Testimony of
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Good morning. My name is Dave Gates. I am the Vice President of Transmission Operations at NorthWestern Energy.

I would like to commend the Commission for convening this technical conference and thank you for providing me with the opportunity to present NorthWestern Energy's viewpoints. I would like to highlight three things the Commission could do to encourage more transmission development, particularly in the West. One, consider new transmission rate design methodologies for "export" transmission lines so that a transmission provider's native load customers do not subsidize facilities that benefit others. Two, explore various financial incentives for new transmission development. And three, provide some guidance on (a) resolving conflicts arising from differences in the generation interconnection and transmission queues and (b) reasonable limitations on the amount of declared network resources attributable to native loads.

NorthWestern Energy owns and operates electric and natural gas distribution and transmission facilities located primarily in Montana and South Dakota.

My comments today will focus on NorthWestern Energy's operations in Montana.

NorthWestern Energy provides regulated electric and natural gas transmission and distribution services to 295,000 electric customers and 156,000 natural gas customers covering over 109,000 square miles in the western two-thirds of Montana. The State of Montana passed legislation in 1997 enabling both electric and natural gas supply deregulation, and, as a result, certain consumers are allowed to purchase electric or gas supply in the wholesale marketplace.[1] Influenced by the electric restructuring process in Montana, NorthWestern Energy's predecessor, The Montana Power Company, in December 1999 sold substantially all of its electric generation facilities to one buyer.

As a result, Northwestern Energy's transmission operations must secure all ancillary services, load following, (or frequency response) and system energy balancing on a contract basis. The market place for these services is immature and illiquid, and procuring these services can be challenging.

Given that NorthWestern Energy is essentially a wires and pipes business, and considering that organic growth in the region is relatively modest—in the 1–1½% range—transmission provides an opportunity for growth. Montana and our neighbor to the North, the Province of Alberta, are both rich in developable natural resources, including coal, wind and natural gas. To assure that these

[1] The 2001 Montana Legislature passed laws extending from July 1, 2002 to July 1, 2007, the transition period for electric consumers to choose retail suppliers. It also affirmed NorthWestern Energy as the default supplier for electric customers who do not choose an alternative supplier during the extended transition period. The 2003 Montana Legislature further extended the transition period until 2027, and provided certain limits on the ability of small customers to move to an alternative supplier.

resources can be made available to the market, significant new transmission must be built in the region.

NorthWestern Energy supports the continued development of Grid West, the Pacific Northwest's proposed Regional Transmission Organization ("RTO"); our company has contributed significant time and resources to the development; in fact, the President of the initiative is a NorthWestern Energy employee. That said, implementation of anything resembling an RTO is several years away at best. Because of this uncertainty, jurisdictional transmission owners have been reluctant to pursue transmission investment in the Grid West footprint.

Against this backdrop, in December of 2004, NorthWestern Energy conducted an Open Season to allow generators, marketers and load serving entities to express interest in new transmission capacity from Montana to Idaho. The interest in this process was overwhelming. Over 2200 MW of interest were expressed on this path, which is currently rated at slightly over 300 MW. As a result, NorthWestern Energy is currently conducting system impact studies for the Montana to Idaho Open Season and evaluating the type and size of facility that is needed to meet the demands of the Open Season requests. These studies should be completed by early May, at which time the results will be shared with the Open Season participants so that we can then proceed to undertake a more detailed facilities study.

As we go forward with the Open Season, Commission guidance on a number of issues would be helpful.

Rate Design

We need to rethink how rates for transmission services are calculated. The current rate design methodology works adequately for network customers and system improvements required to serve those network customers. However, it did not contemplate, nor was it designed to address, “export” or regional transmission expansion. Current rate design methodology crumbles when costs remain local and benefits accrue to customers, sometimes hundreds or thousands of miles distant. For example, significant new generation is being proposed in Montana, but is intended to serve customers outside of NorthWestern Energy’s control area. Under the current rate design methodology, native load customers would be asked to subsidize this transmission expansion while receiving limited benefit. Understandably, state regulators are concerned.

Against this backdrop, NorthWestern Energy urges the Commission to explore new and different rate designs. For example, in the natural gas industry, when new a pipeline adds compression facilities to create new transportation capacity, the cost of incremental facilities can be assigned to the customers that subscribe to and benefit from the new capacity. This type of rate treatment should be

considered, as we explore ways to induce investment in new electric transmission facilities.

Incentive Returns

Additionally, some form of incentive returns should be considered to induce transmission providers to invest scarce capital in infrastructure development. For example, while NorthWestern Energy is working on its Open Season for cost-of-service transmission facilities regulated by the Commission, a third-party is developing a merchant transmission line from Canada to Montana. The Commission should encourage both types of project development. Each should be allowed to earn similar returns on equity and be afforded similar incentives provided to independent transmission companies or other transmission providers.

In addition to these ideas, other items for consideration could be: rate surcharges for identified export transmission lines, Capital buy-downs, or even contributions in aid of construction, coupled with some form of transferable capacity rights.

Generation and Transmission Queue Coordination

Clarity should be brought to the coordination and primacy of the generation and transmission queues. NorthWestern Energy has seen the declaration of new projects as network resources that far exceed current or projected native load requirements. The practical effect of this declaration is to defer, even further,

decisions related to export transmission development. Additionally, this unrealistic view of the future potentially places the increased burden of internal network expansion on native load customers, while the benefit of internal network expansion accrues to others.

Summary

In closing, the Commission should consider three steps to encourage additional investment in transmission facilities. First, explore and implement new rate design methodologies to ensure that those who benefit from "regional" transmission lines pay for the costs. Second, financial incentives to develop new transmission should be available to any developer irrespective of its business structure, that is, whether it is an IOU or a merchant transmission provider. Third, provide guidance on how transmission providers should (i) coordinate the generation and transmission queues, and (ii) can reasonably limit the amount of new generation that can be declared as network resources.