs—including those from reduced generation, operations, or maintenance and repair—should be recovered by customers regardless of the reason for the cost, a result that could conflict with Montana law that requires generation to be "actually used and useful for the convenience of

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<sup>7</sup> In Order 6925f, from Dkt. D2008.6.69, which approved NorthWestern's purchase of 30% of Colstrip Unit 4, the Commission's judgment that the purchase 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 making the purchase was reflected in the 10% return on equity for Colstrip that the Commission awarded in Order 6925f. SB 379 thus poses this question: If, in approving NorthWestern's original Colstrip purchase, the Commission had known that the cost risks of early retirement would be shifted *entirely* from NorthWestern to ratepayers, as mandated in the bill, would the Commission have approved a return on equity of 10%?

the public.”<sup>8</sup> Section 3 also establishes a heightened prudence standard, which the Montana Supreme Court has already considered and rejected.<sup>9</sup> The Supreme Court sided with the Commission in rejecting NorthWestern Energy’s proposed reasonable utility standard, finding that “[i]f ‘prudent’ was restricted to what a reasonable utility would do in similar circumstances, the Commission would be deprived of its own discretion to evaluate and determine whether the utility’s actions were prudent. Tying the outcome to evidence of what other utilities did or would do would remove or reduce the discretion of the Commission to rely on its own expertise.”<sup>10</sup> SB 379 resurrects NorthWestern’s attempt to use its definition of “reasonable utility standard” despite the Commission and the Supreme Court having already rejected that proposal.

- Section 4 of SB 379 appears to exempt replacement power costs, whether determined prudent or not, from the requirement in § 69-3-331 that 90/10 cost sharing be applied, as it is to all other power purchases except for those from “qualifying facilities” (“QFs”). QF production is metered and easily distinguishable from other power purchases, while replacement power costs are not distinguishable from other purchases and hence can be accurately estimated only through methods that are rife with contestable assumptions. Currently the Commission has only adopted the contested calculations of replacement power costs in cases in which it has imposed a disallowance of replacement power costs and removed the costs from the total proposed cost of power purchases in the cost tracker (PCCAM). SB 379 appears to require calculation of replacement power costs, and separation from the shared power purchase costs, for all such costs that are attributable to power outages, reduced generation, operations, or maintenance and repair at coal-fired generating units. If this indeed is the intent of the bill, it would likely increase the analytical workloads of docket parties and PSC staff considerably.
- Various terms used in SB 379 are ambiguous. Section 1 states that “[t]he rate of return must be based on the value attributed to the additional interest, lease, or power purchase agreement . . .” However, traditional rates of return approved by the Commission for a utility have nothing to do with the value of the utility investment or the rate base. The rate of return is a percentage that equals the weighted cost of debt and equity for the utility. The only way for the above-cited bill text to make sense and be correct is to delete the words “rate of” so that the first part of the second sentence reads, “The return must be based on the value . . .” The bill also perhaps contemplates the idea of “return” rather than of “rate of

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<sup>8</sup> Mont. Code Ann. § 69-3-109.

<sup>9</sup> The Court concluded that the Legislature “gave the Commission express latitude to determine if the given costs were prudent—careful, sensible, practical, discreet, wise, or farsighted or, more apt in the regulatory environment, avoiding unnecessary risks—through its own fact finding and administrative authority.” *NorthWestern Corp. v. Mont. PSC*, 2016 MT 239, ¶ 33.

<sup>10</sup> *Id.* ¶ 38

return” when it refers to allowing a “*rate of return* on an additional equity interest, lease, or power purchase agreement” [emphasis added]. Leases can be booked as either an expense or a capital lease. However, there are strict accounting rules regarding the capitalization of a lease. The value of the capital lease is calculated per the terms of the lease. Assigning a book value to a lease based on the book value of the existing ownership share in Colstrip violates the accounting rules and ratemaking principles regarding leases. The same applies to power purchase agreements, which are typically treated as an operating expense, not as a capital asset.<sup>11</sup>

### ***Staff Recommendation***

Staff recommends that the Commission oppose SB 379. The bill dismantles the regulatory balance between NorthWestern and its customers by guaranteeing investment returns to the utility while transferring all risk to ratepayers. SB 379 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.

The implementation of deliberative and evidence-based processes to arrive at decisions that are just and reasonable to both utility and customer is a fundamental responsibility of regulatory commissions in all 50 states, including the Montana Public Service Commission. The fulfillment of that responsibility requires case-specific fact-finding, substantial involvement of affected parties, and comprehensive analysis of details and arguments. SB 379 preempts that responsibility and prescribes terms for a potentially momentous acquisition about which details are unknown, analysis is absent, and deliberation precluded.

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<sup>11</sup> In its comments on the Commission’s proposed rules for resource procurement processes and competitive solicitations, the NorthWest & Intermountain Power Producers Coalition suggests that the Commission should allow a return on equity for power purchase agreements. While not common, there are a few examples of the practice in Washington, Arkansas, and Michigan.