

June 7, 2004

Representative Alan Olson
Chairman, Interim Committee on Energy and Telecommunications
18 Halfbreed Creek Rd
Roundup, Montana 59072-6524

Representative Olson:

As you know, the Governor's Consumer Energy Protection Task Force (GTF) was directed to address three main issues, one of which concerned the financial condition of NorthWestern:

2. The evaluation of current Montana laws and rules to determine whether they are sufficient to protect and support Montana consumers' interests in the event NorthWestern Energy's financial condition deteriorates further;

Since NWE filed for bankruptcy, the GTF shifted its focus to evaluate whether Montana laws and rules are sufficient to protect energy consumers from the financial effects decisions of unregulated subsidiaries have on regulated utilities. The GTF developed specific ring fencing principles and measures that they believe should form the basis for legislation and passed those recommendations along to me. Those recommendations are contained in Attachment A to this letter. I support the work of the Task Force and the specific ring fencing principles and recommendations adopted by the GTF and request that the Interim Committee on Energy and Telecommunications develop ring fencing legislation based upon the GTF's recommendations.

As you also know, the Public Service Commission and the Consumer Counsel have reached an Agreement in Principle (Agreement) with NorthWestern that would result in a set of ring fencing provisions applicable only to NorthWestern. The Task Force voted against a proposal that would prevent the Agreement from being superceded by subsequent ring fencing legislation. This issue of whether energy policy should be formed on a utility-by-utility basis or on a statewide uniform basis should be examined in the development of legislation by the Interim Committee on Electricity and Telecommunication.

I appreciate the work of the Interim Committee on Energy and Telecommunications and respectfully request that you and your committee consider the ring fencing recommendations in Attachment A.

Sincerely,

JUDY MARTZ
Governor

Attachment A.

GOVERNOR'S CONSUMER PROTECTION TASK FORCE

RING FENCING

Discussion:

Ring fencing is a term used to describe various controls undertaken by utility commissions and legislatures to protect the ratepayers of regulated investor-owned utilities from the impacts of riskier activities engaged in by their holding companies or unregulated affiliates. The goal of ring fencing, and these recommendations, is to provide greater stability in terms of cost and quality of service to consumers receiving service from regulated energy utilities in Montana.

On the national level, events which have led to the development of ring fencing protections include: the Enron bankruptcy; the Pacific Gas And Electric bankruptcy; the growing concern of regulators and investors regarding the unforeseen risk taken by energy holding companies associated with their unregulated activities (primarily merchant generation and marketing and trading); the accounting irregularities that have been revealed for several companies associated with marketing and trading operations; and the attempt in Congress to repeal the Public Utility Holding Company Act of 1935 (PUHCA) which governs the regulated utilities and their relationships with parent companies and non-regulated affiliates and proscribes activities in which public utility holding companies may engage.

In Montana, NWE's bankruptcy filing was not caused by its utility operations, but by its failed non-utility affiliates, including Expanets, Blue Dot, and Cornerstone Propane. Additionally, Energy West narrowly avoided bankruptcy after an unregulated affiliate was sued by PPL Montana for improper energy scheduling. To be effective, ring fencing must isolate the regulated utility from the financial risks that may be imposed by the actions of non-utility businesses of the company.

The GTF notes that there is an issue regarding whether the Public Service Commission (PSC) currently has sufficient authority to implement ring fencing. Furthermore, a concern has been raised that by legislatively specifying specific ring fencing authority, the PSC's general authority to regulate may be weakened or limited.

While noting these concerns, the GTF believes that the interests of consumers will be better served by ensuring that the PSC has the explicit authority to implement ring fencing. This position is consistent with those of the PSC and the Montana Consumer Counsel.

One important component of ring fencing not addressed in these recommendations is that of transfer authority, or the PSC's authority to review and approve transfers of utility assets. Transfer authority was omitted from this discussion because the GTF has already taken action on that issue, recommending that the Interim Legislative Committee on Electricity and Telecommunications (ETIC) develop legislation that would clarify the PSC's existing authority.

On May 14, 2004, the PSC and the Montana Consumer Counsel (MCC) entered into an Agreement in Principle (AIP) with Northwestern. The AIP addresses many issues related to the bankruptcy, but also includes issues related to ring fencing. Since the AIP is with NOR, the ring fencing provisions are focused on one regulated utility. After considerable discussion, the GTF declined to support a recommendation to exempt the AIP from being superceded by ring fencing legislation. The GTF did, however, agree to note that the issue of whether the ring fencing provisions contained in the AIP may be overridden by legislation is an issue that the ETIC should consider if it considers developing ring fishing legislation.

Ring Fencing Principles:

The following principles were used to develop ring fencing recommendations and should be used to guide the development of ring fencing legislation:

1. Ring fencing legislation should only apply to regulated energy utilities.
2. Ring fencing legislation should not restrict or weaken any of the PSC's existing statutory authority. This principle should be stated in any proposed legislation.
3. For purposes of ring fencing, the PSC's authority to review affiliate transactions should occur only in instances where the materiality of the transaction is significant. Day to day affiliate transactions should not be subject to PSC authority under ring fencing.

Definitions:

“Regulated energy utility” means a utility owning distribution facilities for distribution of electricity or natural gas to the public and subject to the regulation of the Public Service Commission.

“Affiliate Transaction” is any transaction between the utility operations regulated by the Public Service Commission and an affiliated company of the utility.

Ring Fencing Recommendations:

The GTF recommends that ring fencing legislation be developed based upon the following recommendations:

1. **Dividend payments:** The PSC shall have the authority to review dividend payments from a regulated energy utility to a corporate parent.
 - a. The PSC shall have the authority to limit dividend payments from a regulated energy utility to a corporate parent if those payments would place the utility’s credit quality or utility property in jeopardy.
2. **Inter-company loans:** The PSC shall have the authority to review all inter-company loans or other extensions of credit or advances of working capital between a regulated energy utility and an affiliate interest.
 - a. The PSC shall have the authority to limit or prohibit inter-company loans or other extensions of credit or advances of working capital between a regulated energy utility and an affiliate interest if those activities would place the utility’s credit quality or utility property in jeopardy.
3. **Security issuances:** The PSC shall have the authority to review and approve the use of proceeds in security issuances for which the assets of the regulated energy utility are pledged.
4. **Short-term borrowing:** The PSC shall have the authority to review all external borrowings of a regulated energy utility with a term greater than 120 days.
 - a. The PSC shall have the authority to limit the external borrowings of a regulated energy utility with a term greater than 120 days if the utility’s credit quality or utility property is in jeopardy.
5. **Regulatory forbearance:** A regulated energy utility may request, and the PSC may grant, forbearance from any or all the above provisions. Upon a request from a regulated energy utility with fewer than 100 customers, the PSC shall waive compliance with the requirements set forth in the above recommendations.