Appendix II – Electricity Regulatory Environment in Montana

To inform Missoula’s 100% Clean Electricity Options Report

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Appendix II is a compilation of background information that briefly explains the current status of Montana’s energy regulatory environment, especially as it relates to Missoula’s 100% Clean Electricity Initiative and the Investor Owned Utility, NorthWestern Energy.

We consider this a draft and seek input to ensure that it is both up-to-date and accurate. The primary 100% Options Report and all Appendices will be housed, along with a comment form, at missoulaclimate.org/100-percent.html. Please provide feedback via this webpage.

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Brief history from Montana Power to NorthWestern Energy

Electricity first came to Montana to light and power machinery in copper mines around 1880. The first electric utility was the Brush Electric Light and Power Company, formed in Butte in 1882. By the late 1880s several coal-fired electric generators were providing electricity in Butte and Helena. Hydroelectricity came to Great Falls in 1891 and to Helena in 1898, and as many as 40 municipal electric utilities were generating power from coal-fired steam generators and hydroelectric dams by the end of the 19th century. One of the largest economic interests involved in power production at the time was the holding company that owned the Anaconda Company and also owned a large stake in the Hauser hydroelectric dam on the Missouri River at Helena. After a flood and dam failure in 1908 that threatened reliable electricity supply to company smelters the owners of the Anaconda Company began to consolidate ownership of power generation plants in Montana.

The Montana Power Company was established in 1912 and embarked on a statewide acquisition program to purchase municipal and private utilities that continued until 1940. In 1913 the legislature created the Montana Public Service Commission and authorized it to oversee public utilities and transportation companies including the Montana Power Company, which was regulated as a vertically integrated utility monopoly authorized to own generation assets, transmission, distribution, and provide retail customer services.¹ The Montana Power Company developed many thermal and hydroelectric generation plants over the next 50 years and established an extensive network of electric transmission and distribution lines throughout the state.

In 1997 the Montana Power Company supported a legislative proposal to deregulate Montana utilities. After deregulation passed the legislature Montana Power divested its portfolio of generating assets, which were sold to PPL Montana, a Billings-based subsidiary of Pennsylvania Power and Light, and in 2000 the company sold its transmission and distribution business to NorthWestern Corporation, a Sioux Falls, South Dakota based company. Montana Power Company then restructured itself as Touch America Holdings and attempted to operate as a broadband telecommunications company but the effort failed and the company went bankrupt. NorthWestern Corporation’s utility subsidiary NorthWestern Energy, after struggling with bad financial management and deregulation-disrupted power markets, filed for bankruptcy in 2003. In 2004 a group of five Montana cities operating as Montana Public Power Incorporated attempt to buy NorthWestern Energy but NorthWestern directors rejected the offer. After a decade of financial mismanagement and utility failure to satisfy customers and regulators, the legislature rescinded deregulation in 2007 and NorthWestern Energy was allowed to become a vertically integrated regulated monopoly. The company began to acquire generation assets, first purchasing thermal generation assets from PPL and subsequently acquiring the PPL portfolio of 11 Montana Power Company hydroelectric dams.²

Relationship of the Public Service Commission to Investor Owned Utilities (NorthWestern Energy)

The Montana Public Service Commission was created by the legislature in 1913, originally as the Montana Railroad Commission. The Commission consists of five elected members, each representing an individual district for four year terms. The Commission regulates public utilities, common carriers, railroads, and other regulated industries under Title 69 of the Montana Code Annotated.³ Procedures

¹ http://deq.mt.gov/Energy/montanasenergy/MTEnergyHistory
² http://mtstandard.com/northwestern-energy-a--year-timeline/article_aed1e9fa-3c4a-5330-bc87-3f7bec5e6e0.html
³ http://leg.mt.gov/bills/mca/title_0690/chapters_index.html
and rules governing the Public Service Commission are organized under Department 38 of the
Administrative Rules of the State of Montana, Public Service Regulation. The Commission employs
professional staff in three divisions – Legal and Customer Assistance, Centralized Services, and the
Regulatory Division, all part of the Montana Department of Public Service Regulation. The Regulatory
Division staff is responsible for economic, technical, and public policy analysis of regulated public
utilities. Commission staff implements orders and advises Commissioners on tariff administration,
regional electricity transmission discussions, monitoring and enforcement actions of rules, orders and
other directives, document preparation, case management, as well as oversight of transportation and
pipeline safety. NorthWestern Energy is a regulated public utility supervised by the Public Service
Commission (PSC).

a. Rulemaking – Description and process

Proceedings before the PSC, including those related to operation of public utilities, are organized into
dockets that are subject to public review and participation. Dockets are composed of pleadings and
documents filed with the PSC, organized in public calendars that establish the Commission’s agenda for
dockets and other business and assign dates for docket submissions and public hearings. The
Administrative Rules of the State of Montana (ARM) sets out in detail all rules and procedures applicable
to dockets before the PSC. Rulemaking involves staff review of submissions from parties including
pleadings, motions, notice to parties, filing of complaints, prehearing conferences, settlements,
presiding officers, hearings, public comment, and proposed findings and conclusions based upon all
information submitted to or gathered by the Commission.

Commissioners review docket submissions, attend scheduled presentations in dockets, review analysis
from staff, and issue written public decisions and orders, including orders for rehearing and
reconsideration of arguments. As a part of docket submission procedures and public decisions and
orders Commissioners may establish protective orders, including orders for protection of confidential
information submitted during docket proceedings. Commission decisions and orders are subject to
court appeal under Montana and federal law.

b. Rate Cases – Description and process

A major component of utility regulation is PSC review and authorization of proposed rates for electricity,
charges for customer services, and allowable profit and recovery of investments compatible with utility
company regulated rates of return. Such review and authorization is handled in “rate case” dockets.
Rate cases before the Commission are initiated by a utility via submission of a letter of transmittal that
proposes a rate schedule that supersedes, supplements, or otherwise proposes to change the provisions
of an existing authorized rate schedule. The letter of transmittal must provide information under ARM
Chapter 38.5 and include, at minimum, a detailed statement comparing revenue from sales and services
under existing rate schedules with the cost of services under the revised rate schedule based on
comparison with a 12 month historical test year. The comparison must include detailed financial
analysis of the proposed return, taxes, depreciation, and operating expenses under the new rate, as well
as how the allocation of costs will relate to services. All such analysis must be presented in writing and
supported by accredited financial statements and projections that comply with accounting rules defined

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4 http://www.mtrules.org/gateway/Department.asp?DeptNo=38
5 http://www.mtrules.org/gateway/ChapterHome.asp?Chapter=38%2E5
under the ARM. Rate case dockets are public and open to intervenors including private parties and the Montana Consumer Counsel.

A critical component of a rate case docket is consideration of how the proposed rate change will affect the allowable regulated rate of return to the utility. Regulating utility rate of return on investment is a significant function of Commission, and rate cases must include detailed statements on cost of taxes, debt capital, preferred stock capital, and return on shareholder equity based on utility capitalization. Financial documentation statements are submitted in the rate case docket as working papers and statements, including papers on stock capital, stock dividends, stock par value and splits, bonds, taxes, depreciation, depletion, amortization, capital allocations, working capital, materials, supplies and fuel stocks, operating and maintenance expenses, allocated cost of service, and other financial considerations.

c. **Least Cost Planning**

A Public Service Commission function relevant to renewable energy mandates is its authority to implement least cost goals and policies established under the ARM Subchapter 38.5.201. The goal of this subchapter is to establish guidelines that encourage electric utilities to meet customer needs for reliable, efficient and adequate energy services at the lowest total cost possible while allowing a utility to remain financially sound, all within the authorized scope for PSC regulatory ratemaking review established by the legislature. This includes a specific mandate to address future demand and supply requirements while actively pursuing cost effective energy conservation and considering cost effectiveness in light of long-term social costs. Particularly relevant to the goal of achieving municipal greenhouse gas reduction targets by phasing out fossil fuel resources and integrating new renewable energy generation into the supply portfolio, the ARM guidance states “integrated least cost planning may demonstrate that, on the basis of overall societal costs, previously rate-based resources should be abandoned and replaced by new resources. In addition, least cost plans may show that it is in society's best interest for construction of a new resource to be abandoned in favor of some other resource option. If such situations occur, the commission will open separate proceedings in which it will determine how recovery of the undepreciated, rate-based capital cost will be accomplished.”

The regulations acknowledge that resource planning has a significant impact on the public and direct utilities to thoroughly document and present their judgement so that it can be reasonably understood by the commission and interested parties.

d. **Tariff filings**

Customer rate classes or tariffs may be established or changed during regular rate cases or in independent dockets. A new tariff proposal requires a written statement describing and supporting each new or modified customer class rate design, including a general discussion of the purpose and overall goals and a description of the billing impact for each customer class. Rate proposals may be brought forward by action of the legislature, by a regulated utility, or by an independent public or private intervenor. Within 20 days after receipt of an application for rate design changes the Commission may convene a conference of the interested parties to identify and clarify potential issues associated with the application. Rate design is subject to the broader concept of least cost planning that

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includes consideration of the influence of externalities that reflect the total societal cost of utility service.

**The role of Montana’s State Legislature**

The Montana state legislature is a representative body tasked with creating laws for the benefit of Montana citizens. Individual legislators work together to propose and enact laws related to all aspects of government function and many laws have been enacted that mandate or regulate energy and utility policy. Important examples include creation of the Public Service Commission in 1913, utility deregulation in 1997, passage of the renewable energy mandate in 2005, and utility reregulation in 2007. A more recent and modest example of energy-related legislation is the 2017 legislative requirement that the PSC study the ratepayer impact of state net energy metering policy.

Legislation proposed and passed by both houses of the legislature and subsequently signed by the governor become law in the state of Montana and is codified as part of the Montana Code Annotated (MCA), the compilation of all state laws. Since the legislature meets only every other year it is generally necessary that laws be implemented as detailed rules by delegating power to state agencies in the Executive Branch of government. Rulemaking is carried out by executive agencies such as the Public Service Commission under the authority of the Montana Administrative Procedure Act, which requires that proposed draft rules be subject to public review and comment prior to being adopted as part of the Administrative Rules of Montana. Rules adopted under the ARM are implemented by executive agencies, subject to legal oversight and challenge in Montana and federal courts of law. Finally, subsequent legislatures may eliminate or modify laws and regulations passed by previous legislatures and executive agencies.

**Energy and Telecommunications Interim Committee**

The Energy and Telecommunications Interim Committee (ETIC) is a legislative standing committee established by statute to maintain oversight over the Montana Department of Public Service Regulation and the Public Service Commission.\(^9\) The ETIC is composed of elected Montana legislators and maintains a professional staff, and is tasked under MCA 5-5-230 with maintaining an in-depth overview of the PSC and its activities, including oversight of laws, rules, budget, and implementation of programs. This includes authority to review administrative rules and proposed legislation, and perform program evaluation and monitoring of all phases of PSC operations. The ETIC conducts studies of utility operations and practices, including proposals for new legislation and consideration of innovative energy policies and management practices from the federal government and other states.

**Interactions with other State agencies**

a. **Department of Environmental Quality**

The Montana Public Service Commission has a broad mandate to regulate public utilities, including electricity and natural gas utilities. It shares regulatory authority with other state agencies including the Department of Environmental Quality (MDEQ). The MDEQ is tasked with an important element of the Montana constitution, the right of every Montana citizen to a clean and healthful environment. This mandate includes review of energy facility siting and permitting, public health and safety related to industrial and commercial activities, and environmental protection of air and water for future generations. MDEQ’s mandate is focused firmly on regulating the environmental permitting and impact

of energy producers and utility companies while the PSC mandate relates mostly to the economic impact to Montana citizens from the operations of regulated utilities and energy producers.

b. **Department of Natural Resources and Conservation**

The Montana Department of Natural Resources and Conservation (DNRC) manages state trust lands, water resource management, forestry and oversight of oil and gas operations. In addition to its land and resource management responsibilities DNRC oversees licensing and permitting of many land management activities, and is responsible, with the Department of Health Environmental Sciences, for analyzing and reporting to the Montana Board of Natural Resources and Conservation on the environmental impacts from proposed facilities for the generation, conversion, or distribution of energy. Analysis and reporting of energy project impacts is mandated under the Montana Major Facility Siting Act.\(^{10}\)

c. **Montana Consumer Counsel**

The other important Montana agency engaged in shaping energy and utility policy is the Montana Consumer Counsel (MCC), a part of the legislative branch of Montana government overseen by the Legislative Consumer Committee. The MCC was created under Article XIII, Section 2 of the Montana Constitution as adopted in 1972, to represent consumer interests in hearings before the PSC and other state and federal agencies with authority over utilities and transportation. The MCC employs a professional staff and consultants that participate in dockets and proceedings before the Montana PSC, Federal Energy Regulatory Commission, and Federal Communications Commission, participate in and monitor proposed legislation that may affect Montana consumer ratepayers in the Montana legislature and U.S. Congress, and engage in appropriate proceedings in state and federal courts.

**A description of Federal regulatory roles/authorities**

A number of federal agencies and statues influence policy and decision-making at the Montana state level. While the entire scope of federal influence is too broad to consider here there are five important agencies, laws and policies that influence Montana energy policy.

a. **Federal Energy Regulatory Commission**

The Federal Energy Regulatory Commission (FERC) is an independent federal agency within the Department of Energy created in 1977 to regulate the interstate transmission of electricity, natural gas and oil. FERC also oversees the permitting of proposed natural gas terminals and pipelines, and the licensing of hydroelectric power projects. The Energy Policy Act of 2005 confirmed and expanded FERC’s broad authority to regulate interstate transmission and wholesale sales of electricity; mergers, acquisitions and corporate transactions by electricity companies; review siting applications for electric transmission projects; license and inspect private, municipal and state hydroelectric projects; ensure the reliability of the high voltage transmission system; monitor and investigate energy markets; oversee environmental matters associated with electrical, natural gas and hydroelectric projects; and administer accounting and financial reporting regulations and conduct by regulated utility companies. FERC authority extends to regulated utilities and markets in Montana and to the hydroelectric generation and transmission projects owned and operated by NorthWestern Energy but FERC does not have any authority to regulate retail electricity sales or approve construction of electricity generation facilities.

\(^{10}\) [http://leg.mt.gov/content/Publications/Environmental/1985facilitysiting.pdf](http://leg.mt.gov/content/Publications/Environmental/1985facilitysiting.pdf)
besides hydroelectric dams, nor does it regulate municipal electric utilities or the operation of rural electric cooperatives.

b. **Environmental Protection Agency**

The Environmental Protection Agency (EPA) is a federal agency charged with overseeing the protection of clean air, land and water for citizens of the United States. The EPA is responsible for developing and enforcing federal regulations that protect air, land and water by preventing and regulating the discharge of harmful pollutants by industry, commercial operations and individuals. Regulations and permitting oversight by the EPA seeks to ensure compliance with federal laws that protect environmental health and safety, including laws and regulations that apply to clean air, water and waste storage by power generation facilities owned by electric utilities. EPA also works with state agencies that monitor and enforce state environmental protection laws and regulations. EPA and state environmental protection mandates protect air, water and land by preventing harmful discharges of pollutants from industrial and commercial electrical generation facilities. Enforcing standards for equipment and practices that prevent harmful discharges of toxic or otherwise harmful substances internalizes the cost of pollution by generation facilities, thus helping to account for the actual cost of producing power from polluting sources of energy and establishing an accurate cost baseline whereby non-polluting energy sources are able to compete fairly within the energy supply marketplace.

c. **Public Utilities Regulatory Policy Act**

Congress enacted the Public Utilities Regulatory Policy Act (PURPA) as part of the National Energy Act in 1978 to promote energy conservation and increase the supply and diversity of domestic energy sources. At the time PURPA was created large, monopoly utility companies operating in regulated markets under public regulatory oversight dominated the national utility marketplace. Regulated utilities were slow to adopt energy conservation and renewable energy generation so PURPA established a pathway for small, independent producers to gain market access for alternative energy projects. PURPA created a class of generators, termed Qualifying Facilities (QF), that were entitled to interconnection consideration and competitive purchase pricing based on the avoided cost to a regulated utility from the same amount of power that would otherwise have been purchased from the lowest cost provider displaced by the QF project. QF projects were limited to certain types of generation, such as renewable energy and small-scale waste recovery projects, and to maximum project sizes (80 megawatts).

As utility companies and territories nationwide have evolved into deregulated wholesale markets PURPA has been revised to apply only in those states, including Montana, which remain monopoly utility markets. PURPA is important in Montana as an avenue for small-scale distributed renewable energy projects to gain market access at competitive prices, although recent Montana PSC rulings have made it much more difficult for these projects to utilize the law. At the federal level the U.S. Congress is considering legislation that would further weaken the market access provisions in PURPA, increasing monopoly control over energy supply by regulated utilities such as NorthWestern Energy and curbing electricity supply diversity and market competition.

d. **Northwest Electric Power Planning and Conservation Act**

In 1980 the U.S. Congress passed the Pacific Northwest Electric Power Planning and Conservation Act, which directed Montana, Idaho, Oregon, and Washington to adopt regional long term power planning

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policies to ensure adequate, efficient, economic, and reliable power.\textsuperscript{12} The Act established the Northwest Power Planning and Conservation Council under 16 US Code Chapter 12H, to address and mitigate impacts on fish and wildlife affected by the system of hydroelectric dams on the Columbia River. The Act sets forth provisions that direct the Council and its professional staff to evaluate impacts related to selling power, acquiring resources, implementing energy conservation measures, and establishing rates for the sale and allocation of electric energy. In order to accomplish its mission the Council engages stakeholders in the region in developing regional plans and programs related to energy, conservation and natural resource management in the Columbia River system, including the Clark Fork River drainage in Montana. Each participating state appoints two members to the Council serving three-year terms, responsible for developing, updating and implementing the regional conservation and electric power plan.

\textbf{Utility Planning}

\textbf{a. Process and Documents}

Utility planning is regulated by the Public Service Commission, which is overseen by the Montana legislature’s Energy and Telecommunications Interim Committee. Utility planning is defined by Montana law and administrative rules. The operation of these laws and rules was reviewed by the ETIC in 2018 and the findings were compiled in a report to the legislature, “Least-Cost Integrated Resource and Electricity Supply Resource Planning.”\textsuperscript{13} It confirms that all Montana utilities are required to undertake long-term planning and clarifies that different planning requirements apply to each of the state’s major regulated utilities. While two different laws evolved to regulate utility planning, both require planning that considers the relationship between resource planning, energy procurement, and ratemaking. Further, all planning must consider environmental and social externalities in resource portfolio decision-making, competitive bidding, market uncertainty and risk, optimizing the balance between energy supply and demand, and public involvement by stakeholders.

\textbf{b. Integrated Resource Plans}

The Montana Integrated Least-Cost Resource Planning and Acquisition Act of 1993 (MCA 69-3-12) is part of Title 69 Chapter 3 of the Montana Code Annotated which provides for the regulation of Montana’s non-restructured utilities. The legislation was created in response to legal challenges of Montana Power Company’s investment in coal-fired generation at Colstrip that failed to provide for meaningful public participation or long-term energy supply planning. The Act established PSC authority to require the Montana Power Company and Montana-Dakota Utilities (MDU) to file integrated resource planning documents with the commission, affirmed that utilities could recover costs for investing in energy efficiency and other components of integrated resource plans, and eliminated duplication between PSC resource planning and requirements under the Major Facilities Siting Act. The Act also gave Montana DEQ and Montana Consumer Counsel the authority to review and comment on integrated resource plans. Standards established under the Act were codified under the Administrative Rules of Montana at 38.5.2001.

Integrated Resource Planning under the Act was in effect for all regulated Montana utilities until 1997 when the Montana legislature moved to deregulate utilities operating in the state. While MDU continued to operate under existing law, deregulation triggered a chain of events that resulted in the

\textsuperscript{12} https://www.nwcouncil.org/media/5227150/poweract.pdf

sale and bankruptcy of the Montana Power Company and the establishment of NorthWestern Energy as the successor utility to Montana Power. Consequently, NorthWestern is regulated as a “restructured” utility subject to MCA Title 69, Chapter 8 while MDU is regulated as a “non-restructured” utility subject to MCA Title 69, Chapter 3.

c. **Electricity Supply Resource Procurement Plans**

In 2002 the Montana legislature initiated proceedings to address new rules for default energy supply resource planning in the deregulated energy market served by NorthWestern Energy. Risk and uncertainty under deregulation created financial challenges for the company so NorthWestern Energy worked with the legislature to create new rules authorizing PSC-approved resource procurement planning that ensured investments by the utility could be recovered from ratepayers under long-term contracts. Consumer group opposition to guaranteed cost recovery failed to derail the proposed legislation and in 2003 legislation passed that implemented a new policy for electricity supply resource procurement planning process and cost preapproval. When the legislature subsequently moved to repeal deregulation and allow default energy supply providers to reacquire generation assets, NorthWestern Energy successfully persuaded legislators to expand planning and preapproval to include PSC review and authorization of new power generating facility cost recovery. The authorization requiring that NorthWestern Energy present Electric Supply Resource Procurement Plans to the PSC for approval was adopted as part of the Electric Utility Industry Generation Reintegration Act of 2007. Today the PSC simply comments on the resource plans and does not formally approve or deny them.

**Synopsis of current Utility procurement plans**

NorthWestern Energy submitted an Electricity Supply Resource Procurement Plan to the PSC in 2015. The plan evaluated NorthWestern’s perceived need for new energy supply and proposed significant investments in new natural gas generating capacity subject to cost recovery from utility rate payers. It evaluated the benefits of energy conservation, demand reduction, energy efficiency, renewable energy, and energy storage as part of the resource planning process. As per the legal standards set out for resource procurement planning the proposal was subject to public review and participation in the planning docket.

The PSC, other public agencies, and the general public reviewed the NorthWestern Energy plan and identified areas where it did not adequately consider potential benefits of expanded energy conservation, efficiency investments and demand reduction policies. Public reviewers and the PSC also identified where the plan failed to adequately consider the potential cost and environmental benefits of greater investment in renewable energy and energy storage. The PSC found that there was insufficient public access to and participation in the planning process. In 2017 the PSC determined that the NorthWestern plan was inadequate and did not authorize any asset acquisitions under the plan. Instead it advised NorthWestern to amend the plan with greater consideration of conservation measures, consideration of additional renewable energy assets in the supply portfolio, and improved public process. The PSC extended the deadline for NorthWestern to prepare and submit a revised plan, to December 2018.

The need for balancing NorthWestern Energy’s preference for natural gas assets with other clean energy options was articulated by the Public Service Commission when it directed NorthWestern to broaden its

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stakeholder outreach to include more comments on how the desired energy supply mix might comply with least-cost energy supply planning criteria including conservation measures and social considerations.

NorthWestern Energy resource procurement plans are subject to review on a two year cycle. Public comment on the Resource Procurement Plan is mandated under PSC and resource planning legislation. Interested parties may file comments and testify before the PSC after a plan has been submitted. The PSC does not approve or reject the plan, but rather Commission has nine months after a plan is filed to respond with its own comments.