Service Date: November 23, 2004

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

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COMMENTS OF THE MONTANA PUBLIC SERVICE COMMISSION TO THE NORTHWEST POWER AND CONSERVATION COUNCIL ON ITS DRAFT FIFTH POWER PLAN

On September 22, 2004, the Northwest Power and Conservation Council (Council) approved its draft Fifth Pacific Northwest Electric Power and Conservation Plan (Plan) for release for public comment. The Plan was developed pursuant to requirements of the Pacific Northwest Electric Power and Conservation Act of 1980. The Council requested comments on the entire draft Plan, and highlighted a number of specific issues for which it is particularly interested in regional reactions. These include the Plan's increased focus on risk analysis, conservation acquisition, demand response, wind generation, climate change policies, regional transmission-related issues and independent power generators.

The Montana Public Service Commission (MPSC) appreciates the opportunity to comment on the Council's draft Plan. The Commission also appreciates the enormity of the Council's responsibility to develop a comprehensive, long-term, regional power plan in the midst of a rapidly evolving environment. The Commission commends the Council for its thorough and thoughtful consideration of the many issues facing Northwest electricity utilities, policy makers, entrepreneurs and consumers. Due to limited resources, our comments necessarily reflect a higher level evaluation of the Plan.

Montana is emerging from a turbulent period in its energy history. In 1997 the Montana Legislature enacted Senate Bill 390, restructuring the state's primary investor owned utility, Montana Power Company, and authorizing retail customers to purchase electricity supply from unregulated suppliers. Within a four-year period following enactment of SB 390, Montana Power sold its coal-fired and hydroelectric generation resources that were the basis of supply costs for two-thirds of the state's retail electricity consumers to PPL Montana, and its

transmission and distribution utility business to NorthWestern Energy. NorthWestern Energy stepped into the role of being a default supplier to Montana Power's former retail customer base with no generation of its own and, in the winter and spring of 2001, while wholesale market prices for electricity were at unprecedented levels, began the process of developing a resource portfolio comprised entirely of wholesale power purchase contracts. NorthWestern Energy, along with policy makers in Montana, including the MPSC, continues to struggle with issues related to long-term resource planning and portfolio development in a still-evolving, highly uncertain wholesale market environment. From Montana's perspective, the Council's draft Plan offers a timely discussion of planning tools and strategies for responding to that environment.

Risk analysis

The preferred plan the Council identified in the draft Plan trades away some cost benefits in return for the lowest degree of risk. The Council asked whether its choice of the lowest risk plan is reasonable. In Montana, NorthWestern Energy, its technical advisory committee and the MPSC are continually evaluating cost-risk trade-offs associated with the development of a reasonable, long-term supply portfolio. The Council was right to enhance the risk analysis in the Plan. The 2000-2001 wholesale market experience showed the substantial economic and social disruption that can accompany volatile and imperfect energy markets. Clearly, developing tools to evaluate cost-risk trade-offs enhances resource planning and allows better-informed decisions. The Council's choice of the lowest risk plan is probably reasonable, but the decision appears to have been aided by the nature of the cost-risk trade-off; the region foregoes relatively little in cost benefits in order to achieve significant reductions in risk. It would seem important to monitor and update the shape of the efficiency frontier over time so that to the extent the nature of the cost-risk trade-off changes appropriate adjustments in planning and procurement strategies can occur.

Conservation

The Council asked whether the aggressive and sustained acquisition of conservation in the preferred Plan is reasonable and achievable. The Council noted that while its recommended conservation path reduces both costs and risks in the long-term, small rate increases may result in the near term. The MPSC agrees that a long-term perspective is appropriate when evaluating the cost and risk benefits of conservation. The MPSC also agrees with the Council's treatment of conservation as an important and effective resource for meeting the region's energy needs. In spite of the long-term benefits of conservation resources, near term rate impacts can create barriers to optimal acquisition and, therefore, should not be ignored. Innovative approaches for maximizing participant funding, accelerating investment in more efficient equipment and appliances, minimizing free-riders and take-back effects, and designing economically efficient rate structures could help. To the extent the Council can serve as a conduit for information sharing between utilities, policy makers and others trying to implement conservation acquisition programs, the MPSC encourages the Council to do so.

The Council identified a wide-ranging list of entities whose coordinated efforts will be required to achieve the Plan's conservation targets. The development of a strategic plan for conservation acquisition, as described in Action Plan item CNSV-3, is therefore essential. The MPSC commends the Council for taking a leadership role in putting together a forum to develop the strategic plan. The resulting assignment of implementation roles will be particularly useful to agencies such as the MPSC.

Demand response

The Council asked whether it is appropriate for utilities to develop and use demand response programs. As a potential cost-effective resource, the MPSC believes demand response programs are an important component in any comprehensive utility resource portfolio. MPSC rules specifically require NorthWestern Energy to integrate demand response programs into a long-term resource procurement strategy. As the Council correctly recognized, demand response programs have the potential to provide reliability and economic efficiency benefits.

Technological advances continue to make demand response options more feasible, user-friendly and cost effective. To the extent demand response programs help reduce peak loads served by natural gas-fired generation, the demand for natural gas may ease, mitigating electricity price volatility and upward pressure on natural gas prices. However, the Council, utilities and policy makers should guard against demand response actions that could actually reduce efficiency from a societal perspective. For example greater reliance on emergency diesel generators as a demand response tool may produce negative effects on local air sheds and public health. The MPSC supports the Council's recommended action plan items regarding demand response. The Council's action plan item DR-6 is especially noteworthy; a Council-led regional discussion of the economic and public policy issues surrounding retail rate design in the context of the evolving wholesale market environment would be beneficial and timely from the MPSC's perspective.

Global climate change policy – external costs

The Council's decision to address risks related to climate change is certainly appropriate. In general, the assumptions the Council used to evaluate possible carbon tax emissions policies appear to fall within a zone of reasonableness. However, it would be beneficial for the Council to expand its portfolio analysis beyond climate change risk to enable the identification of the lowest total social cost plan. The MPSC's integrated resource planning approach has embraced long-term total social costs as the appropriate cost measure for more than a decade. Although the Council correctly noted the difficulty of quantifying the environmental effects and costs for the array of emissions associated with generating electricity (Draft Plan at 2-21), these effects and costs are nevertheless real. Furthermore, government regulations, whether in the form of a cap and trade system or a tax, do not necessarily internalize these costs and effects completely into economic decision-making, and there are external costs related to electricity production, in addition to CO2, that are not currently subject to regulation, as the Council noted. It would be useful for policy makers to know how the resource mix in the lowest cost, lowest risk preferred

plan, based on direct costs, compares to the resource mix in the lowest total social cost plan. Public policy decisions informed by such a comparison may improve long-run economic efficiency.

Resource Adequacy

The Council's draft Plan defines resource adequacy as "[a] condition in which the Region is assured that, in aggregate, utilities or other load servicing entities (LSE) have acquired sufficient resources to satisfy forecasted future loads reliably" (italics omitted).
State commissions in their role as retail utility regulators are responsible for ensuring that their load serving entities have planned adequately for sufficient resources to meet their retail load. In the past where most public utilities directly owned or arranged firm contracts for resources to meet expected load, this was a fairly straightforward matter. As the draft Report (Plan?) discusses, restructuring of the industry within the Western Interconnection has broadened the environment in which resource adequacy must be evaluated. And as the draft Report (Plan?) points out, the definition of resource adequacy may be more complex than historically envisioned, encompassing economic adequacy, not simply physical adequacy. The Council suggests that this issue be addressed in the appropriate forums in the Northwest and Western region. The MPSC supports this proposal.

Transmission

For the first time in one of its plans the Council explicitly addresses transmission outside the context of resource adequacy and cost effectiveness. In previous plans the Council states it assumed the incentives were in place to assure reliable and cost-effective operation of the transmission system and expansion of the system if warranted. The Council believes that those assumptions are no longer reasonable in light of the changes in the region as a result of industry restructuring and because of our region's recent experience with a poorly designed wholesale market. One tangible action the Council has taken to address regional transmission issues is to

support the Regional Representatives Group (RRG) of Grid West. The MPSC notes that the Council's participation in the RRG has been invaluable to moving the dialogue along in the RRG process. It has also been very helpful from the MPSC's perspective to have a neutral party involved in the process with the objective of furthering the region's overall public interest. The MPSC encourages the Council to continue to be involved in the RRG process of Grid West and any subsequent or alternative processes.

The draft Plan briefly notes the role of market monitoring to making the current hybrid regulated/deregulated market work successfully in the future. The draft Plan suggests that any independent transmission operator should collect the data necessary to evaluate the market's performance and report regularly on its competitiveness and efficiency. The MPSC agrees that market monitoring should be given a major emphasis in the future operation of the system and believes this will benefit the region. The draft Plan did not further identify possible reporting relationships. The MPSC would encourage all involved in the RRG process or any alternative processes to identify those reporting links and responsibilities as concretely and as early as possible in order to avoid some of the conflicts now arising in other regions of the country.

Role of the Bonneville Power Administration

Under the Northwest Power Act of 1980 the Council and Bonneville Power Administration have certain responsibilities. In its draft Plan the Council recommends fundamental change in how Bonneville will carry out its role in power supply in the region. The Council recommends however that Bonneville maintain its current support of low-income weatherization and conservation activities including market transformation, limited development and demonstration activities and program design and administration. The MPSC agrees with these recommendations regarding weatherization and conservation activities.

The Council believes that Bonneville is in a unique position whereby it can encourage the development of some renewable resources in the region through certain activities. The MSPC

concurs and notes that the wider region could benefit from a more diverse resource base structured to be more resilient in the face of future market conditions.

Done and dated this 23rd day of November, 2004, by a vote of 5 - 0.

BY THE MONTANA PUBLIC SERVICE COMMISSION

BOB ROWE, Chairman
THOMAS J. SCHNEIDER, Vice-Chairman
MATT BRAINARD, Commissioner
GREG JERGESON, Commissioner
JAY STOVALL, Commissioner

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