

# NorthWestern<sup>™</sup> Energy

February 15, 2007

Greg Lind

2/23/07

SB 195

SENATE *Natural Resources & Energy*

Exhibit No. 4

Date 2-23-07

Bill No. SB 195

Senator Greg Lind  
Chairman  
Senate Natural Resources and Energy  
PO Box 200500  
Helena, MT 59620-4800

Dear Senator Lind:

This letter is in response to your request to Michael J. Hanson of NorthWestern Energy (NorthWestern) regarding the specifics of its unregulated 30-percent leasehold interest in Colstrip Unit 4 on February 6, 2007 (copy enclosed). The following provides a brief summary:

NorthWestern currently leases a 30% share of Colstrip Unit 4, a 740 megawatt demonstrated-capacity coal-fired power plant located in southeastern Montana. The lease term runs through December 31, 2018. NorthWestern's leased interest represents approximately 222 megawatts at full load. NorthWestern is currently attempting to purchase the Mellon Financial Services Corporation portion of the lease. A long-term coal supply contract with Western Energy Company provides the coal necessary to run the Colstrip facility.

NorthWestern sells the majority of our generation from Colstrip Unit 4 to Puget Sound Energy and DB Energy Trading, LLC, (DB) under agreements expiring on December 29, 2010. When operating at full contract capacity, 97 megawatts is delivered to Puget and 111 megawatts to DB plus losses.

NorthWestern repurchases 111 megawatts from DB through December 2010, which is available for market sales to other third parties through June 2007. Beginning July 1, 2007, 90 megawatts has been committed to supply a portion of the Montana default supply load at an initial price of \$35.25, escalating to \$36.25 at the conclusion of the agreement on December 31, 2018. This price compares very favorably with the new contract price received from PPL-MT for the 2007 - 2014 period. Under the new PPL-MT agreement, which is a blend of thermal and low cost hydroelectric generation, the electricity supply price will be \$44.95 commencing July 1, 2007 escalating to \$52.95 in 2014.

NorthWestern currently has approximately 132 megawatts of uncommitted Colstrip 4 baseload capacity after December 31, 2010.

Also enclosed a more detailed summary of Colstrip 4 for your review as well. I hope this information is helpful and satisfies your request.

Sincerely,



Patrick R. Corcoran

Enclosures

# Montana State Senate



SENATOR GREG LIND  
SENATE DISTRICT 50

HELENA ADDRESS:  
PO BOX 200500  
HELENA, MONTANA 59620-0500  
PHONE: (406) 444-4800

HOME ADDRESS:  
7383 HIGHLINE CT  
MISSOULA, MT 59808  
PHONE: (406) 842-5195

COMMITTEES:  
FINANCE AND CLAIMS (HHS)  
NATURAL RESOURCES  
ENERGY AND TELECOMMUNICATIONS

*The Big Sky Country*

February 6, 2007

Michael J. Hanson  
President and Chief Executive Officer  
NorthWestern Energy  
40 East Broadway  
Butte, MT 59701

Dear Mr. Hanson:

I am writing to you in my capacity as a customer of NorthWestern Energy and as the Chair of the Montana State Senate Committee on Natural Resources and Energy. With the importance of and interest in the future of energy in Montana, I would like some additional information with respect to the operations of NorthWestern Energy Corporation (d/b/a NorthWestern Energy).

Would you please provide my committee with specifics of your generation at Colstrip, Montana? The following paragraph is from the NWE website:

**"We lease a 30 percent share of Colstrip Unit 4, a 740-megawatt demonstrated-capacity coal-fired power plant in southeastern Montana, through our unregulated Colstrip Unit 4 Lease Management Division, and sell this share principally to third parties".**

I am specifically requesting the contracted allocation of your share (to whom), the expiration dates of the contracts (by contract), contract contingencies, renewal provisions and the price delivered power (by contract).

This information is critical to our understanding the complex regulatory proposals before this legislature and how they will interact with 330,000+ constituents.

Your timely response would be greatly appreciated.

Sincerely,

Greg Lind  
Senate District 50  
Chair, Senate Natural Resources & Energy

## NorthWestern Energy – Colstrip 4 Summary

### INTRODUCTION

The Colstrip Project is located in the city of Colstrip, in southeastern Montana. This is the site of four thermal generating plants -- Colstrip Units 1&2 and Colstrip Units 3&4. Colstrip Units 1&2 are twin 333 gross MW plants that have been in operation since the mid-1970s. Colstrip Units 3&4 are twin 805 gross MW plants that have been in operation since the mid-1980s. Colstrip Units 1&2 have different ownership than Colstrip Units 3&4 and are also subject to different contractual arrangements. The entire generating plant complex has historically been referred to as the "Colstrip Project." *PPL now refers to the plant complex as CSES or Colstrip Steam Electric Station*

### COLSTRIP PROJECT OVERVIEW

#### 1999 Generation Asset Sale

Prior to MPC's Generation Asset Sale of December 1999 (the actual sale closed on December 17, 1999), MPC was a 50% Owner of Colstrip Units 1&2 and a 30% Owner/Leaseholder of Units 3&4. On December 17, 1999, MPC sold substantially all of its generation assets to PPL Montana, including its interest in Colstrip Units 1,2 and 3. MPC did not transfer its leasehold interest in Colstrip Unit 4 (or its interest in the Milltown Dam). Colstrip Unit 4 was the only asset offered in the generation sale that MPC did not own in fee. MPC's assets related to Colstrip 4 were transferred in whole to NorthWestern Corporation (NWE) as part of its purchase of MPC in February 2002.

Colstrip 4 assets generally include the following:

- 30% leasehold interest in Unit 4 severed personal property situated on the generating site, cooling tower site and coal storage and ash holding sites, the "Severed Sites", which personal property was sold and leased back as part of a leveraged lease transaction in 1985.
- 15% leasehold interest in the common facilities for Units 3&4 severed personal property on the Severed Sites, which was sold and leased back as part of the 1985 leveraged lease.
- Fee ownership in certain retained assets, which consist of real and personal properties, including a share of common facilities for Units 3 & 4 and of the allocated share of Units 3 and 4 in the Common Facilities (further defined below) used by Units 1, 2, 3 and 4. These assets were not sold as part of the 1985 leveraged lease transaction but were leased by the Ground Lease and subleased back to MPC. The ownership interest of NWE is subject to the Ground Lease and sublease back.
- Fee ownership in the Colstrip Unit 4 related real property, consisting of certain residential and non-residential real estate in Colstrip associated with Colstrip Unit 3&4, but which was not part of the 1985 sale/leaseback transaction.

- A 100 MW interest in the approximately 240-mile 500 kV transmission system running from Colstrip to Townsend, Montana and associated transmission contracts. (These transmission-related interests were not part of the 1985 sale/leaseback transaction.) MPC transferred approximately 111 MW of this original 210MW dedicated transmission capacity to the regulated utility at the time of the LADWP PPA assignment to Duke Energy Trading and Marketing. The LADWP PPA and subsequent assignment to Duke is discussed in detail later in this document
- Colstrip Unit 4 related interests in water rights for the Colstrip Project

Currently, Puget Sound Energy and PPL Montana each have a 50% fee interest in Units 1&2. The owners of Unit 3 are: Puget Sound Energy 25%; Portland General Electric 20%; Avista 15%; PacifiCorp 10% and PPL Montana 30%. For both Colstrip Units 1&2 and Unit 3, each owner's interest is held as a tenant in common, not as joint tenants or through a partnership or other legal entity. NWE has a total 30% interest in Unit 4. This is a leasehold interest, resulting from the sale/leaseback transaction in 1985. The other owners of Unit 4 are: Puget Sound Energy 25%; Portland General Electric 20%; Avista 15%; and PacifiCorp 10%. Because Colstrip Units 3 and 4 are operated contractually as a project, NWE's 30% interest in Unit 4 translates to a 15% Project Interest in each Colstrip Units 3 & 4. This is accomplished through the Colstrip Units 3&4 Ownership and Operation Agreement and the Colstrip Units 3&4 Generating Project Reciprocal Sharing Agreement (RSA), which is discussed later in this document.

In addition to the plants themselves, the Colstrip Project includes "Common Facilities". As used herein, "Common Facilities" means those facilities common to all four of the generating units; i.e., Colstrip Units 1, 2, 3, and 4, such as the intake water system, coal handling facilities and the surge pond. There are also facilities common to just Units 1&2 or Units 3&4, respectively, and such facilities common to Units 3&4 are referred to herein as "common facilities for Units 3&4". Ownership of the Common Facilities is split between Units 1&2 and Units 3&4, with different ownership percentages as set forth in the Common Facilities Agreement. In connection with the sale/leaseback of MPC's 30% interest in Unit 4 (now NWE's interest), MPC also leased and subleased back 15% of some of the common facilities for Units 3&4 and the allocated share of Units 3&4 in the Common Facilities.

#### **Colstrip Operator**

Prior to MPC's Generation Sale, MPC was the Operator of the Colstrip Project. PPL Montana assumed the role of Operator of the Colstrip Project as part of the sale process.

Although contractually there are separate operating agreements for Units 1&2, for Units 3&4 and for the Common Facilities, the entire site functionally operates as one unit. PPL Montana serves as Operator and is responsible for all the requirements of operating and maintaining the Project and acts as the agent for all the owners in that capacity.

In its capacity as operator, PPL Montana is reimbursed for its costs but does not receive an operating fee. It also is responsible for employment relations with all employees at the Colstrip Project, both union and non-union.

## **COLSTRIP UNIT 4 CONTRACTS AND AGREEMENTS**

### **Colstrip Unit 4 Sale/Leaseback Transaction - Background**

MPC participated in the construction and ownership of Colstrip Units 3 and 4 to meet the growing demand for electric resources in Montana; however, as the construction of Units 3&4 neared completion, load projections changed dramatically, primarily due to the closure of Arco's Montana operations. Because load projections did not show a need for the power from Colstrip Unit 4 for several years, MPC decided to market the output of Colstrip Unit 4 off-system and that it would not attempt to rate base its share of Unit 4. In order to accomplish this, MPC sold or leased in a sale/leaseback transaction (Lease) its 30% undivided interest (approximately 220 MW) in Colstrip Unit 4 and a 15% undivided interest in certain common facilities for Units 3 and 4.

MPC did not sell any real property as part of the Lease transaction. Rather, MPC retained ownership of all real property and some personal property, but leased such real property and personal property to the other parties to the Lease transaction pursuant to a ground lease, and those parties, in turn subleased the property back to MPC. NWE's fee ownership interest in this Colstrip Unit 4 related real property and personal property is subject to this ground lease and sublease.

### **Colstrip 4 Participation Agreements**

The sale/leaseback transaction was effected through two Participation Agreements, which essentially mirror each other in regard to substantive terms. One Participation Agreement is among:

- United States Trust Company of New York (Owner Trustee);
- SGE (New York) Associates, whose primary partner is General Electric Capital (Owner Participant);
- The Montana Power Company (Lessee) (now NWE);
- Bankers Trust Company (Indenture Trustee).

The other Participation Agreement is among:

- United States Trust Company of New York (Owner Trustee);
- Mellon Financial Services Corporation\* (Owner Participant);
- The Montana Power Company (Lessee) (now NWE);
- Bankers Trust Company (Indenture Trustee).

(\*Note: Burnham Leasing Corporation was the original Owner Participant, but assigned its interests to Mellon.)

SGE (New York) Associates owns a 19.28571% undivided interest in Colstrip Unit 4 and a 9.642855% undivided interest of the Units 3 and 4 share in the common facilities and Common Facilities. Mellon Financial Services Corporation owns a 10.71429% undivided interest in Colstrip Unit 4 and a 5.357145% undivided interest of the Units 3&4 share in the common facilities and Common Facilities.

The Lease, has a 25-year term that began on December 30, 1985 and ends December 29, 2010. The Lessee has the right to purchase the facility at any time after 15 years for the greater of the market value or the Casualty Value (defined in Schedule 2 of the Lease). The Lessee may

extend the Lease beyond the initial 25 years at one-half of the current Lease amount for an initial extension of 8 years. The option to extend the Lease has been exercised. The Lessee also may choose to terminate the Lease after 20 years if the Lessee finds a buyer that will purchase the property at fair market value and pay any difference between the "Termination Value" (defined in Schedule 4 of the Lease) and the fair market value.

#### **Unit 4 Power Sales/Purchase Agreements**

To manage and administer the Lease and to market the electrical output of Colstrip Unit 4, MPC created the Colstrip 4 Lease Management Division (CS4LMD) as a separate business group within the corporate structure. CS4LMD's marketing effort initially resulted in the execution of two long-term power sales agreements, which substantially utilized the electrical output of MPC's leased share of Colstrip Unit 4. The original agreements were each executed in 1989 and were with (1) Puget Sound Energy, Inc. (formerly Puget Sound Power and Light) (Puget PSA), and (2) the Los Angeles Department of Water and Power (LADWP) (1989 LADWP PSA). Both agreements had a term through December 29, 2010, which is the same term as the Lease.

In December 1999, MPC reached agreement with LADWP to terminate the remaining 11-year term of the LADWP PSA. The termination agreement also resulted in a new Power Purchase Agreement (PPA) with LADWP, which became effective December 21, 1999 and will terminate December 29, 2010. LADWP has assigned all of its rights and obligations under the PPA to Duke Energy Trading and Marketing, LLC.

#### ***1999 LADWP PPA (has been assigned to Duke Energy Trading and Marketing, LLC)***

In 1989 MPC and the City of Los Angeles Department of Water and Power (LADWP) entered into a Power Sales Agreement (PSA) with a term from July 17, 1989 through December 29, 2010. However, in December 1999, MPC and LADWP entered into an agreement to terminate the remaining term of the existing agreement (Termination Agreement) and entered into a new Power Purchase Agreement (1999 PPA), which became effective December 21, 1999 and continues in effect through December 29, 2010. As a result of the termination, MPC received approximately \$106 million from LADWP. This payment was recorded as a deferred credit on the balance sheet of MPC and it was being amortized to revenue over the remaining term of the contract. This amortization was eliminated following NorthWestern's Chapter 11 Bankruptcy and subsequent fresh start accounting. Current income taxes were recorded and paid in 1999 leaving a substantial deferred income tax asset.

LADWP immediately assigned all of its rights and obligations under the 1999 PPA to Duke Energy Trading and Marketing, LLC (DETM). MPC and DETM entered into Amendment #1 to the PPA on March 28, 2000. NorthWestern and DETM entered into Amendment #2 to the PPA on January 22, 2004 as a result of negotiations related to the Chapter 11 bankruptcy of NorthWestern Corporation. The major changes associated with Amendment #2 changed the price for purchase of power by DETM and provided for repurchase by NorthWestern of all power purchased by DETM and changed the Delivery point definition to any point available on NW system as long as repurchase was at the same point.

The 1999 PPA provides for the delivery of 111 MW of capacity to DETM at Garrison (Garrison is a substation on the western end of NWE's transmission system). Amendment #1 provides

that, upon the request of DETM, NWE may, at its sole discretion, make energy and capacity available at Alternate Points of Delivery (as defined in Amendment #1). Such energy deliveries to Alternate Points of Delivery shall be on terms and at rates per MWH agreed to in advance by NWE and DETM. Amendment # 2 provides for any point of delivery on NWE's system as long as capacity exists and repurchase takes place at the same time and place. The 1999 PPA provides DETM with a minimum annual energy guarantee of 75% load factor. Amendment #2 changes the original guarantee and sets a minimum annual energy delivery in terms of MW's delivered and eliminates the load factor guarantee. This annual minimum delivery is set at 802,197MW.

The PPA energy entitlement is based upon the output of NWE's 15% Project Share of both Colstrip Units 3&4. MPC and PPL Montana have entered into the Colstrip Units 3&4 Generating Project Reciprocal Sharing Agreement (RSA) which provides both MPC (now NWE) and PPL Montana a 15% Project Share in the Colstrip Units 3&4 Project (Project).

Compensation for services rendered in accordance with the PPA is defined in Exhibit A-1 and Exhibit A-2 of Amendment #2 of the PPA

***DETM PPA has been assigned to DB Energy Trading***

In December 2005, DETM assigned the PPA to DB Energy Trading LLC. NorthWestern and DB agreed to Amendment #3 at that same time. The major contract change associated with Amendment #3 was that it provided for a minimum monthly payment to DB under the sale and repurchase depicted in Exhibit A-3 of Amendment #3 provided, however, that the 24 month rolling capacity factor was not influenced by any force majeure event. If a force majeure event causes the 24-month rolling average capacity factor to slip below 75% then an adjusted minimum monthly payment can be calculated and used instead. The basis for the adjustment is the ratio of the then current 24-month rolling capacity factor divided by 75% multiplied by what would be the minimum monthly payment shown in Exhibit A-3. Additionally, Exhibit A-3 lists the Annual Payment Threshold which is equal to the Minimum Monthly Payment multiplied by 12.

***Puget Sound Energy (PSE) Power Sales Agreement***

The Power Sales Agreement (PSA) with Puget Sound Energy (Puget) went into effect October 1, 1989, and continues through December 29, 2010. The PSA provides Puget with 94 MW of capacity delivered to Puget's system. An additional 3 MW of capacity is delivered at Colstrip pursuant to Amendment #1 to the PSA. A minimum annual energy guarantee of 75% load factor based upon the 94 MW delivered to Puget's system is required under the PSA.

Under the PSA, Puget may request to schedule energy at the Point of Delivery each hour based upon the Net Generating Capability of the Colstrip 3&4 Project pursuant to Section 4 of the PSA. As with DETM, Puget's energy entitlement is based upon the output of both Colstrip Units 3 and 4. MPC and PPL Montana have entered into the Colstrip Units 3&4 Generating Project Reciprocal Sharing Agreement (RSA) which provides both MPC (now NWE) and PPL Montana a 15% Project Share in the Colstrip Units 3&4 Project (Project).

Compensation for services rendered under the PSA is defined in Section 6 of the PSA and is based on a Monthly Fixed Charge Rate (defined in Section 1.1.11 and further defined in Section

6 of the PSA). The Monthly Fixed Charge Rate has been modified pursuant to Amendment #1 to the PSA.

Under the PSA, Puget also pays an energy charge based on MPC's monthly fuel cost at the Colstrip Units 3&4 Project. Complete compensation provisions are defined within the PSA.

Transmission of the energy under the PSA is outlined in Section 5 of the PSA and further clarified pursuant to Amendment #1 to the PSA. Generally, transmission service from Colstrip to the Point of Delivery (Puget's system) under the PSA is provided under the following agreements.

- Colstrip to Townsend, MT - NWE-dedicated transmission on the Colstrip Transmission System.
- Townsend to Garrison MT - NWE has dedicated transmission on NWE's share of the Montana Intertie -- Colstrip Project/Bonneville Power Administration (BPA) Agreement DE-MS79-81BP90210.
- Garrison MT to Point of Delivery - Puget/BPA Agreement DE-MS79-94BP93947 Amendment #1 to the PSA provides that this General Transmission Agreement meets NWE's obligations pursuant to Section 5 of the PSA.

#### ***NorthWestern Energy 90MW Baseload PPA***

NorthWestern Corporation has agreed to provide 90MW baseload to NorthWestern Energy's Default Supply Function. As of this time, there is no legal document of the PPA as a company cannot contract with itself, however, it is contemplated that NorthWestern will be moving the Colstrip lease asset to an LLC. Such a move will require an affiliate contract between the parties to be executed. The terms of the agreement are to be as follows: The term will be from July 2007 through December 2018, the quantity will be 90MW of baseload unit contingent power without reserves, and the delivery point will be the Colstrip Switchyard. The source of the energy will be the repurchase energy described in detail in the above DB PPA summary through December 2010 and then will be directly from the plants subsequent to the DB contract expiration.

#### **NWE/PPL Colstrip Units 3&4 Generating Project Reciprocal Sharing Agreement**

There are certain contractual obligations contained in the Power Sales and Power Purchase Agreements, the Colstrip 4 Lease agreements, and certain of the Colstrip Project agreements with respect to the operation of Colstrip Units 3&4. Under these various agreements, Unit 3 and Unit 4 are operated jointly as twin units. The contractual obligations relative to joint operation of Units 3&4 include, but are not limited to: (1) governance under the various agreements; (2) the apportionment of the output of the plants to meet the obligations under the Power Sales and Power Purchase Agreements; and (3) the means of sharing the cost of operation, maintenance, and capital improvements between NWE and PPL. These obligations are met by NWE and PPL Montana through the NWE/PPL Colstrip Units 3&4 Generating Project Reciprocal Sharing Agreement.

### **Colstrip Project Agreements**

Ownership and operation of the Colstrip Project is governed by various Project Agreements, which can be divided into agreements specific to Units 1&2, agreements specific to Units 3&4 and agreements applicable to Units 1-4. The following is a list of the Project Agreements applicable to Unit 4. Brief summaries, unless already discussed, are provided below.

Agreements specific to Units 3&4 include:

- Colstrip Units 3&4 Ownership and Operation Agreement (plus amendments)
- Colstrip, Units 3&4 Amended and Restated Coal Supply Agreement
- Colstrip Units 3&4 Coal Transportation Agreement (plus amendments)

Agreements applicable to Units 1-4 include:

- Common Facilities Agreement (plus amendments)
- Colstrip Project Transmission Agreement (plus amendments)

#### ***Colstrip 3&4 Amended and Restated Coal Supply Agreement***

The coal supply for Colstrip Units 3&4 is Western Energy Company's Rosebud Mine, now owned by Westmoreland Mining LLC. The mine area that supplies coal to Colstrip Units 3&4 is located approximately six miles from the power plant site. The coal is transported via a 4.2-mile long overland conveyor from the mine to the plants; therefore there is a coal supply agreement and a separate coal transportation agreement. From 1993 to 1999, Colstrip Units 3&4 have taken delivery of coal (in total) ranging from 4.32 to 6.99 million tons per year. NWE's share of the Unit 3&4 tonnage is approximately 15%, but NWE and the other project owners budget for their respective coal requirements separately and also are invoiced separately. NWE pays for its coal based on its allocation of generation from NWE's 15% Project Share in Colstrip Units 3&4 in accordance with the RSA.

#### ***Colstrip Units 3&4 Coal Transportation Agreement***

The Coal Transportation Agreement (CTA) was amended on August 24, 1998. The CTA's term is through December 31, 2019.