

# 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. )

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### **PREFILED DIRECT TESTIMONY OF JOHN HINES ON BEHALF OF THE MONTANA DEPARTMENT OF ENVIRONMENTAL QUALITY AND THE MONTANA OFFICE OF THE NORTHWEST POWER PLANNING COUNCIL**

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#### **Introduction**

##### **Q. Please state your name, address, and position.**

A. My name is John D. Hines. I am an Economist and the Administrator of the Montana office of the Northwest Power Planning Council (NPPC), at 1301 Lockey, Helena, MT.

##### **Q. Mr. Hines, please describe your educational and work background.**

A. I hold B.A. and M.A. degrees in Economics from the University of Montana. My work experience includes: economist for the Alaska Consumer Advocacy Program, a consumer organization that represents consumers on utility issues before the Alaska Public Service Commission; an economic consultant with the World Bank, and an economist with the Northwest Power Planning Council. I have been employed with the NPPC since 1989, working as a conservation and policy analyst on state and regional electricity issues. For the past three years my work has focused on issues surrounding electric industry restructuring.

##### **Q. What is the purpose of your testimony?**

A. My testimony will be on the public purpose component of MPC's transition plan.

##### **Q. What work experience do you have that relates to your testimony on public purpose programs?**

A. During 1995 and 1996, I provided staff support for the Comprehensive Review of the Northwest Energy System. Part of my responsibilities included serving on several work groups, including the public purposes work group. I also worked on the low income sub-group to the public purposes group. Recommendations from these groups were incorporated into the final report which was accepted by the region's four governors.

I have also been working with the Racicot Administration in various capacities on electric restructuring issues. My areas of work include: formulating the Racicot Administration's "Principles on Electric Industry Restructuring"; worked on the development, negotiations, and implementation of the electric restructuring legislation that was passed into law; and served as the facilitator for both the large negotiating group which drafted SB 390 and the public purpose sub-group which developed a substantial part of the policy for the public purpose section of the legislation.

I am a designated member of Montana Power's Least Cost Advisory Committee and a board member, representing Montana, on the Northwest Energy Efficiency Alliance, a non-profit corporation established to promote energy conservation market transformation efforts in the Northwest.

**Q. Please outline the deficiencies that are in the public purpose section of MPC's proposed Transition Plan.**

A. First, there is no clearly defined framework or criteria for allocating public purpose dollars between alternative public purpose programs. Nor has MPC proposed a binding process for developing such a framework or criteria. Second, DEQ/NPPC does not agree with the proposed allocation of public purpose funds; we advocate additional funds for low income consumers. Third, we believe MPC should take a statewide perspective in evaluating and funding public purpose programs. And fourth, SB 390 clearly directs unexpended large customer obligations to be paid by the utility to the state fund. MPC proposes to divert this funding obligation to their own programs.

## **Framework**

**Q. Explain in greater detail the deficiencies regarding MPC's framework for allocating public purpose dollars.**

A. MPC's allocation does not appear to be dependent on or based upon any decision-making framework. MPC's transition plan only puts forth the most generic set of guidelines for allocating or distributing public purpose funds. MPC's plan states: "This distribution considers the requirements of the act, the relative importance of these public purpose efforts in Montana, need, cost-effectiveness, and public policy." Data requests by DEQ/NPPC (DEQ No. 2-034 (a) and (b)), resulted in no additional clarification. MPC's testimony (DRH p.4 lines 14 -16) also states that they will consider public input. This is insufficient. The 'trust us' approach leaves too many important public policy decisions in the hands of MPC, without the benefit of public oversight, review and direction.

Further, MPC has not set forth the specific goals or objectives it is trying to achieve by funding the various programs. Therefore, it is impossible to assess whether MPC's proposed programs and/or funding allocations are appropriate. Secondly, without a clear statement of program goals and objectives, the evaluation of program effectiveness and impacts will be at best highly subjective, and at worst useless. MPC's proposal does not contain safeguards to ensure public purpose dollars are being put to their intended use.

**Q. Please clarify what you mean by "intended use."**

A. Per the legislation, the public interest requires the ongoing protection of consumers through continued funding for public purpose programs. DEQ/NPPC believes the intended

use, within the program areas listed by the legislation, is those expenditures that further or enhance the public interest. This may include expenditures for programs that: improve the standard of living for low-income consumers, intervene in the market because important costs are externalized and not being captured, mitigate specific market barriers, or most preferable -- some combination of the above.

**Q. Can you provide examples of unintended uses?**

A. Yes. DEQ/NPPC does not believe that public purpose funding should be used to subsidize resource development activities that will occur in response to a competitive market. The competitive electricity market should provide clear marginal cost pricing, allowing consumers and marketers to make informed decisions. As an example, we do not recommend providing funds to buy down renewable resource costs just to make them competitive. Renewable resource suppliers (i.e., "Green marketers") have a market niche they can exploit.

In addition, under MPC's proposed framework, there is the potential that public purpose dollars might be used to unfairly promote or advantage the unregulated side of MPC or to be used as a tool to retain key customers. Greater clarity in the framework, including process and criteria, will also provide MPC with greater protection from future challenges to its funding allocations.

**Q. What are the problems associated with a lack of framework, identified process or criteria, and goals and objectives?**

A. The biggest problem from DEQ/NPPC's perspective is the arbitrariness associated with making funding decisions. Arbitrary funding decisions lead to distrust in regard to why funds are allocated, undermining support for the concept of public purpose funding.

In addition to making funding allocations without the benefit of a framework, MPC's testimony indicates they wish even greater flexibility to alter budget allocations as conditions warrant. The inference from this request is that MPC will be making this determination, although they state they will take into consideration public input and other unspecified factors. Additional flexibility, after PSC approval of the funding allocation, without a decision-making apparatus, only exacerbates the problems outlined in this testimony.

Other potential problems that may arise include: self-dealing or programs which are implemented to make the company better off, and affiliated transactions. An eventual outcome from this method of allocating funds may be that the ratepayers, who are paying for these programs, have less ownership in and support for public purpose programs.

**Q. Please elaborate on your concerns regarding potential self-dealing and affiliated transactions.**

A. Self-dealing describes any actions undertaken by the regulated utility to advantage the unregulated portion of the company. For example, MPC could direct conservation programs paid for by the USBC toward customers who are most likely to leave MPC's unregulated supply system.

An affiliated transaction with self-dealing occurs when the regulated utility works in concert with and advantages an unregulated part of the company. One example is for the distribution company to allocate USBC derived funds directly to the unregulated supply

company's renewable department, without at a minimum, the safeguard of a competitive bid process. DEQ/NPPC raised the issue of competitive bids in data request No. 2-029. MPC's response: "A competitive bid process could be used to accomplish some of these objectives, but should not be the only mechanism available. Flexibility is a critical factor . . ." These comments seem to validate our concerns.

A self-dealing or affiliated transaction situation would make MPC better off. However, this was not the intent of the public purposes section of SB 390.

**Q. Does MPC's proposed approach differ from their past practice?**

A. In general, no. And therein is a significant problem. There is a distinction between past expenditures for public purpose programs in a vertically integrated utility and the new paradigm where the distribution utility serves primarily as the collector of funds, external to the operation of the utility. The old model was built on the assumption that public purpose programs, in most cases, had to be beneficial to the utility and to society. For example, in the past utilities evaluated the benefits and costs of implementing conservation programs, measured against their avoided cost for new supply resources and rate impacts. In the new paradigm under SB 390, the public purpose dollars will be collected separate from the distribution utility's operating costs, and collected from all customers statewide. No utility is singularly disadvantaged. This distinction generates the need for greater public oversight and understanding of funding decisions because these are truly public expenditures for the public's welfare. In a deregulated environment when a universal systems benefit charge is collected from all customers in the state, the utility is not the appropriate arbiter of what public purposes should be funded and at what level. Therefore, the continued maintenance of tight control by the utility is no longer valid.

**Q. Given the problems you have discussed, do you have any recommendations for the PSC to implement?**

**A. Yes. First, the PSC should require MPC to set up a process which will result in the development of a funding allocation mechanism, including the development of criteria and definitions, and goals and objectives. The process should be open to the public. The outcomes from the process should be binding on the company.**

**The process should take into account the following:**

- \* The allocation methodology must be clear and transparent and the funding outcomes should be able to be replicated outside of the company.**
- \* Safeguards should be put in place to prevent unintended uses.**
- \* Goals and objectives must be developed for each of the public purpose categories.**
- \* A prioritization mechanism to facilitate funding decisions between competing categories should be developed.**
- \* Funding decisions within program categories should be made where possible via competitive bid. However, DEQ/NPPC recommends that no funding allocation should be made to the unregulated portion of the company without undergoing a competitive bid process. The results from the competitive bid process should be binding on the company.**

**\* Definitions for key terms such as what constitutes a low-income consumer and what is cost-effective conservation should be developed. Where possible, these definitions should be made in conjunction with other utilities in the state, including the rural electric coops.**

**\* No party should receive public purpose funding without agreeing to submit its program to an evaluation by accepted protocols and standards.**

**In conclusion, DEQ/NPPC believes the PSC should require MPC to set up a process that binds the company to the recommendations from the process. The process should at a minimum address the issues listed above. In addition, in the development of the framework, we recommend the PSC minimize MPC's future role in determining funding allocations. There is no reason for MPC to retain their former planning and implementation role in a restructured electric industry.**

## **MPC's Proposed Funding Allocations**

**Q. Please explain your concerns regarding MPC's proposed funding allocations among public purpose programs.**

A. First, as set forth below, there is a clearly defined need for additional low income funding that MPC apparently did not take into account. Second, MPC has not attempted to substantiate that dollars being allocated for conservation meet the cost-effectiveness criteria required by SB 390. MPC has not even defined what measure of cost-effectiveness they are employing. Third, MPC has not stated the objectives they are trying to accomplish by acquiring renewable resources.

**Q. What level of funding has MPC proposed for allocation to low-income programs?**

A. MPC, in its transition plan, advocates the minimum amount of funding allowed by law - 17 percent of the public purpose funds.

**Q. Do you see any distinction among the various public purpose programs that MPC has targeted for funding?**

A. Yes we do. First, as noted previously, the legislation specifies that at least 17 percent of all public purpose funding must be for low income purposes. No other public purpose program has a funding requirement. The Administration's Principles and the SB 390 legislation recognize that certain public purposes may be less likely to be implemented than others as a result of the emergence of competitive market forces. For example, cost-effective conservation and renewable resource programs are more consistent with market based resource development than is assistance with low income energy bills. Absent public purpose programs, there is no market for providing energy assistance to low-income consumers.

**Q. Given this large unfunded need for low-income consumers, why did MPC allocate the minimum amount toward this program?**

A. DEQ data request No. 1.022, asked MPC why the minimal amount was being committed to low income assistance. MPC's response was that their low income weatherization efforts:

"have reduced the potential market for low-income electric savings." Their perspective seems to be that the low-income program should be a strict energy efficiency program, resulting in resource acquisition. This ignores the additional funding need for customer bill assistance and the fact that low income assistance is not a resource program.

**Q. What are the concerns regarding the proposed funding allocation for low income programs?**

A. MPC in its transition plan does not appear to fully recognize the funding need of low income consumers. Testimony will show that there is a substantial unfunded need for low-income consumer programs. This contrasts with MPC's low income funding allocation which is set at the minimum amount specified in the law. The Administration's testimony suggests that a reprioritization of public purpose funds to low-income programs is warranted.

**Q. Can you explain how the minimum of 17 percent for low income became a part of the public purpose funding package?**

A. Yes I can. I was a member of the public purposes sub-group that developed this part of the public purpose package.

In January, 1997, the Governor's Low-Income Energy Advisory Council submitted to the Governor recommendations which identified the need for energy assistance and recommended a plan and resources necessary to meet that need. These recommendations formed the basis for determining the minimum funding need for low-income consumers statewide. The Advisory Council identified a gap between the cost of LIHEAP, Weatherization, and Energy Share and the amount provided for those programs by the federal government and Energy Share. The gap is \$3.7 million for FY98 and FY99.

The electric industry makes up about 64 percent of the gross operating revenues of the four primary fuels used for heating. The result translates into a minimum obligation of \$2.37 million per year by the electric industry. This was calculated to be 17 percent of the total 2.4 percent universal systems benefit charge. **EXHIBIT 1.**

**Q. Does this 17 percent meet all of the future needs of Montana's low-income consumers?**

A. No. This allocation only provides a fixed amount of money based on 1995 electric retail sales. The costs of heating homes, insulating materials, and the number of low-income consumers are not fixed. These cost components are generally increasing over time.

Also, with the four primary heating fuels contributing their respective shares, the 17 percent is designed only to fund an identified gap in short term funding levels. It is not designed to fund need either in the short or long term. The Advisory Council identified 62,625 low-income households in Montana potentially eligible for LIEAP. An additional 17,439 households meet the Energy Share criteria (between 125 and 150 percent of poverty). This is compared with up to 22,000 households that apply for and receive heating assistance under LIEAP.

Allocating additional public purpose funding beyond the minimum amount prescribed by the legislation can be used to help meet the additional needs identified by the Low Income Task Force and in this docket through the Department of Health and Human Services' witness, Tom Schneider.

**Q. Do you have any recommendations to make to the PSC regarding reallocating public purpose dollars?**

**A. Yes. In the absence of solid funding justifications for conservation and renewables, coupled with a clearly defined and illustrated funding need for low-income programs, the Administration believes more of the public purpose funding should be allocated toward low income programs.**

**Q. What is the result of providing more money for low-income programs?**

A. First, providing additional money for low-income consumers means these energy consumers will have lower heating bills. Low-income families in Montana spend approximately 14.2 percent of household income on energy bills while the average energy burden for all Montana families is approximately 4.1 percent of household income. **EXHIBIT 2.** Programs like bill assistance or weatherization will clearly reduce this burden in an immediate time frame.

The other effect of altering the funding allocation is a reduction in the amount of money available for the other allowable public purpose programs identified in SB 390. It is difficult to judge what benefits will be lost from decreasing funding in these other areas. This is due primarily to the lack of information justifying the plan's proposed allocation scheme. For example in regard to renewables, MPC proposes to continue the existing 1 million dollar funding level. The objective the company is trying to achieve through this annual expenditure is unclear.

In conclusion, the benefit of providing more money for low-income consumers is straightforward while the detrimental effects of decreasing funds for other public purpose programs are uncertain.

**Q. Do you have any other concerns regarding MPC's funding allocation?**

A. I would like to talk briefly about the planning perspective that MPC proposes to employ. MPC has taken the position that the universe of potential public purpose programs is confined to its service territory, a company perspective. They propose to allocate all of the money collected from their distribution system back to their customers rather than pursuing public purpose expenditures that bring the most benefit to the state. The perspective DEQ/NPPC proposes is to define the universe as statewide for implementing public purposes. Looking at the funding universe from the state perspective increases the effectiveness and invested value of the limited public purpose dollars.

**Q. Why should MPC take a broader public purpose funding perspective that extends beyond its own customers?**

A. The legislation provides that all electricity customers in Montana share in the benefits from a restructured industry. Governor Racicot's "Electricity Restructuring Principles" declare it is in Montana's interest to maintain important public purposes. Neither the Principles nor SB 390 suggest that public purposes should be undertaken to further the utility's welfare. These documents direct Montana or the public interest should be better off as the result of public purpose expenditures. These benefits, in order to be maximized, should be spent where there is the greatest need or where the "biggest bang for the buck" occurs.

We believe the key concept should be what is in the best interest of the state's consumers:

not any individual or group such as a particular utilities' consumers. DEQ/NPPC proposes undertaking those public purpose programs that provide the greatest benefit for the citizens of Montana.

**Q. Can you provide an example where greater benefits may accrue from a statewide perspective?**

A. Yes. The extent and degree of poverty varies throughout the state. Some utilities serve a greater percentage of low-income consumers than others. The ability to allocate a scarce amount of low-income assistance to those locales where the need is greatest, unconstrained by utility boundaries, will maximize the low-income benefits from the state perspective.

**Q. What recommendations do you have to make to the PSC regarding the planning perspective for allocating public purpose dollars?**

**A. DEQ/NPPC recommends the PSC require MPC to take a statewide perspective when evaluating and implementing public purpose programs.**

**Q. Do you have any other comments regarding MPC's proposed public purpose allocations?**

A. Just one more. DEQ/NPPC agrees with MPC's statement regarding the need to transform many of the public purpose ventures to the competitive market and concentrate funding on those ventures that are not amenable to a market. Conservation and renewable programs are resource acquisitions and thus should be designed with the immediate goal of transferring them to the competitive market. However, MPC has not shown in its testimony that they are pursuing this transfer of resource acquisitions to the competitive market or set forth a time-table.

**DEQ/NPPC recommends the PSC require MPC to fund through public purpose dollars only those programs which are not amenable to a market.**

## **Large Customer Rebate**

**Q. Please provide additional explanation regarding MPC's proposal to redirect the yearly surplus LCR account into its own programs.**

A. MPC, in its transition plan states: "any excess amounts (from the LCR account) will be made available to support other public investments in the following year". This is contrary to SB 390. Section 22(2)(E) states: "If a utility's or a customer's credit for internal activities do not satisfy the annual funding provisions of subsection (2), then the utility shall make a payment to the Universal system benefits fund for any difference." Section 69-8-402(2)(e), MCA.

**Q. What type of expenditures by large customers qualify for a USBC credit?**

A. DEQ/NPPC believes the statute is clear on this topic. Section 22(7)(b)(i-ii) states qualifying expenditures are: expenditures that result in a reduction in the consumption of electrical energy in the customer's facility and those portions of power expenditures for the

acquisition or support of renewable energy or conservation-related activities. Allowing an expansion in the definition of the type of qualifying programs for large customers dilutes the quality of programs while significantly increasing the need for oversight and control.

**Q. What are your recommendations regarding the large customer rebate issues?**

**A. First, the PSC should require MPC to reallocate unexpended funds from the large customer rebate account to the universal system benefits fund. These dollars, consistent with SB 390, should be sent directly to the state fund.**

**Second, we recommend the PSC maintain a narrow interpretation on what types of public purpose activities qualify for credit.**

**Q. Does this conclude your testimony?**

A. Yes it does.