

Restructuring Testimony

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

IN THE MATTER of the) UTILITY DIVISION
Application of) DOCKET NO. D97.7.90
MONTANA POWER)
COMPANY for)
Approval of its Electric Utility
Restructuring)
Transition Plan Filed Pursuant
to Senate Bill 390.)

**PREFILED DIRECT TESTIMONY OF MICK ROBINSON ON BEHALF OF THE
MONTANA DEPARTMENT OF ENVIRONMENTAL QUALITY AND THE MONTANA
OFFICE OF THE NORTHWEST POWER PLANNING COUNCIL**

Introduction

Q: Please state your name and business address.

A. My name is Mick Robinson, and my business address is State Capitol, Helena, MT 59620-0801.

Q: Who is your employer and in what capacity do you serve?

A: I am employed by Governor Racicot as Director of Policy. In my current capacity I am the Governor's chief advisor on all major policy matters. I was the Administration's point person on SB 390, The Electric Utility Restructuring and Choice Act.

Q: Please state your educational background and work experience.

A: I received my BA in Accounting from Carroll College in 1972 and my MBA, with financial emphasis, from Washington State University in 1974. In 1974 I was licensed in Montana as a Certified Public Accountant. Since my graduation I have worked as a private accountant for Galusha, Higgins and Galusha from 1974-1978. I was an accounting professor at Carroll College from 1978-1989. I worked in state government as the Accounting and Budgeting Administrator for the Department of Justice from 1989-1993 and was appointed by the Governor as Director of the Department of Revenue from 1993-1996. I have been in my present position since December 1996.

Q: What was your involvement in SB 390, the Electric Utility Industry Restructuring and Customer Choice Act?

A: I led the Governor's efforts on electricity restructuring during the last legislative session. I directed the development of the **Racicot Administration Electricity Restructuring Principles** that the Governor adopted to guide the legislative debate on electricity restructuring. I served as the Governor's chief negotiator of SB 390 to ensure that the

Administration's principles were included in SB 390. A copy of these principles is attached to my testimony as Exhibit A.

Q: What is the purpose of the DEQ/NPPC testimony in this docket?

A: Senate Bill 390 laid a basic foundation for providing electricity customers retail choice and allowing competition in Montana and left the specifics of implementation to transition plans that are subject to approval by the Commission. DEQ/NPPC's testimony is intended to provide, for the record, those essential public policies that should be included in MPC's transition plan in order to move Montana to customer choice in four years and promote full and healthy competition in the provision of electricity and related energy services.

Q: Please describe the Administration's witnesses.

A: In addition to myself, DEQ/NPPC intends to offer three witnesses. I will address the broad issues that are addressed in SB 390 and lay out the major policies that are contained in the legislation. Dr. Larry Nordell will address the policy issues surrounding stranded costs and the essential changes that must be made in moving from monopoly-provided electricity choice to one that allows competitive markets to fully develop. John Hines will address the policy issues surrounding the provision of public benefits programs in the transition to competitive markets. Alan Davis will address the policy issues surrounding functional separation, pilot programs and customer education. Wayne Wetzel will appear as a witness for DNRC and Tom Schneider will appear as a witness for DPHHS. Both will be appearing as part of an overall Administration team looking at the issues surrounding MPC's restructuring filing.

Q: What is SB 390?

A: SB 390 is the Electric Utility Industry Restructuring and Customer Choice Act that was passed last legislative session and signed by the Governor. The legislation restructures the electricity industry in Montana and provides for retail customer choice.

Q: What was the Administration's involvement in SB 390?

A: We assumed two principal roles. The first was to open the process for developing SB 390 so that all stakeholders could be involved in the development of the legislation. This included serving as facilitators for many of the work sessions that resulted in a draft of SB 390. Our second role was to promote a balance in policies necessary for good public policy in Montana, given the competing and divergent interests in the debate over restructuring.

Q: How did you go about achieving this balance?

A: At the beginning of the session we developed a set of principles entitled the **Racicot Administration Electricity Restructuring Principles** that we thought represented a balanced approach to restructuring. We circulated draft sets of these principles to all the major players in the debate and made the necessary modifications to accommodate, as best we could, the concerns of the competing interests. The Governor then adopted them. What is significant about the principles is that they represented a general agreement at the policy level on a restructuring bill and they represented a clear communication from the Administration of what had to be in the bill for the Governor to sign it.

Q: Is SB 390 consistent with the principles?

A: In general, yes, but there are one or two specifics, such as all customers immediately going to choice, that are different than the specific principle, yet consistent with the overall goal of the restructuring principles.

Q: What were the major goals of restructuring the electricity industry in the principles and in SB 390?

A: The Administration believes, all other things being equal, that competition is preferred to regulation in the supply of electricity in Montana. Competition with fully functioning markets will better serve our citizens by offering them better electric products, services and a wider range of choices. Competitive markets in the provision of electricity and related services also bring market discipline to prices. It was our position that healthy competition in the electricity industry had significant benefits for Montana in both the short and long run. The Administration's belief in the benefits of competition was the basis of our support for SB 390.

Significant events happening outside Montana collectively suggested to us that it might be in the state's best interest to control our own destiny related to electricity choice, as opposed to having a solution imposed on Montana by the federal government. We wanted to shape the future of Montana's electricity industry to fit Montana's special needs.

An orderly transition to choice was another goal of the restructuring bill. We recognized that these changes couldn't happen overnight and there needed to be a logical transition to choice. It was also critical that important public benefits currently provided by our electric system be continued or maintained during the transition to competition.

The Administration wanted to ensure ratepayers that they would be no worse off during the transition to choice than they would be under the current form of regulation. Ratepayers' interests had to be balanced with those of the utilities. We wanted utilities to have a fair process for recovering stranded costs if they could clearly demonstrate that stranded costs existed, that the costs were evaluated over their asset life and that these costs were fully mitigated.

Q: What happens if the generation of power is deregulated, and competition doesn't materialize for customers in Montana?

A: Such a situation would present the absolute worst case for Montana. Utilities would get their energy supplies deregulated, but customers would not really have choice. In effect this would create a deregulated monopoly. The consequences of this to Montana consumers would be that there would be no effective competition, and therefore prices to consumers might be higher and the innovation and new products that competition could bring might not be available in Montana.

Q: Does MPC's filing raise some of these concerns regarding whether there will be effective competition during the transition to choice in Montana?

A: Yes it does. I will expand on these later in my testimony.

Q: Can all the electric services be provided by competitive markets?

A: No, transmission and distribution services should continue to be provided by regulated monopolies, but generation and retail energy services can and should be provided by competitive markets. This is what is contained in SB 390. Transmission and distribution by

their nature are monopolies and continue as regulated monopolies. Electricity generation and retail energy services are provided competitively by markets and are not to be a part of the regulated business. Utilities are required in SB 390 to functionally separate their generation, transmission, distribution and energy services businesses from each other and develop enforceable protocols that prevent self dealing between the business enterprises.

Q: What has to happen to get to these competitive markets?

A: There has to be a transition from the current regulated monopoly to an unregulated supply market and to choice for retail customers. Utilities have to segregate their business enterprises into separate pieces. Additional care must be taken to not give advantages to the current providers of these services over any new entrants in the markets.

Q: What about public benefits?

A: Important public benefits must be preserved in the transition to customer choice. MPC should provide a framework that allows the public to understand how public benefit dollars are allocated. Energy efficiency and renewable energy are examples of electricity resources that can be provided by competitive markets. In order for these markets to develop, energy service companies and "green power" marketers must have fair and open access to customers. Low income energy services, however, are not likely to be provided by markets, so there must be provisions for taking the needs of low income consumers into account as we move to retail choice and beyond.

Q: What about the recovery of utility stranded costs?

A: Stranded costs are a utility's above-market costs associated with power supply, and are not recoverable in markets. They actually are the difference between market prices and actual utility costs over the life of the assets, as these assets are transferred from the regulated to the unregulated business of the utility. If market prices exceed the costs, stranded costs are negative and utilities should compensate ratepayers. If stranded costs are positive then ratepayers should compensate the utility.

Q: What about ratepayers and their rates?

A: Effective competition and customer choice should result in lower prices and more products if markets are allowed to fully develop. However, there was a substantial public concern that ratepayers would be worse off during the transition to customer choice. The Administration wanted to make sure that ratepayers were at least as well off during the transition to choice as they would be under the current regulated markets. This is why we insisted that a rate cap be contained in SB 390.

Q: Please give an overview of SB 390.

A: SB 390 was the legislation that restructured the electricity industry in Montana and allows retail customers to choose an electricity supplier. It represents a compromise among the various interests and the utilities in moving to retail choice. The compromise in SB 390 is that if utilities open their systems to full retail choice and competition, then they would be able to earn unregulated profits on their generation assets and they would have a fair process to recover stranded costs. Utilities have to clearly demonstrate that stranded costs exist, that they evaluate them over their asset life and that these costs are fully mitigated. The bill includes three categories of stranded costs with different conditions and recovery periods for each type. To open their systems to competition, utilities must functionally

separate their regulated and unregulated enterprises and prevent self-dealing between them in order to make sure that there is full and effective competition, which protects consumers when the industry prices are deregulated. Ratepayers are protected with a rate cap. The pathway to choice is to be through the use of pilot programs with an educational effort, and important public benefits are to be preserved. At the end of the transition period all MPC customers would have the ability to choose their electricity supplier. Utilities are given the responsibility to submit transition plans, consistent with SB 390, to the Public Service Commission (PSC), and the PSC has the authority to approve, modify or deny a utility's plan based on the documented record for that utility.

Q: MPC has taken a number of interpretations over the content of SB 390 in its filing. Do you agree with MPC's interpretation of SB 390?

A: In some instances, I do not believe MPC's interpretation is consistent with SB 390 and certainly not what we negotiated as a part of the bill. If MPC's interpretation on issues such as stranded cost, functional separation, and the rate cap were part of the bill, I would not have recommended that the Governor sign SB 390.

Q: Does SB 390 contain a rate cap or a rate freeze for the 4-year transition period?

A: SB 390 contains a rate cap, not a freeze. We were trying to ensure that customers, with specific exceptions, were no worse off with current rates during the 4-year transition period. It was not, as MPC proposes, to guarantee MPC a set revenue requirement during the transition period regardless of what happens to MPC's costs. In fact, exceptions were included in the bill for some utility costs that might increase during the transition. The specific reference is that "utilities may not charge rates higher than those rates in effect on July 1, 1998." Section 69-8-211(6)(a), MCA. It is very clear what was intended in SB 390. If costs go down under the rate cap in SB 390, so do rates. It is not, as MPC proposes, that if costs go down, MPC is guaranteed its current revenue requirement and the associated increase in profits.

Q: Does SB 390 provide for recovery of utility transition costs?

A: Yes, provided the utilities meet several criteria. First the costs must be "net verifiable generation-related and electricity supply costs, including costs of capital, that become unrecoverable as a result of implementation of this chapter or of a federal law requiring retail open access or customer choice." Section 69-8-103(22), MCA. SB 390 creates several categories of stranded costs, but places certain criteria on these costs in order for them to be recovered by the utility. As previously stated they must be "net verifiable" costs that "become unrecoverable as a result" of competition. The costs must be "reasonably demonstrable" and must be considered on a "net basis." Only the "unmitigable" costs are allowed to be recovered and "Transition costs must reflect all reasonable mitigation by the public utility." Section 69-8-211(2)(a), MCA.

Utilities must make an "affirmative showing" that stranded costs meet several criteria. There are three ways to determine generation related stranded costs including "estimating future market values," "appraisal," and "competitive bid sale." Section 69-8-211(2), MCA.

Q: What does providing for recovery of stranded cost actually do for the utility?

A: Transition costs are intended to determine how much the utility, or the ratepayer, should be compensated when an asset is transferred from the regulated to the unregulated business enterprise. It is in effect the "transfer" value of the assets over their useful life in relation to the assets' value on the books of the regulated utility. If the market value of the

assets exceed book value, then the utility should compensate the ratepayer for the transfer. If the book value exceeds the market value, then the ratepayer should compensate the utility.

Q: Do you agree with MPC's interpretations of the stranded cost portion of SB 390 contained in MPC's filing?

A: No. There are several areas of disagreement between what MPC proposes in its filing and what is in SB 390. I will address the major areas of disagreement.

Q: Does SB 390 require a long-term view of the market price and the costs of the generation assets or some other long-term view for determining generation related transition costs?

A: Yes, the three methods listed in SB 390 are long term approaches to stranded cost recovery. If the generation related assets are worth little now because of current low prices, but worth more in the future because they are low cost assets, then ratepayers shouldn't have to pay the stranded cost based on today's prices, only to have the utility reap the benefit of the higher market prices in the future. This requires valuing the assets over their useful life. To hold to MPC's assertion that SB 390 requires only a 4-year view is not correct. In fact, it could result in MPC getting double recovery for the same assets. Once for the 4-year period when generation related transition cost are recovered and again when market prices rise and the assets are deregulated. It was never intended that MPC could recover twice for the same assets.

This issue originated in the discussions regarding SB 390 as it relates to the 2188 hydro relicensing costs that MPC wanted to include in rates during the transition period. We looked at provisions for accepting the current above-market risk for ratepayers today in exchange for a share of the future benefits going to ratepayers. If MPC makes ratepayers pay for investments today, these investments must be netted, as required in SB 390, against the future benefits of the low cost power in MPC's system.

Q: Is there other netting that MPC must do in order to get recovery of stranded costs?

A: Yes, In addition to netting within a category of stranded costs, MPC must net the "negative" stranded costs or over-collections in one category of stranded costs (generation-related or electricity supply costs, regulatory assets, or qualifying facilities) against the other stranded costs in other categories.

Q: Does SB 390 contain provisions for a reopener in the determination of transition costs for qualifying facilities (QF) until such time as the utility mitigates these QF contracts?

A: No. Utilities are only allowed to recover the unmitigated portion of the above market costs of QFs. Reopeners were considered during the discussions of SB 390, but were rejected because the additional complexity didn't seem to merit the benefits of a future look at market values. The utility is not entitled to recover any above market price costs associated with QFs until the utility has mitigated, to the fullest extent possible, the QF contracts. There are no provisions in SB 390 for MPC's proposal on QF cost recovery.

Q: Does SB 390 bind the Commission solely to MPC's proposal for stranded cost recovery?

A: SB 390 gives the utility three methods to propose for determining transition cost for generating assets, and it can choose the one it wants to use. They are all intended to get to the same place, asset value. The utility in this rate proceeding has the burden of proof to prove up its numbers. The Commission cannot tell the utility which method to choose. However, other parties can also present their cases regarding alternative proposals for determining MPC's transition costs. The Commission can pick the method and numbers it thinks are the best from either MPC's or the other parties' evidence in the record and "modify" MPC's plan accordingly.

Q: MPC asserts that SB 390 only requires it to separate its regulated energy services from its unregulated energy services business. Do you agree with that interpretation?

A: No. From the beginning of the discussions on SB 390 we sought to ensure the energy services were separated from the distribution business. We knew a number of electricity suppliers offer energy efficiency services and metering and billing services as part of the package of energy services they offer to customers. In order for these businesses to compete, MPC has to truly open up its retail energy services business, and ensure there is no self dealing between the distribution monopoly and the energy services business.

MPC's proposal is to guarantee a linkage to its customers by maintaining direct access through its continued provision of metering and billing services and the recovery of these costs through a non-escapable charge on all customers. New and innovative metering and billing services would only be provided to customers if they pay extra for them, or get them from a provider in addition to those services already offered by MPC. MPC's proposal clearly frustrates competition. With MPC owning an energy services company, an electricity supply company, a natural gas utility, a telephone company, and being a provider of Internet services, it is to MPC's advantage to not open these competitive services to other providers.

SB 390 is clear on functional separation, and MPC's interpretation of the legislation is inconsistent with what the legislation requires. MPC's interpretation would severely impede the development of effective competition in the provision of energy services in Montana.

Q: Does the FERC approved code of conduct, as MPC maintains, comport with SB 390?

A: Not completely. SB 390 is very specific that MPC has to adopt a code "consistent with" the FERC approved code. Section 69-8-204(4), MCA. The reason is apparent: the FERC code only applies to the separation between power marketing and transmission, which is only a part of the SB 390 required separation. The other part, separation of the distribution system from power marketing and energy services, is not in the FERC code, but is required by SB 390.

Q: What is the importance of pilot programs and customer education in getting to full customer choice?

A: In SB 390, pilot programs were chosen as a way of creating a logical pathway to customer choice rather than all customers going at one time. They were also intended to gather the necessary information as to whether there was going to be real competition in Montana. Since MPC is the current provider of service, any customer that leaves MPC for energy services or energy supply is a lost customer to MPC. There is no natural or financial incentive for MPC to have pilot programs succeed. We agreed to support the pilot concept out of recognition that markets weren't going to happen overnight and there were some

transitional issues that needed to be developed. What this means for pilots is that they should create a logical and successful path for full customer choice in a way that attracts new energy suppliers to serve Montana customers. If the programs are too cumbersome or don't have enough participants, then neither customers nor suppliers will want to participate, which will impede the development of effective competition in Montana.

Public education regarding the changes that are taking place and the availability of pilot programs is essential to the ultimate success of retail choice in Montana. Customers must be given objective, unbiased, and factual information to make informed choices. Special care must be taken so that the marketing efforts on the part of incumbent utilities are clearly separated from the educational activities associated with informing consumers about choice and their options. This educational effort must precede the pilot programs with sufficient lead time to allow for successful pilot programs.

A great deal hinges on the successful implementation of pilot programs in Montana and the educational effort associated with moving to full customer choice. The programs must be designed to succeed from the beginning. Prior to any deregulation of MPC's generating assets or recovery of stranded costs, the basics of the education effort and the pilot programs must be approved as a part of the entire transition plan so there is some likelihood of successfully getting to full customer choice.

Q: What is your overall impression of MPC's transition filing?

A: I think it represents a starting point for the proceedings. As with MPC's initial draft of SB 390, the plan is too advantageous to MPC and it needs to be modified to provide for a more balanced approach to transition MPC to full retail choice.

MPC's proposed plan, when taken as a package, gives MPC advantages at the expense of other competitors and consumers in Montana and if approved as currently filed, would more than likely frustrate, rather than promote, full retail competition in Montana. The Administration's witnesses will be more detailed in the concerns that the Administration has with MPC's plan, but I will provide a general overview. If the Commission modifies MPC's plan in accordance with our suggestions, it could promote a logical pathway to full retail choice in Montana that balances the interests of the major stakeholders involved in this proceeding.

Q: Could you be more specific in your concerns with MPC's initial transition plan filing?

A: MPC's transition plan presents these major concerns to the Administration:

1. The plan fails to demonstrate MPC's stranded costs.
2. The plan overstates MPC's stranded costs by failing to provide for the net, long-term value of the MPC's assets.
3. MPC's QF recovery proposal fails to show mitigation, to the fullest extent possible, of any QF stranded costs. MPC's proposal ensures full recovery of QF contract costs without any mitigation on its part.
4. MPC has not fully separated its regulated businesses from its unregulated businesses. MPC wants services, such as the metering and billing services that MPC offers as competitively provided services outside Montana, to be

provided by MPC without any competition by keeping them as part of the distribution company in Montana and making all customers pay for them through a non-bypassable charge on their bill. The effect of MPC's proposal is to inhibit competitors from providing these services in Montana.

5. MPC's delivery service charge has non-escapable charges for customers in Montana that pay for competitive services offered by MPC, which inhibits competitors from offering these services within MPC's service territory.

6. MPC has not provided the necessary firewalls for functionally separating its regulated from unregulated businesses, including the protections from self-dealing all the way up the management chain.

7. MPC's USBC program does not provide a framework to ensure that the essential public purposes will be provided as part of MPC's program. It also contains provisions that might lead to self-dealing between the regulated and unregulated portions of MPC.

8. MPC's proposed pilot programs begin with too few customers initially qualifying for choice, contain features like random selection that inhibit customers from participating in the pilot programs, and don't afford aggregators the opportunity to bring aggregations of customers into the programs. These pilots must be designed to get full competition to customers in Montana and not be designed to inhibit that competition. While we acknowledge that the pilots are being developed concurrently with this docket, they must be developed in sufficient detail and approved by the Commission prior to or as a part of the Commission approving MPC's deregulation of its generation assets or recovery of its stranded costs.

9. MPC's education program also is evolving, but once again it must be approved by the Commission prior to or as a part of the Commission approving MPC's deregulation of its generation assets or recovery of its stranded costs. The consumer education program should make sure customers are well informed before they have to make a choice, that they are aware of and know how to decide about choice and participate in pilot programs. The consumer education program has to be clearly separated from MPC's marketing efforts and done in such a way that it does not give MPC an advantage over any of its competitors.

When taken as a package, MPC's plan needs important changes to promote customer choice, encourage new entrants to serve Montana customers, and to not give MPC an advantage in the transition to choice. If the Commission modifies MPC's plan to address the issues raised in DEQ/NPPC testimony, MPC's plan will arrive at that balance necessary to get to full retail choice in Montana consistent with the provisions in SB 390.

Q: Does this conclude your testimony?

A: Yes.