



Montana Public Service Commission

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The Honorable John D. Dingell, Ranking Member
Commerce Committee Democratic Office
564 Ford House Office Building
U.S. House of Representatives
Washington, D.C. 20515

Dear Representative Dingell:

Enclosed please find the Montana Public Service Commission's responses to the questions included in your April 10, 1997 letter. We hope our responses will be helpful as the Committee examines electric industry restructuring issues and considers federal legislation. If any of our responses are unclear, or if you would like additional information, please don't hesitate to contact us.

Sincerely,

A handwritten signature in cursive script that reads "Dave Fisher".

Dave Fisher
Chairman

enclosure

1. *Has your Commission or State legislature considered or adopted retail competition? If retail competition is occurring at this point, what effect has it had on consumer prices.*

Attached is a copy of Montana Senate Bill 390 which was passed by the 1997 legislature and signed by the Governor. This legislation requires electric utilities to implement full retail competition by July 2002. As retail competition is not now occurring, its effect on consumer prices cannot be determined.

2. *Has your state asked Congress to enact legislation mandating retail competition? Has it sought Congressional action to enable or assist it in adopting retail competition? Has it requested or recommended any other type of Congressional action.*

No.

3. *Does your Commission currently have sufficient authority to resolve stranded cost issues in the event Congress enacts legislation providing for retail competition by a date certain? If not, what timing and other problems might ensue? What could Congress do to address any such problems?*

In the attached copy of Montana Senate Bill 390 the Commission's authority regarding resolution of stranded cost issues is addressed in section 12. Senate Bill 390 provides sufficient authority to resolve stranded cost issues.

4. *Are there any other areas in which your State currently does not have the necessary authority to address issues arising from federal legislation mandating competition, or repeal of the Public Utility Holding Company Act of 1935 (PUCHA) or the Public Utility Regulatory Policies Act of 1978?*

The Montana Public Service Commission cannot assess whether it lacks authority to address issues under federal legislation mandating competition without reviewing what the Congress might pass. Montana Senate Bill 390 mandates competition and grants the Commission authority to deal with issues arising from competition. On repeal of the PUHCA or PURPA, the Commission would not lose any authority it presently has. Whether it would lack authority to address issues arising from the repeal is speculative

5. *Would any constitutional issues be raised by federal legislation:*
 - a. *mandating that states choose between adopting retail competition by a date certain and having a federal agency preemptively impose retail competition?*
 - b. *requiring states to conduct a proceeding on retail competition, reserving to the states discretion not to adopt retail competition if they determine doing so would not be in its consumers' best interests?*

This question is moot since Montana has already enacted Senate Bill 390 mandating adoption of retail competition by a date certain. The Commission is already required to conduct a proceeding on retail competition. There is no possibility of exercising an option not to adopt competition based on a finding that it would not be in the consumers' best interests.

6. *From a practical standpoint, what problems would arise if congress adopted legislation mandating retail competition which did not grandfather prior state action?*

An answer to this question depends on the nature of the legislation adopted by congress and when this legislation is passed. Montana will soon begin implementing retail competition according to the provisions of Montana Senate Bill 390. To the extent legislation adopted by Congress differs from Montana Senate Bill 390, and depending on how far along Montana is in implementing its own legislation, problems could arise with respect to any or all aspects of electric restructuring, including the date by when customers can choose, utility recovery of stranded costs, scope and manner of state regulation of utilities, market structure and effectiveness and environmental and social considerations.

7. *In hearings before the Energy and Power Subcommittee during the last Congress, some witnesses took the position that Congressional legislation mandating retail competition is necessary to protect the interests of small and residential customers. This was based on the assertion that large industrial customers are able to negotiate lower rates with state utility commissions, and that the incidence of such rate reductions is on the increase.*

- a. *Are you aware of any study or analysis relevant to your State that supports this conclusion?*

We are not aware of any Montana specific analysis that addresses this issue. Historically, large industrial customers have advocated specific rates, either for themselves or for their class, in the context of general rate filings before the PSC. In 1993 the PSC allowed Montana Power Company to implement an electric industrial retention/interruptible (EIRI) rate for a phosphorus reduction plant. That plant has since shut down and the rate is no longer applicable. In 1996 the PSC approved a negotiated rate between Montana Power Company and a newly attracted industrial customer. The negotiated service terms and prices were approved based on a PSC finding that the Company's other ratepayers will be, at a minimum, unharmed by the rates charged to the new load.

- b. *Please provide any information you can on the historical relationship between residential and industrial rates, the extent to which one customer class has subsidized another, and whether or not this trend has altered in recent years.*

A complete answer to this question would require a clear definition of the term "subsidized." In designing electric rates, the Montana PSC relies on economic costs. Economic cost-based rates use marginal, avoidable and opportunity cost concepts to establish prices. It is the Montana

PSC's policy to set prices for all customer classes that cover economic costs. Such prices may or may not cover embedded (accounting or book) costs. Historically, rates charged to industrial class customers have tended to be less than those charged to the residential class.

8. *Although electricity rates vary widely within the U.S., they have fallen recently in some parts of the country. Please provide any information you can about rate trends in your state, and how they affect various customer classes.*

Based on information in NARUC's publication *Residential Electric Bills Summer 1995*, the weighted average (based on residential customers served) residential rate for Montana Power, Montana Dakota Utilities and Pacific Power and Light is 5.5948¢ per kwh. The weighted average rate for these utilities five years ago (summer 1990) was 5.264¢ per kwh. Therefore, residential rates in Montana have increased about 6 percent since 1990. These figures cover nearly all residential customers served by PSC-regulated utilities but do not reflect rates charged by cooperative utilities which serve about one quarter of all Montana's electricity customers. Information on the trend of commercial and industrial rates is not readily available. Such information could be provided but, due to staff resource constraints, additional time would be needed.

9. *Some proponents of retail competition hold the view that all electricity resources should be sold at a market price and that state authority to regulate retail rates should be eliminated. How would such a policy affect shareholders and ratepayers? What mechanisms could states or Congress employ to manage these issues? In a restructured electric industry, who should receive the benefits of these low-cost resources -- utility ratepayers, utility shareholders or the highest bidder?*

This question appears to suggest the potential for the complete elimination of all retail regulation of electricity service. However, it is widely accepted that a vertically integrated firm within the industry typically has three separable production functions: generation (production, or supply), transmission and distribution. Montana's Senate Bill 390 eventually eliminates regulation of the price of retail electricity supply--regulation of transmission and distribution service continues and even suppliers will, at least initially, be subject to licensing and other regulatory requirements. Additionally, there is not now, and probably never will be a single market price for generation. Although there may be "a" tariffed price for "all" electricity resources, such market prices have yet to evolve. With this preliminary statement, answers to each of the specific questions in number nine follow.

How would such a policy affect shareholders and ratepayers?

Assuming markets are not competitive, but retail regulation is eliminated, one would predict monopoly firms to exercise market power. For investor-owned utilities, and other things being equal, shareholder earnings would rise, and ratepayers would pay higher prices. Of course, there is some strategic behavior that would counsel against predicting the extraction of maximum

consumer surplus. The behavior of Montana's utilities would not be the exception to these predictions. If other things are not equal, and if competitive markets exist, this response changes. More specifically, under Montana's Senate Bill 390 customers exercising choice in Montana will pay for some of an investor-owned utility's stranded costs. One of Senate Bill 390's goals is to insulate shareholders from lack of recovery of stranded costs. How much insulation depends on market prices used in future rate cases to set transition charges.

What mechanisms could states or Congress employ to manage these issues?

Congress could enact legislation that prohibits the elimination of retail regulation until a state commission has deemed markets to be sufficiently competitive. There should be no absolute sunset of retail regulation before workable competition is deemed to exist in a market.

In a restructured electric industry, who should receive the benefits of low-cost resources -- utility ratepayers, utility shareholders or the highest bidder?

We assume by "restructured" absolute deregulation of all retail regulation is intended and that by "low-cost" the intent is reference to a resource for which market prices exceed the otherwise allowed ratemaking cost. We also assume that despite restructuring there is some sort of transition that permits recovery of utility stranded costs as alleged and as modified by any intervening state Commission adjustments.

To answer the question one must consider how high cost resources are treated. One needs to balance high cost and low cost resources. Therefore, who should be burdened with high-cost resources? Clearly, all high-cost resources are not logically the burden of ratepayers. For logical reasons, Montana Power Company's (MPC) shareholders should be responsible for a share of all above cost Qualifying Facility (QF) contracts as they are for MPC's own generation resources. Similarly, the benefits of low-cost hydro resources should be shared. If, however, all high-cost resources (QF, conservation and owned generation) are the burden of ratepayers, and not shared, fairness would call for all benefits, to the extent there are any, of low-cost resources to flow only to ratepayers.

10. *Of those states which have adopted retail competition, how many have addressed the issue of "reciprocity", (that is, whether or not the state can bar sellers located in states which have not adopted retail competition from access to its retail markets)? Whose interest does a reciprocity requirement affect? Is a reciprocity requirement the only way to protect those interests, or are there alternatives? Would such an arrangement raise constitutional issues?*

Montana's Senate Bill 390 addresses reciprocity in Section 28. Montana Power Company has asserted that this reciprocity provision is needed to ensure that the Company is not placed at a competitive disadvantage in regional markets. Therefore, reciprocity appears to affect utility shareholders' interests. To the extent reciprocity requirements act as barriers to the entrance of

competing suppliers or preserve an incumbent utility's market power, consumers' interests may also be affected. From a workability perspective, there may be issues associated with monitoring and enforcing reciprocity provisions. The Montana Commission has not studied alternatives to reciprocity. The Commission leaves to the courts any determination of whether these provisions are constitutional.

11. *If Congress were to require unbundling of local distribution company services as part of a retail competition mandate, what practical problems might this present to state regulators?*

As a preface to this answer, please be aware that the Montana Commission believes that unbundling generally produces more customer choice. Also, if implemented properly, unbundling of local distribution services may increase economic efficiency and lower costs and prices. A potentially significant practical problem with unbundling local distribution services may be with customer understanding and acceptance. At present, this may be true in Montana because electric and gas utility customers soon will have customer choice for energy supplies. If one overlaid on top of this customer choice for meter reading and billing, line extensions and other distribution services, customers may be overwhelmed with too many decisions at the same time. An easy fix for this dilemma is to implement the unbundling of distribution services before choice for energy supply is implemented. Implementation on or before the year 1999 would give owners of distribution facilities and state public service commissions a chance to develop conventions and guidelines for potential suppliers of distribution services.

12. *Does your Commission face particular problems in connection with public power or federal power in an increasingly competitive electricity market?*

Bonneville Power Administration (BPA) has a presence in western Montana. A regional group is evaluating the problems associated with BPA and working on regional oversight of transmission in the form of an independent grid operator called IndeGO. The Commission does not regulate public power.

13. *How would federal legislation mandating competition by a near term date certain affect funding needs for your Commission? If additional funding were needed, would it be available, and what problems might arise if it were not?*

The Montana Commission believes that it could implement federal legislation without additional resources if it were similar to the Montana legislation, which provides for choice to small Montana Power Company customers by 2002. If the federal legislation included significant reporting requirements or other requirements that exceeded those of the Montana legislation, then additional resources may be needed. For example, if the Montana Commission were to oversee the simultaneous movement to choice by all Montana utilities, including cooperatives, one or more additional staff persons may be needed. Funding could be available if approved by the

Montana Legislature, which will meet in January, 1999. State "general funds" are not affected by the Commission budget, because it is funded by a flexible tax on regulated utility gross revenues.

14. *Has your Commission considered or adopted securitization plans as a means of providing for recovery of utility stranded assets? What risks are inherent in this approach, and who bears them.*

Montana's Senate Bill 390 contains a section on transition cost financing. The risk of stranded assets which have been securitized is shifted from the utility to the ratepayer. Once bonds have been issued, ratepayers are committed to repayment of the principal and interest on the bonds, even if subsequent events show that the bonded amount of stranded costs was set too high.

15. *There is a wide divergence of opinion as to whether or not PUCHA should be modified or repealed. Given the record level of merger activity, this question may become significant for all state regulators, whether or not they currently have regulatory responsibilities relating to registered holding company activities.*
- a. *Do you believe PUCHA impedes competition, at the wholesale or retail level? Can "effective competition" be achieved regardless of whether Congress enacts changes to PUCHA?*
- b. *Do you believe Congress should modify or repeal PUCHA? If so, why, and under what if any conditions?*
- c. *Should Congress enact legislation to modify the holding in Ohio Power Co. V. FERC, 954 F.2d 779 (D.C. Cir. 1992)?*

As a member of the National Association of Regulatory Utility Commissions (NARUC), the Commission supported the NARUC resolution adopted March 4, 1993 and reported in the NARUC Bulletin, No. 10, 1993, pp. 11-12, captioned "Resolution Supporting Legislation to Clarify Jurisdiction of Federal and State Commissions Concerning Regulation of Investor-owned Electric Utilities Serving Retail Ratepayers." In this Resolution, NARUC noted that the amendments to PUHCA from the Energy Policy Act of 1992 did not address the issues of (1) State public utility commissions' review of the reasonableness of wholesale purchases by electric utilities that serve retail ratepayers; (2) jurisdiction of State regulatory commissions over intrastate wholesale power transactions by electric utilities serving retail ratepayers; (3) authorization of State commissions to engage in regional integrated resource planning for registered holding company utility systems; and (4) clarifying the roles that the SEC, FERC and State commissions will assume in regulating the terms and conditions of wholesale contracts entered into by electric utilities that serve retail ratepayers as well as diversification of economic activity by utilities. Therefore, NARUC resolved that it supported efforts to examine these issues and enact necessary legislation. The Commission believes that these same issues must be addressed in repeal or any modification of PUHCA.

In NARUC Resolution adopted March 1, 1995 captioned "Resolution on Legislation to Change The Public Utility Holding Company Act of 1935" (adopted March 1, 1995), NARUC resolved that any legislation to change PUHCA should wait until the SEC has completed its investigation and released its findings on its investigation of the implications of repeal or change to PUHCA. NARUC believed that any PUHCA legislation should ensure that the States' authority to regulate utility holding companies is not preempted or restricted, including State review of requests for diversification and State requirements that holding companies place non-utility businesses in separate subsidiaries. NARUC wanted to assure that States continue to have authority to regulate interaffiliate transactions and to require divestiture of utility businesses, if necessary. The States must have the opportunity to fill any regulatory gaps in State laws and secure adequate regulatory resources, before repeal or change of PUHCA's provisions related to diversification, interaffiliate transactions, securities issuances, mergers and acquisitions. PUHCA legislation, or its repeal, should establish a State right of access to all books and records. As soon as these elements are assured for the States, the NARUC resolution posed that the elements of PUHCA that are redundant at the State level should then be repealed.

To answer the questions, the Commission would have to devote much staff time to evaluation. NARUC has addressed the components of possible change and repeal of PUHCA in its resolutions and continues to monitor PUHCA in light of impending competition. PUHCA would appear to impede competition at the wholesale, not retail, level, in allowing the SEC to approve prices for coal or other energy commodities. Retail intrastate competition would be only indirectly affected. "Effective competition" could probably be achieved despite PUHCA, but this assumption is only speculative. The Commission has not formulated a position on the repeal of PUHCA, but will follow closely the evaluations by NARUC in making its determination. The holding in Ohio Power, Company v. FERC, would probably be part of the evaluation, as it allows the SEC to approve and establish the price of commodities such as coal, even if FERC (or the States?) determines that the SEC price (sold by an affiliate to a registered utility holding company or its subsidiary) exceeds the market price.