



# Energy and Telecommunications Interim Committee

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## 58th Montana Legislature

### SENATE MEMBERS

ROYAL JOHNSON  
DON RYAN  
EMILY STONINGTON  
FRED THOMAS

### HOUSE MEMBERS

DANIEL FUCHS  
DAVE GALLIK  
GARY MATTHEWS  
ALAN OLSON

### COMMITTEE STAFF

MARY VANDENBOSCH, Research Analyst  
TODD EVERTS, Staff Attorney  
REBECCA SATTLER, Secretary

# MINUTES

Date: June 9, 2004

Isabel Bills Community Learning Center, Colstrip, Montana

Please Note: These are summary minutes. Testimony and discussion are paraphrased and condensed. Committee tapes are on file in the offices of the Legislative Services Division. **Exhibits for this meeting are available upon request. Legislative Council policy requires a charge of 15 cents a page for copies of the document.**

### COMMITTEE MEMBERS PRESENT

SEN. ROYAL JOHNSON  
SEN. DON RYAN  
SEN. FRED THOMAS

REP. ALAN OLSON (Chairman)  
REP. GARY MATTHEWS  
REP. DAVE GALLIK

### COMMITTEE MEMBERS ABSENT

SEN. EMILY STONINGTON  
REP. DANIEL FUCHS

### STAFF PRESENT

MARY VANDENBOSCH, Research Analyst  
CYNTHIA A. PETERSON, Secretary

### VISITORS

Agenda, Attachment 1.  
Visitors' list, Attachment 2.

### COMMITTEE ACTION

- The ETIC voted to not consider the legislation proposed in LC1010.

### BUSINESS

- **Call to Order**

The June 9, 2004, Energy and Telecommunications Interim Committee (ETIC) meeting was called to Order by Chairman Alan Olson at 8:20 a.m. in the Isabel Bills Community Learning Center Library, Colstrip, Montana.

- **Roll Call**

The secretary noted the roll (Attachment 3).

- **Approval of Minutes**

The minutes of the March 25, 2004, ETIC were approved.

## **WELCOME AND INTRODUCTIONS**

Mr. John Williams, Mayor of Colstrip, and Mr. Jim Nygaard, Superintendent of Schools, welcomed the ETIC to Colstrip.

## **UPDATES**

- **Governor's Task Force**

Chairman Olson reported the Governor's Task Force had their final meeting on May 24, and ring-fencing was the last issue addressed by the Task Force. Chairman Olson submitted a copy of the Task Force's discussion and the principles it used to adopt ring-fencing recommendations (EXHIBIT 1).

In addressing Building Codes, Chairman Olson stated the Task Force is recommending the Department of Labor and Industry (DOL) adopt the 2003 International Energy Conservation Code. Chairman Olson reported the Task Force rejected implementing a mobile home replacement program, but instructed the Department of Environmental Quality to monitor development of mobile home replacement programs in other states. Chairman Olson submitted a copy of "New Energy Code for Residential Buildings in Montana Consumer Cost-Effectiveness Analysis," dated January 30, 2004 (EXHIBIT 2).

- **Public Service Commission—Commissioner Greg Jergeson**

Mr. Greg Jergeson, Commissioner, Montana Public Service Commission (PSC), provided the ETIC with an update on telecommunications. Comm. Jergeson stated the telecommunications industry has many companies and a lot of players. Comm. Jergeson stated there are very few customers who use only one telecommunication company. Comm. Jergeson identified inter-carrier compensation and who pays the costs as a major source of contention between the companies, as well as a focus of the PSC. Comm. Jergeson stated other issues such as designation of eligible telecommunication carriers for distribution of Universal Service Funds or the establishment of extended area of service relate back to how companies are compensated for telecommunication services. Comm. Jergeson stated a roundtable workshop with all the

players is scheduled for June 29, 2004. The PSC has submitted comments to the Federal Communications System on how voice-over-internet protocol (VOIP) should be handled. Comm. Jergeson explained the people who have developed VOIP technology claim they are not standard telecommunications companies and should not be subject to the same regulatory regimes as other telecommunication companies. Based on comments made to the Federal Communications System, Comm. Jergeson suggest these issues should be sorted out.

In addressing energy, Comm. Jergeson reported the PSC is analyzing the Electricity Supply Procurement Plan submitted by NorthWestern Energy (NWE). The PSC is attempting to analyze the plan and has hired a consultant to assist with the analysis. Comm. Rowe and Comm. Jergeson both held public meetings in their districts, so NWE could present its plan and the public could ask questions. The PSC will submit comments to NWE about the strengths and weaknesses of the plan, and Comm. Jergeson identified implementation of the plan as critical as NWE brings the procurement contracts they negotiate to the PSC for approval. The Basin Creek Facility is the first plan NWE brought before the PSC. Comm. Jergeson stated the PSC is anxious to get through the process within the time frame requested by the Legislature, but is struggling with several issues that could lead to regulatory delay. Comm. Jergeson suggested issues of contention between NWE and other companies operating in the energy field could lead to regulatory delay.

- **Questions from the Committee**

Rep. Gary Matthews asked if Ronan Telephone had filed suit against the State of Montana and the PSC and requested an update on the litigation. Comm. Jergeson responded the PSC is frequently the subject of many lawsuits. Mr. Steve Vick's understanding is the action is not a lawsuit, but rather an appeal of a decision.

Sen. Royal Johnson inquired about the Basin Creek Facility and whether in the procurement process they had shown the kind of cost they think the gas will be. Comm. Jergeson replied staff is reviewing the numbers, and overall a major issue to deal with in analyzing natural gas generated electricity facilities is what is happening to the cost of fuel. Comm. Jergeson suggested there are advantages to natural gas generally because it is clean and easy to turn on and off, which enables them to meet peak power loads easier. Comm. Jergeson noted while the startup costs up front are not high, the high cost of fuel has reached new levels.

Sen. Johnson recalled plans being discussed during the 2003 Legislature to move gas from Cut Bank and wondered if that was still part of the program. Comm. Jergeson did not have any knowledge of moving gas from Cut Bank.

Sen. Fred Thomas was concerned that the next new generation project to be approved under default supply would be a natural gas-based generation. Sen. Thomas recalled in the past, the PSC turned down very economical projects based on coal and wind, but is now considering natural gas. Sen. Thomas thought the PSC was moving in the wrong direction and suggested coal and wind were the right track. Comm. Jergeson agreed with Sen. Thomas's concerns, and responded the PSC has to take NWE's proposals in the order in which they are presented. Comm. Jergeson cited one of the problems with wind is how the back it up when the wind is not blowing, but the demand is still present. Comm. Jergeson stated he is interested in exploring compressed air storage as a backup. Comm. Jergeson suggested using old stripper wells to store air.

Sen. Thomas inquired whether the PSC could reject proposals based on pricing or whatever reasoning the PSC wants to use. Comm. Jergeson replied there are a number of factors which need to be looked at. Comm. Jergeson identified coal as an efficient source of electricity cost wise, and is efficient when it is operated to meet baseload. However, coal is not conducive to meeting peak load. Comm. Jergeson noted that while technology may be improving which would enable coal to better meet peak load, that technology is not available.

Sen. Ryan wanted to know what factors are available to the PSC to reject a contract. Comm. Jergeson identified cost, whether the source matches load, and the mix of energy resources that would facilitate additional power resources in Montana as key elements.

Sen. Ryan asked if renewability was a factor the PSC would consider. Comm. Jergeson replied the procurement rules adopted by the Legislature refer to a mix of sources, including renewables.

Rep. Dave Gallik asked if Basin Creek was the only thing being reviewed with regard to the default supply portfolio. Comm. Jergeson replied it is the only one at this point, although he expects Thompson River and Tiber Dam to be coming in shortly. Rep. Gallik asked if there was any equity or debt investment in Basin Creek by NWE or any of its affiliates or subsidiaries. Comm. Jergeson replied not as far as he knows.

Sen. Thomas recalled the law requires a utility to offer a green power product and was curious whether it had ever been implemented by NWE and the PSC. Comm. Jergeson had very little information about green power, but thought the NWE and PSC were committed to offering green power, but did not know where the power would come from.

- **Other–Staff and Committee Members**

Ms. Mary Vandenbosch, Legislative Research Analyst, announced that the Environmental Quality Council (EQC) is circulating draft reports and recommendations for public comment, and comments on the EQC Energy Policy Subcommittee report are due June 30. Ms. Vandenbosch explained one of the Subcommittee's recommendations was to requests a bill draft changing the loan eligibility amount for alternative energy systems from \$10,000 to \$40,000 and to make non-profits eligible for alternative energy system grants. Ms. Vandenbosch further explained EQC established an adjudication funding alternatives working group which is looking for alternatives to pay for the adjudication of water rights on a more timely basis. One of the alternatives the working group is considering is a fee for beneficial use of water, which would include hydroelectric plants.

***(Tape 1; Side B)***

Ms. Vandenbosch reported the Energy Policy Subcommittee is concerned about how the General Agreement on Trade and Services could affect Montana's energy policy. Ms. Vandenbosch reported DOL is moving forward with adopting new building codes and will be holding a public hearing on July 9, 2004. DOL is proposing to adopt the International Building Code, and the Governor's Task Force is recommending adopting the two additional provisions contained in Exhibit 2.

**DEVELOPMENT OF OTTER CREEK TRACTS**

- **Mike Gustafson, Wesco Resources**

Mr. Mike Gustafson and Mr. Doug Day, Wesco Resources, submitted a summary of written testimony pertaining to Development of the Otter Creek Tracts (EXHIBIT 3). Mr. Gustafson submitted a list of pro-active initiatives the State of Montana could implement that would expedite the development of coal (EXHIBIT 4). Mr. Gustafson solicited discussion from the ETIC regarding these proposed initiatives.

Sen. Thomas recalled the intent of legislation in the last session was to get assets ready to lease and wanted to know where they were in the process. Mr. Gustafson replied the question is now that the State of Montana owns the assets, how much does it really know about them. Mr. Gustafson thought there was very little reliable coal-quality data available, and suggested the program should provide a certain level of understanding in terms of reserves and coal volume. Mr. Gustafson directed the ETIC to Exhibit 3, Attachment E.

Chairman Olson wondered if the tracts had been put out for bid and leased. Mr. Gustafson replied they had not. Chairman Olson asked if it was normal procedure to get a prospecting permit before the leases are owned. Mr. Gustafson explained the State of Montana owns the assets and thought it would be prudent for the owner to be knowledgeable about the assets and would want to enhance the value of the assets before going out for competitive bid. Chairman Olson noted it strays from the norm that if you are going to lease a property for mineral development, you lease it and then do your prospecting. Mr. Gustafson replied there is no question that in the past the State has established a minimum bid, DNRC makes a recommendation to the Land Board, and the Land Board puts it up for competitive lease for a term with minimal development requirements. Mr. Gustafson suggested changing the mind set in terms of how the State of Montana should dispose of its assets to ensure timely development and to maximize the benefits. Mr. Gustafson thought it was a question of whether the State of Montana wants to be passive or proactive, and noted the decision rests with the Legislature and the Governor.

Sen. Thomas recalled that in the legislation that was passed last session, the legislature wanted to determine what the assets were in the ground, and the data would be available to anyone who wants to bid on a future lease.

Rep. Matthews recalled the State of Montana had to do an Environmental Impact Statement (EIS), and the person who goes into the project had to do another EIS. Rep. Matthews recalled the first EIS was eliminated.

Sen. Johnson stated the State of Montana acquired the property because of an exchange because the property had some value, and asked how they are supposed to know whether there is coal on the property. Mr. Gustafson explained the Otter Creek Tracts 1, 2 and 3 were defined by the Bureau of Land Management in a regional Powder River Basin study performed in 1984, and these three tracts were recommended to be made available for federal leasing. Mr. Gustafson explained a certain level of assessment was required based on existing data at the time. Mr. Gustafson knows there is coal located on the property, but identified the real issue as the quality of the coal. Mr. Gustafson stated the Bureau of Land Management (BLM) along with the United States Geological Survey (USGS), and various other environmental agencies, identified Otter Creek Tracts 1, 2 and 3 as suitable for mining. The State of Montana has the option to take \$10 million in minerals. Mr. Gustafson suggested the ETIC take a look at

the work done under the Racicot administration in 1998 in making the determination. Mr. Gustafson explained there is a question of how to reach an evaluation of \$10 million. Mr. Day added there has been some level of drilling in the past, so there was quite a bit of drill-hole data in the intervening sections, but very little coal-quality data.

Sen. Johnson wondered if coal-quality data could be obtained from a drill hole or whether part of the surface had to be removed and tested. Mr. Day explained when a drill rig moves on site and is able to get a good sample of the coal, it will drill a hole and do various tests to define the limitations of the coal, and then drill a core hole and take a sample of the coal to determine specifications. Mr. Day explained the first step has been done, but in most cases a core sample was not taken and sent to a laboratory. Mr. Gustafson added sizeable bulk samples will have to be utilized in certain boilers to determine quality.

Sen. Johnson asked if everyone will have access to the data, and Mr. Gustafson stated they would. Sen. Johnson referenced Exhibit E and wondered why a company would want the State of Montana to have an \$800 million potential liability. Mr. Gustafson replied it was his understanding the State of Montana did not have full faith and credit, and stated it is trying get the cost of money. Mr. Gustafson recalled the \$500 million for transmission and \$200 million for rail transportation, and another \$100 million had to do with the Crow Tribe. Chairman Olson disagreed and stated it was \$800 million to develop Montana's coal resources and nothing was specific to the railroad or the Tribes. Sen. Johnson identified this as an important fact and the State of Montana should be preparing to say it is not going to issue that amount of bonds. Mr. Gustafson replied the concept was to attempt to reduce the cost of money, and it would not kill the project, and noted other states are doing the same thing. Mr. Gustafson stated the State of Montana owns the assets and has a high-fiduciary responsibility to inventory all the assets and be proactive in making the assets available to the industry and groups that may be willing to take a development risk. Mr. Gustafson identified an agreement between the State Land Board and the Northern Cheyenne Tribe as being a cloud over the property. Mr. Gustafson identified the lack of clarity and the inability to quantify, and how it may or may not impact risk, as a very difficult problem.

Rep. Gallik inquired if Mr. Gustafson was talking about bonding-type legislation or if there were other potential private partnerships with regard to transmission, rail, and other infrastructure. Mr. Gustafson explained he was suggesting the broadened scope of inquiry on the part of the State of Montana, and may want to seek assistance, and was not specific to any bond.

Rep. Gallik inquired what their consortium is looking like as far as public participation other than the leasing of the potential tracts. Mr. Gustafson replied they have been focused on resource evaluation and resource aggregation. Mr. Gustafson suggested looking at water and charting out a flow so any potential investor will understand the time lines involved in the regulatory process by a state agency.

Rep. Matthews asked if Wescor had spoken with the Northern Cheyenne Tribe. Mr. Gustafson replied they have spoken with individual members only.

Sen. Thomas asked how long it will take to inventory the cultural resources. Mr. Rich Atkinson replied it would take place this summer. Sen. Thomas wanted to know when the Department of Natural Resource and Conservation (DNRC) could consider permits. Mr. Gustafson replied that was up to DNRC and the State Land Board.

Sen. Johnson noticed there are seven bullets on Exhibit E, and asked Mr. Gustafson if his company had attached a number to each one of the bullets. Mr. Gustafson replied it had not, and Sen. Johnson requested him to do so. Mr. Gustafson replied the fixed cost is already available.

*(Tape 2; Side A)*

## **ROCKY MOUNTAIN POWER PLAN**

- **Paul Gatzemeier, Centennial Energy Resources**

Mr. Paul Gatzemeier spoke about energy development in general and specifically about their plant at Hardin, Montana. Mr. Gatzemeier submitted a written copy of his Power Point presentation to the ETIC (EXHIBIT 5).

- **Questions from the Committee**

Rep. Gallik wanted to know what the cost of power would be once the company is up and running. Mr. Gatzemeier replied the cost of power would be \$36 per megawatt hour. Rep. Gallik followed up by asking if that power would ever be part of the default supply portfolio, and Mr. Gatzemeier responded they had attempted to negotiate a deal, and explained their marginal cost is less than \$13 per megawatt hour versus the traditional cost in a simple-cycle gas plant of \$60 per megawatt hour. Mr. Gatzemeier indicated they could make an offer, but NWE would have to bring the contract forward. Rep. Gallik summarized that even their price is competitive and possibly even less expensive, but for whatever reason, they have not been invited to participate. Mr. Gatzemeier agreed with Rep. Gallik.

Sen. Thomas wanted to know how the emissions from the new plant compare to Colstrip. Mr. Gatzemeier explained that in the area of particulates new technology is more effective than what is in place in Colstrip. In the area of sulphur dioxide emissions, Colstrip 3 and 4 are very clean plants, and the plant in Hardin will be equal or cleaner than Colstrip 3 and 4.

Sen. Ryan was curious about the 40 mine and transportation jobs and whether Centennial would build its own road and how Mr. Gatzemeier derived the figures. Mr. Gatzemeier explained they spoke with various trucking companies and did their own analysis based on number of trucks and frequency of delivery. Mr. Gatzemeier also said they would haul on the public roadways.

Chairman Olson noted Mr. Gatzemeier did not present any information on tax revenues on electricity production, property taxes, or corporate income taxes. Mr. Gatzemeier agreed to obtain the information for Chairman Olson.

## **PSC LEGISLATION REVIEW**

- **Review of Process–Mary Vandebosch**

Ms. Vandebosch explained there are two aspects to the process, and the ETIC is required by law to review legislation proposed by the Department of Public Service Regulation and has the option of requesting staff to draft legislation. Ms. Vandebosch emphasized that requesting a bill to be drafted does not necessarily mean the ETIC endorses the bill, although the Laws database will reference that the bill was drafted at the request of the ETIC.

- **Review of Proposals–Greg Jergeson**

Comm. Jergeson reviewed Potential PSC Legislation for the ETIC's consideration (EXHIBIT 6).

### ***(Tape 2; Side B)***

Sen. Thomas suggested there are two areas under electricity. The first is the old model of regulation where a company assumes some costs and comes before the PSC. On the supply side, however, Sen. Thomas hoped for a more proactive role for the PSC. Sen. Thomas commented he hopes the PSC is not too limited regarding the default supply.

Comm. Jergeson responded the PSC will be submitting comments as to the strengths and weaknesses in the plan, and the process is not a contested case proceeding.

Sen. Johnson identified the problem as the constant statement by the PSC that they do not have the necessary power. Sen. Johnson wondered if Comm. Jergeson now felt like the PSC had the necessary power to get the job done. Comm. Jergeson responded the PSC does not have the power that a good portion of the public expects the PSC to have. Comm. Jergeson noted the impact on consumers is significant and people are not satisfied when they see the PSC does not regulate price of gas. Sen. Johnson asked if Comm. Jergeson would like the Legislature to consider a bill that would allow the PSC to regulate the price of gas. Comm. Jergeson stated that would require federal legislation, and suggested going to the Congressional Delegation.

Sen. Johnson noted his latest bill from NWE is broken down, but he thought the bill was very confusing. Comm. Jergeson admitted he is also puzzled by the bills. Sen. Johnson asked if the PSC has the authority to look at a bill and ask NWE to justify all the charges. Comm. Jergeson replied the PSC does have that authority, but clarified standard charges are more closely regulated by the PSC, but costs for electricity get blended among various contracts. Comm. Jergeson also clarified that electricity from Colstrip may follow a transmission line before it goes into distribution.



Sen. Ryan had questions about the property tax tracker and whether if there were additional mills added by levies, NWE could ask the PSC to make an adjustment. Comm. Jergeson replied they could and commented he found it interesting that the bill is being brought at a time when property taxes are expected to stay the same.

Rep. Matthews asked if other states had provisions where incentives for gas companies to purchase natural gas at a lower cost were passed to consumers. Comm. Jergeson replied gas companies are not allowed to have a markup on commodity price, and the rate of return is earned on delivering volumes to the customer. Comm. Jergeson stated that high rates cause conservation responses from the public and, therefore, volumes might be down.

Rep. Gallik thought it would make sense to look at an incentive to keep the price of power down and in addressing the current default supply portfolio, Rep. Gallik thought those who build the portfolio have no incentive to keep the price down. Comm. Jergeson agreed that is an issue and replied that the PSC is struggling with the issue. Rep. Gallik inquired whether there was a potential legislative response. Comm. Jergeson was uncertain what the solution would be.

### **NORTHWESTERN CORP. BANKRUPTCY CASE UPDATE**

- **Commissioner Greg Jergeson**

Comm. Jergeson provided the ETIC with an update of NWE's bankruptcy and explained the PSC's main concern was ratepayer protection throughout the bankruptcy. Comm. Jergeson submitted a copy of "Agreement in Principle Between NOR, MPSC and MCC" (AIP) (EXHIBIT 7). Comm. Jergeson stated the AIP helps to negate the PSC's concerns with the reorganization plan and thought the AIP provided a great deal of ratepayer protection. Comm. Jergeson highlighted the importance of implementing a rate-review schedule. In addition, ring-fencing was emphasized as important to any utility emerging out of bankruptcy. Comm. Jergeson noted the ring-fencing language had to be negotiated and the language provides a great deal of protection for ratepayers and still provides opportunities for the corporation if they manage themselves properly.

- **Questions from the Committee**

Rep. Gallik asked if the AIP ties the hands of the PSC and would prevent them from supporting another proposal. Comm. Jergeson replied the AIP would not presuppose prejudice against other alternatives, but pointed out the actual decision rests with the creditors. Rep. Gallik asked if the PSC has the ability to advocate for another proposal. Comm. Jergeson replied if another proposal were ideal, the same kind of principles in the AIP would apply. Comm. Jergeson noted the question remains what can be done to satisfy the creditors and not impact ratepayers.

Rep. Gallik noted the AIP requires NWE to pay the reasonable fees and out-of-pocket expenses, and asked if all of the costs would be recouped, and Montana would come through the process having not spent any money. Comm. Jergeson replied his understanding was Montana would recoup all of its expenses.

Sen. Thomas asked if ring-fencing would have allowed the PSC to do something better than it did when it approved the transaction when MPC was sold to NWE. Comm. Jergeson explained

when NWE purchased the distribution utility from MPC, the structure was as an affiliate that would have been ring-fenced from the troubles of the parent company. Subsequent to the transaction, the company reorganized, and the PSC did not object to the reorganization. Comm. Jergeson thought having a ring-fencing provision in the law would be a good idea.

*(Tape 3; Side A)*

### **RATE-BASING OF DEFAULT SUPPLIER-OWNED GENERATION ASSETS**

Ms. Vandebosch directed the ETIC to her memorandum presenting the ETIC with a decisions checklist (EXHIBIT 8) and requested direction regarding potential legislation.

Ms. Vandebosch submitted a memorandum from Mr. Todd Everts and proposed legislation (LC1010) which would allow a default supplier to rate-base default supply that is owned by the default supplier (EXHIBIT 9). Ms. Vandebosch explained the bill would authorize the default supplier to own generation assets and to include those assets in the default supply and to recover those costs. The legislation would also provide for PSC pre-approval for that portion of the default supply. Ms. Vandebosch identified the key question as how to keep the playing field level in terms of the default supplier's assets being on a level playing field with those provided by other energy suppliers. Ms. Vandebosch directed the ETIC to page 14, subsection (f), and asked if that subsection would provide a level enough playing field. Ms. Vandebosch identified another issue as being whether advance approval by the PSC of inclusion of an asset should be allowed.

Rep. Gallik recalled this kind of legislation was what got them into the situation with First Megawatts. Rep. Gallik further recalled that they were to be included in the default supply, but there were problems because some of the others wanted to keep their bidding process private.

Ms. Vandebosch explained how the process would work was still to be determined and admitted there were outstanding issues. Ms. Vandebosch identified the competitive bidding process as key.

Comm. Jergeson added the PSC is struggling with a number of confidentiality issues and who gets to decide what is protected information. Comm. Jergeson was confident they could find a way to accommodate confidentiality issues. Comm. Jergeson was partial to the notion of allowing the default supplier to reacquire generation assets, and stated he would not limit it to electricity.

Chairman Olson wondered if the competitors knew what they are competing against now. Comm. Jergeson stated they did not.

Mr. Vick clarified it depends on the RFP process and stated one of Comm. Stovall's concerns is the RFP process, and that only the one plan can qualify. Comm. Jergeson added the current PSC may be hopelessly divided, but did not view the division as being along partisan lines.

Chairman Olson expressed that generally all the RFPs were rate-based. Comm. Jergeson replied it is not based upon the cost of a facility necessarily, but is based upon the sense that the provider is offering a market-based price for the electricity to the default supplier. Chairman Olson pointed out he was referring to "market-based" versus ownership of a plant with a

regulated rate or return. Mr. Vick clarified that Chairman Olson was speaking about cost-based rates.

Sen. Ryan inquired as to how the situation could be worked out, and Mr. Vick replied he did not have a proposal, but was merely expressing a concern on behalf of Comm. Stovall. Sen. Ryan continued by saying if cost-based is put into the rates, there would be an assumption it would be paid off over the lifetime of the plant, and he thought it would be difficult to predict what the market would do over a long period of time.

Sen. Johnson asked if the legislation would take the State back to regulated power. Comm. Jergeson explained the legislation would allow a default supplier to vertically integrate, and that to whatever degree they could vertically integrate could be regulated. Sen. Johnson recalled First Megawatt's plan was the ratepayers would pay the money to build the plant and electricity would be used only during peak loads. Sen. Johnson would like to know how the portfolio compares with the market of other portfolios and recalled that electricity went up 58 percent after July 2002.

Sen. Thomas stated he hoped the language on p. 14, subsection (f), would be retained because the language provides there has to be a better alternative, and the only reason to rate-base at this time would be to benefit the utility. Sen. Thomas stated rate-basing requires the consumer to pickup all the risk. Sen. Thomas wanted to retain the language to protect consumers.

Rep. Gallik did not feel there was a problem and understood the difference between rate-based and cost-based is that rate-based means you get to place generation charges into the price you sell power to, but you don't have to take it back out if you have a large profit such as what happened in 2001. Rep. Gallik suggested the ETIC could be working on other issues and did not feel the legislation was necessary.

Chairman Olson suggested the ETIC had spent too much time on gas generation and noted natural gas generation is not used for baseload. Chairman Olson suggested the focus should be on baseload. Chairman Olson spoke about the exposure to citizens and thought citizens of Montana would lose more riding the markets. Chairman Olson agreed Co-ops have been stable, but noted that when the Co-ops took out those contracts 20 years ago, it was high-priced power, and the contracts will expire in 2008. Chairman Olson suggested that is why the Co-ops are looking to build generation facilities. Chairman Olson stated transmission upgrades are needed to use coal-fired generation, and those upgrades will result in Montana being at the mercy of the California markets. Chairman Olson would like the ETIC to look 20 years down the road, which would include rate-base generation for the baseload with a rate of return controlled by the PSC, to bring stability to the system.

Rep. Gallik suggested Montana is not ready given the situation with Montana First Megawatts, Touch America, and The Montana Power Company, and NWE's bankruptcy. Rep. Gallik stated he has not heard anyone from NWE say they want to build more generation. Rep. Gallik did not think Montana was ready and suggested the players are not interested in building generation.

Sen. Ryan suggested the ETIC look at the potential harm and noted one of the problems is the Legislature only meets for ninety days every two years. Sen. Ryan would like to see a solution

that provides options and suggested the PSC should be trusted to make decisions when options are presented.

Mr. Vick explained his understanding of the legislation is cost-based rates and that it is not a bid process. Mr. Vick noted the PSC could disallow costs.

Sen. Thomas again identified retention of the language “least cost alternative” as critical, but suggested the language would not survive since it does not benefit the utility.

Chairman Olson recalled that when MPC owned generation facilities at Colstrip the rates continued to escalate year after year when Montana rate based that share of Colstrip.

Sen. Johnson recalled MPC did raise their rates on a continuing basis, but was covering increases in wages and benefits for its entire company. Sen. Johnson suggested it would be better to encourage people who are currently trying to build plants in Montana to say what their power will be worth.

Chairman Olson asked why there would be two sets of standards for investor-owned utilities in Montana and noted MDU is allowed to own generation and put it in the rate.

Rep. Gallik moved the ETIC pass on the proposed legislation. The motion carried by roll call vote (EXHIBIT 10).

***(Tape 3; Side B)***

### **COAL BED NATURAL GAS IN MONTANA—STATUS, BARRIERS AND OPPORTUNITIES**

- **Tom Richmond, Board of Oil and Gas Conservation**

Mr. Tom Richmond, Board of Oil and Gas Conservation, submitted a book to the ETIC entitled, “Coal Bed Methane Primer, New Source of Natural Gas—Environmental Implications” (EXHIBIT 11) and reviewed statistics on the oil and gas industry in Montana (EXHIBIT 12).

- **Jan Sensibaugh, Department of Environmental Quality**

Ms. Jan Sensibaugh, Director of the Montana Department of Environmental Quality (EQC) reported there are two activities that relate to coal bed methane, including permitting activities and a planning effort of creating total maximum daily load numbers from the Powder River and Tongue River and negotiating with Wyoming on which state is going to be able to discharge how much into the Tongue and Powder Rivers. Ms. Sensibaugh explained that since Wyoming is upstream, if it discharged up to Montana’s standards, Montana would not allow any discharge into the rivers.

Ms. Sensibaugh reported there is one individual Montana permit issued to Fidelity Gas and Exploration (Fidelity) which will allow up to 1600 g.p.m. for the Tongue River near the Montana/Wyoming border. Ms. Sensibaugh also stated they are processing Fidelity’s application to renew; however, a lawsuit has been filed on the initial permit that was issued. Ms. Sensibaugh thought a lawsuit would be filed against the renewal permit as well.

Ms. Sensibaugh identified two pending permits: The first is for Powder River Gas, which would allow 1,122 g.p.m. of treated coal bed methane water. Ms. Sensibaugh explained an EIS was done with the Bureau of Land Management (BLM) and that EIS required individual MEPA analysis of the permits issued. BLM had decided it will not issue a drilling permit until after DEQ issues a discharge permit because BLM would like to approve the Water Management Plan as part of its drilling permit. In the future, MEPA and NEPA reviews will be done together, so there will not be two separate environmental review processes.

Ms. Sensibaugh stated Fidelity also has a pending application to treat and to discharge up to 1,700 g.p.m. to the Tongue River above the reservoir, but the application is not complete, and DEQ is working with Fidelity on the application.

Ms. Sensibaugh explained DEQ has a general permit where people can give notice that they are going to discharge under the permit. This permit will cover the discharge of coal bed methane water to off-channel impoundment. Ms. Sensibaugh addressed a court decision regarding whether Fidelity needed to secure a water discharge permit for coal bed methane water which was overturned by the Ninth Circuit Court of Appeals and how the court decision affected new permits.

Ms. Sensibaugh testified about DEQ's involvement in a Powder River Basin Working Group to identify monitoring for water and air quality, and other issues that need to be reconciled.

Ms. Sensibaugh identified the drought as a very difficult problem and explained how the drought is affecting their data collection efforts and ability to identify water quality. Ms. Sensibaugh testified DEQ needs to develop a total maximum daily load (TMDL) for the Powder River. Although the Tongue River is not listed as impaired, a TMDL is being done to provide baseline data. Ms. Sensibaugh spoke about on-going negotiations with Wyoming regarding the Tongue River.

- **Bruce Williams, Fidelity Exploration and Production Company**

Mr. Bruce Williams, Vice President of Operations for Fidelity Exploration and Production Company, explained Fidelity is the only producer of coal bed natural gas in Montana. Mr. Williams submitted a written power point presentation (EXHIBIT 13) and Fidelity Exploration and Production Company's case outlines (EXHIBIT 14). Mr. Williams provided an industry's perspective and outlined the things they look at when choosing to develop a resource. Mr. Williams also spoke about resource uncertainty and transportation capability across the Powder River Basin and how it affects the industry. Mr. Williams did not feel transportation capability would be a problem for Fidelity, but noted it would be a problem for people who develop away from Fidelity and stated if the resource is there, transportation capacity will

follow. Mr. Williams admitted he did not understand the impact of income tax upon Fidelity, but stated Montana's tax structure is generally favorable for industry. Mr. Williams explained Fidelity's experience in Montana contained in Exhibit 13.

***(Tape 4; Side A)***

Mr. Williams spoke about regulatory paralysis created by lawsuits. Mr. Williams thought it was interesting that Fidelity was the only producer of coal bed natural gas present at the meeting and suggested ETIC should contact Yates Petroleum, Marathon Petroleum, and Nance Petroleum and ask them why they were not present at the hearing. Mr. Williams thought the answer the ETIC receives will be indicative of the barriers to production.

• **Questions from the Committee**

Rep. Matthews recalled that Fidelity had begun testing the soil and crops on the Tongue River and asked for a status report on that project. Mr. Williams explained the Tongue River Agronomic Monitoring and Protection Plan (AMPP) was conducted in the fall 2003 by 19 volunteers, and fall sampling will be conducted every year. Mr. Williams was positive they have obtained good baseline data and will be able to monitor the area. Mr. Williams directed the ETIC to Energy Lab's website or the AMPP website.

Sen. Thomas stated money is needed for schools, natural gas for consumers, and the environment also needs protection. Sen. Thomas noted all the litigation could be deadly to any project in the state. With regard to litigation, Sen. Thomas wanted to know if the problem was with state laws, elected judges, or federal laws. Mr. Williams responded four of the lawsuits were brought in state court and the rest are in federal court. The issues raised around the lawsuits are associated with the EISs, and most of the lawsuits are related to process issues under MEPA. Mr. Williams was confident there was enough data gathered and enough monitoring to protect the environment.

Rep. Gallik asked Mr. Williams to identify what specifically is wrong with the MEPA process. Mr. Williams recalled the same question being asked during the last session, and he could not name a specific piece of the process that results in lawsuits being filed. Rep. Gallik pointed out that without specificity, the ETIC would not be able to help.

Rep. Olson interjected and suggested a "loser pays" theory and requested Mr. Richmond to provide information regarding MEIC v. Montana Board of Oil and Gas. Mr. Richmond explained the case revolves around a disagreement about when an agency takes a final action. Mr. Richmond identified an evidentiary hearing process for the plans and development. This provides a public forum for the applicant to provide a description of his plan and an opportunity for expert witness and public testimony to help persuade the Board. At the end of that process, a decision is made based upon the evidence, and then staff is told to comply with MEPA. The MEIC lawsuit claims the Board should have done an environmental analysis before it heard the plan of development. Mr. Richmond cited disagreement on at what point a MEPA analysis should be required and whether it should be before or after the Board sees a project. Mr. Richmond stated they are still waiting for a decision from the judge.

Rep. Gallik noted Mr. Williams's material indicates Wyoming has a large permit demand and Montana has a limited permit demand, but Montana's process is very slow, and asked Ms. Sensibaugh for an explanation. Ms. Sensibaugh stated that the information is reflective of all permits, not just coal bed methane permits. In addition, Ms. Sensibaugh recalled that Wyoming was having a difficult time keeping up with permits several years ago, and has now moved a lot of resources into their water quality permitting process. Ms. Sensibaugh stated she will be asking the Legislature for more employees and noted they cannot keep up with current permitting requirements without coal bed methane being factored in. In addition, Ms. Sensibaugh stated there is a tremendous turnover in water quality permit employees. Ms. Sensibaugh agreed the process is slow, but clarified it is slow for everything, not just coal bed methane.

Sen. Johnson spoke about the coal bed methane leasing that used to occur in the Stillwater/ Carbon County area, and asked why they stopped. Mr. Williams replied it was an economic decision to no longer pursue exploration and development in that area.

Sen. Ryan asked Ms. Sensibaugh if the Department of Environmental Quality had been affected by vacancy savings. Ms. Sensibaugh answered it had and estimated three additional FTE would be needed. Ms. Sensibaugh identified salary as a key reason for employee turnover.

### **PUBLIC COMMENT**

Mr. Wally McRae, a long-term charter member of the Northern Plains Resource Council (NPRC), noticed NPRC was not recognized as a key player in the game and suggested that may be a reason why NPRC resorts to litigation. Mr. McRae suggested coal bed methane development could be done responsibly and done right. Mr. McRae identified enforcement of current laws by the industry and state agencies as a problem. Mr. McRae testified there was a potential that families could be precluded from staying on their farms and ranches if development of coal bed methane is not done responsibly.

Rep. Gallik inquired how much the State of Montana would need to pay in attorney fees under a "loser pay" scenario. Mr. McRae stated the amount would be significant, but could not identify an exact dollar amount.

Chairman Olson asked how many times the State of Montana has had to reimburse the plaintiffs for legal fees. Mr. McRae replied the State of Montana has never been required to reimburse for legal fees.

Rep. Gallik agreed with Mr. McRae that development of coal bed methane could be done right and asked Mr. McRae to identify the impediments to doing it right. Mr. McRae identified loss of the aquifer as a problem. Mr. McRae explained the industry will replace water up to a mile away from a coal bed methane well; however, the EIS states the draw down in an aquifer will reach as far as 14 miles and will not replace itself within the lifetime of any living person. Mr. McRae suggested the use of water is held to be a property right, and that the loss of the free-flowing streams would start additional litigation. Mr. McRae wondered what would happen when there is a water quality violation on the Tongue River and who would get shut off.

Ms. Sensibaugh responded to Mr. McRae's concerns and stated the drought has distorted

numbers and is causing violations. Ms. Sensibaugh explained monitors will be placed at the border, so they will be able to identify whether it is a Wyoming or Montana problem. Ms. Sensibaugh explained monitors will be placed on outflows and if everyone is meeting their permit standards, a TMDL will be done and everyone will be cut back evenly to meet the standard. Ms. Sensibaugh cautioned this would not be an easy process and could very easily result in litigation.

Chairman Olson noted Fidelity is required to monitor the aquifer and asked Mr. Richmond what the draw down is at the permit boundaries. Mr. Richmond replied the zero contour line after four years of production has not left the project boundary.

Mr. Clint McRae, representing Rocker Six Cattle Company on the Rosebud, grew up with the Colstrip boom. Mr. McRae asked the ETIC to remember that the reclamation of the Colstrip mine was not done out of corporate responsibility but was forced by NRC. Mr. McRae did not believe development of coal bed methane in Wyoming was a positive experience and suggested the Wyoming experience be viewed as a lesson rather than a blueprint. In addressing the numerous lawsuits, Mr. McRae suggested the ETIC should tell the state and federal agencies to do their job.

***(Tape 4; Side B)***

Mr. McRae wondered who the ranchers would go to when their springs dry up. Mr. McRae stated when methane land application stops, nothing will grow on the ground, and Mr. McRae thought the landowners should not be expected to absorb the cost of treating the soil to raise crops. Mr. McRae testified he had to fight to become a member of the TMDL Group and suggested the landowners on the Rosebud did not have adequate representation in that group. Mr. McRae identified the Rosebud as unique because of sub-irrigation. Mr. McRae suggested the Legislature "shot itself in the foot" as far as funding the schools and suggested the methane companies could pay the full 13.7 percent tax. Mr. McRae also testified that the third water right created for coal bed methane development is affecting senior water rights. Another issue Mr. McRae identified is the lack of mitigation for aquifer loss. Mr. McRae explained that water quality and water quantity are what enabled ranchers to homestead successfully in the first place.

Mr. Nick Older has lived on the Rosebud since 1947. Mr. Older identified agriculture as the largest industry in Montana and spoke about how the landowners had to pay the increase in taxes when Colstrip was developed. Mr. Older stated half of the domestic water in Montana comes out of aquifers and 90 percent of the rural water comes out of aquifers. Mr. Older suggested looking down the road and recognizing the importance of agriculture in Montana. Mr. Older encouraged the ETIC to look beyond the immediate and consider what will be happening in 30 years, and cautioned people with good land will fight for their land.

Mr. Jim Rogers, Rosebud Conservation District, stated the Coal Bed Methane Protection Act placed a \$50,000 liability on resource damages from coal bed methane. Mr. Rogers reported that \$50,000 cap would be insufficient to pay for the natural resource damage that could be done from coal bed methane drilling in southeastern Montana. Mr. Rogers spoke about his personal experiences with coal bed methane ponds and discharge waters. Mr. Rogers testified that pumping water up just to get the gas out of it and then letting the water go is not a good use of water, and creates poor soil conditions.



Mr. John Driscoll, a former Public Service Commissioner, testified that he feels strongly about developing energy policies that will enable the United States to get out of the Middle East. Mr. Driscoll is trying to refamiliarize himself with energy issues, and complimented the ETIC on its work. Mr. Driscoll respectfully requested ETIC staff make available to the members of ETIC an article that appeared in *Wired Magazine* two and one-half years ago entitled "Energy Web" by John C. Star, who started the Electric Power Research Institute. Mr. Driscoll suggested the article contains good conclusions based on experience and could help Montana move forward.

## **ADJOURN**

The June 9, 2004, meeting of the Energy and Telecommunications ETIC adjourned at 3:50 p.m.