AAA No. 77-198-000416-12

AMERICAN ARBITRATION ASSOCIATION

In the Matter of Arbitration Between

CONFEDERATED SALISH AND KOOTENAI TRIBES OF THE FLATHEAD RESERVATION,
Claimant

and

PPL MONTANA, LLC,
Respondent

FINAL AWARD

I. JURISDICTION AND PROCEDURAL MATTERS

A. The 1985 FERC Order

This Final Award is issued in an arbitration proceeding conducted pursuant to an Order of the Federal Energy Regulatory Commission ("FERC") in *The Montana Power Company, Confederated Salish and Kootenai Tribes of the Flathead Reservation*, 32 FERC ¶ 61,070 (July 17, 1985) (the "1985 FERC Order").

The 1985 FERC Order resolved a contested licensing proceeding between The Montana Power Company ("MPC") and The Confederated Salish and Kootenai Tribes of the Flathead Reservation ("CSKT") regarding a hydroelectric project located on the Flathead River in Montana (the "Kerr Project"). The dispute was resolved by providing that the license for the Kerr Project would be issued jointly to MPC and CSKT, MPC would operate the Kerr Project for at least the first 30 years of the license period, and CSKT would have the option to purchase the Kerr Project for a period of time commencing on the 30th anniversary of the Effective Date of the license. The specified purchase price was a formula referred to as the Conveyance Price.

Anticipating the possibility of disagreement regarding application of the formula, the 1985 FERC Order provided that any dispute regarding the Conveyance Price would be resolved by arbitration:

> (3)(a) No later than the 25th anniversary of the Effective Date, MPC shall provide the Tribes, the Secretary, and the Commission with a written estimate of the Conveyance Price as of the 30th anniversary of the Effective Date, together with an explanation of how that estimate was derived. MPC shall provide an updated estimate and explanation on or before the 27th anniversary of the Effective Date. Within 60 days after receipt of that updated estimate the Tribes shall, if they wish to dispute such estimate, so notify MPC, the Commission, and

> the Secretary in writing. If the Tribes do not give such notice, then such estimate shall, upon expiration of the notice period and until the establishment of a succeeding Estimated Conveyance Price under subparagraph (b), constitute the Estimated Conveyance Price.
>
> If the Tribes do timely give such notice, and if the parties cannot resolve the dispute by negotiation within 60 days from such notice, then a board of arbitration, constituted as hereafter described, shall promptly be convened. The board shall estimate the Conveyance Price, as of the 30th anniversary of the Effective Date, which estimate shall, until the establishing of a succeeding Estimated Conveyance Price under subparagraph (b), constitute the Estimated Conveyance Price. The decision will explain in reasonable detail the basis for the estimate. The board will issue its decision no later than six months after the 28th anniversary of the Effective Date.

Ordering Paragraph (C)(3)(a).

The 1985 FERC Order further specified the procedures to be followed in the arbitration:

> (e) Any arbitration proceedings pursuant to this paragraph (C) shall be conducted under the Commercial Arbitration Rules of the American Arbitration Association (the AAA), subject to any additional rules or provisions existing under Federal law. The board of arbitration shall consist of one member selected by the Tribes, one member selected by MPC, and a third member selected by the other two members. If the latter cannot agree upon a third member, then such member shall be selected by the AAA. The decision of the board shall be final and binding upon the parties. Any court proceeding arising out of the arbitration proceedings shall, to the extent possible, be brought in Federal court.

Ordering Paragraph (C)(3)(e).

B. Institution of Arbitration Proceedings

PPL Montana, LLC ("PPLM") is the successor to MPC as the operator and co-licensee of the Kerr Project. PPLM timely gave the notice of the estimated Conveyance Price on or before the 27th anniversary of the Effective Date, as contemplated by Ordering Paragraph (C)(3)(a). CSKT timely disputed that estimate. The parties were unable to resolve their disagreement.

On December 21, 2012, CSKT filed a Statement of Claim and Demand for Arbitration with the AAA. PPLM filed its Response to CSKT's Statement of Claim and Demand for Arbitration on January 18, 2013.

Pursuant to the procedures of the AAA, the following persons were appointed as members of the Arbitration Panel:

> David B. Raskin, Partner, Steptoe & Johnson LLP, Washington, D.C.
>
> James A. Snyder, Partner, BKD, LLP, Kansas City, Missouri.
>
> Layn R. Phillips, Partner, Irell & Manella, LLP, Newport Beach California. Former United States District Judge.

Pursuant to Ordering Paragraph (C)(3)(e) of the 1985 FERC Order, one member of the Panel was selected by CSKT, one member was selected by PPLM and the third member of the Panel was selected by the other two members. CSKT selected Mr. Snyder and PPLM selected Mr. Raskin. Messrs. Raskin and Snyder selected Judge Phillips as the third member of the Panel.

As the only Panel member not selected by a party, Judge Phillips was designated as Chair of the Arbitration Panel. See Commercial Arbitration Rules of the American Arbitration Association, Rule R-14.

C. Jurisdictional Challenge

On April 26, 2012 (prior to the commencement of this arbitration proceeding) PPLM filed a Petition for Declaratory Order with FERC, asking FERC to decide certain issues related to the determination of the Conveyance Price. FERC did not respond to PPLM's Petition prior to the institution of the arbitration proceeding.

On May 10, 2013, PPLM filed with the Panel a Motion for Determination of the Board's Jurisdictional Authority and Referral of Certain Issues to FERC. The Motion asserted that the Panel had no authority to decide certain issues relevant to determination of the Conveyance Price and requested that the Panel refer such issues to FERC. After full briefing, the Panel unanimously denied PPLM's motion in an Opinion and Order issued July 17, 2013.

On July 22, 2013, PPLM filed with FERC a Motion to Lodge and Request for Expedited Action, in which it sought to lodge the Panel's July 17, 2013 Opinion and Order with FERC and requested FERC to take prompt action on PPLM's Petition for Declaratory Order.

On October 15, 2013, FERC responded to PPLM's Petition for Declaratory Order and its Motion to Lodge and Request for Expedited Action. *PPL Montana LLC*, 145 FERC ¶ 61,043 (October 15, 2013) (the "2013 FERC Order"). FERC held that "as specified in the License, the Board of Arbitration (Board) is the appropriate entity to resolve disputes as to the Conveyance Price." (2013 FERC Order, Paragraph 2.) FERC also provided guidance on certain accounting issues pending before the Panel.

D. Hearing

Hearing was held in Newport Beach, California from January 22, 2014 to January 29, 2014, inclusive. The parties presented direct and rebuttal testimony in writing prior to the hearing. Cross-examination and redirect testimony occurred at the hearing.

CSKT presented evidence from the following witnesses:

1. Thomas C. King;
2. Ernie J. Kindt;
3. Julie Desimone;
4. Nancy Heller Hughes;
5. Howard J. Axelrod;
6. Brian Lipscomb;
7. Joseph Durglo;
8. Vern Clairmont;
9. Ronald Trosper;
10. Antoine Incashola.

PPLM presented evidence from the following witnesses:

1. Bruce E. Warner;
2. John L. Alke;
3. David M. Eberhardt;
4. James K. Guest;
5. John Jourdonnais;
6. Charles S. Baker;

7. David B. Kinnard.

Both parties submitted numerous written exhibits which were entered into evidence. The parties also submitted pre-hearing and post-hearing briefs and written answers to questions posed by the Panel. The testimony, the exhibits, the briefs and all other submissions were considered by the Panel.

E. Partial Award

On January 29, 2014, the Panel issued a Partial Award determining certain aspects of the Conveyance Price. The Partial Award is hereby incorporated by reference into this Final Award.

F. Majority Decision

This Final Award constitutes the decision of a majority of the Panel. See Commercial Arbitration Rules of the American Arbitration Association, R. 44(a).

II. FACTUAL BACKGROUND

A. The Parties

PPLM is a Delaware limited liability company. PPLM is an indirect wholly-owned subsidiary of PPL Corporation, a publicly-held Pennsylvania corporation, with its headquarters in Allentown, Pennsylvania.

CSKT is a federally recognized Indian tribe comprised of the Bitterroot Salish, the Pend d'Oreille, and the Kootenai Tribes. CSKT is headquartered in Pablo, Montana. By the terms of a treaty with the United States, CSKT holds possession of the Flathead Reservation in Montana.

B. The Kerr Project

The Kerr Project is a FERC-regulated hydroelectric dam and associated facilities located on the Flathead River in northwestern Montana. The Project Works are located within the Flathead Reservation. The Kerr Project is located on the lower Flathead River approximately 4.5 miles downstream from the natural outlet of Flathead Lake. Flathead Lake is the largest natural freshwater lake west of the Mississippi. The lake and the nearby portions of the Flathead River house a thriving and varied fishery, and support a varied population of wildlife and vegetation. The area contains a number of historic and prehistoric cultural resource sites. Flathead Lake is also an important recreation site.

An initial 50-year license to construct and operate the Kerr Project was issued by the Federal Power Commission to the Rocky Mountain Power Company (a subsidiary of MPC) on May 23, 1930. The license was transferred to MPC in 1938. The dam and first generating unit began commercial operation in 1939, the second unit in 1949, and the third unit in 1954.

C. The 1985 FERC Order

The initial license for the Kerr Project expired on May 22, 1980. MPC applied for renewal of its license on June 1, 1976. CSKT filed a competing application for a new license on July 2, 1976. Pending the issuance of a new license, FERC issued an annual license to MPC for each license year.

After lengthy negotiations, the competing applicants agreed to a compromise, which was approved by, and incorporated into, the 1985 FERC Order. Pursuant to the settlement, FERC issued a license to MPC and CSKT as joint licensees. The license term commenced on September 5, 1985 (the "Effective Date") and will expire 50 years thereafter. MPC would control, operate, maintain and have exclusive right to, and interest in, the Kerr Project and all of the rights and obligations of the licensee under the license from the Effective Date until the Conveyance Date (as defined in the 1985 FERC Order).

The 1985 FERC Order granted CSKT the right to purchase the Kerr Project from MPC at any time between the 30th and 40th anniversaries of the Effective Date, upon one year's notice. CSKT would compensate MPC for transfer of the Kerr Project by paying MPC the "Conveyance Price." Ordering Paragraph (C)(2) of the 1985 FERC Order defined the Conveyance Price as follows:

> (2) The term "Conveyance Price" shall mean the sum of (a) the actual original cost of the project (including any additions and improvements thereto) less accumulated depreciation, as reflected in MPC's FERC accounts (as those accounts are maintained in accordance with routine Commission audit and compliance procedures), as of the Conveyance Date; (b) the original cost, less accumulated depreciation as of the Conveyance Date, of any automatic control equipment located at MPC's dispatch center and not included in (a) that is being used as of the time of conveyance to control the operation of the project and for which MPC has no other comparable need after the conveyance; (c)(i) the cost to MPC of replacing any communications facilities that are among the project works conveyed to the Tribes, but that are, in addition, used and useful in the operation of MPC's integrated system, minus (ii) the original cost, less accumulated depreciation, of such equipment to the extent included in (a) above; and (d) the original cost of any flooding rights or other interests in realty outside the project boundary which interests, at the Conveyance Date, are used and useful in the operation of the Project, remain effective at least until the termination of this joint license, and are assignable to the Tribes.

The 1985 FERC Order also added Articles 45, 46 and 47 to the license. These articles required MPC to submit various environmental mitigation plans for approval. They also authorized the Secretary of the Interior to impose additional license conditions with respect to wildlife and related environmental concerns pursuant to Section 4(e) of the Federal Power Act. Section 4(e) of the Federal Power Act (16 U.S.C. § 797(e)) provides that a FERC license for a dam located within a reservation of the United States "shall be subject to and contain such conditions as the Secretary of the department under whose supervision such reservation falls shall deem necessary for the adequate protection and utilization of such reservation."

D. The 1997 and 1998 FERC Orders

After extensive studies, the Department of the Interior filed its Section 4(e) conditions in 1994 and revised them in 1995. The conditions imposed certain operating restrictions on the Kerr Project. They also required MPC to conduct numerous activities for the preservation of fish, wildlife and habitat. These conditions were added as Articles 55-79 of the license.

MPC objected to these requirements. FERC approved Interior's conditions, holding that it had no discretion to reject them under the Federal Power Act. *The Montana Power Company, Confederated Salish and Kootenai Tribes of the Flathead Reservation*, 79 FERC ¶ 61,376 (June 25, 1997).

MPC and CSKT both sought rehearing on various issues. FERC granted rehearing on certain issues not here relevant, and denied rehearing on all other issues. *The Montana Power Company, Confederated Salish and Kootenai Tribes of the Flathead Reservation*, 85 FERC ¶ 61,164 (October 30, 1998).

MPC appealed the 1997 and 1998 FERC Orders to the Court of Appeals for the District of Columbia Circuit.

E. MPC's Sale of the Kerr Project to PPLM

While MPC's appeal was pending, MPC agreed to sell its generation assets (including the Kerr Project) to an affiliate of PPLM. PPLM succeeded to the rights of its affiliate. FERC approved transfer of MPC's interest in the Kerr Project license to PPLM by an order dated July

7, 1999. *Montana Power Company, Confederated Salish and Kootenai Tribes of the Flathead Reservation, PP&L Montana, LLC*, 88 FERC ¶ 62,010 (July 7, 1999).

F. The 2000 FERC Order

During the pendency of MPC's appeal of the 1997 and 1998 FERC Orders, the parties (now including PPLM) reached a compromise agreement regarding the issues in dispute. The settlement was approved by FERC and incorporated into a FERC Order, reported as *PPL Montana, LLC, Confederated Salish and Kootenai Tribes of the Flathead Nation*, 93 FERC ¶ 62,198 (December 14, 2000) (the "2000 FERC Order"). The settlement modified the environmental mitigation requirements in certain respects. The settlement also modified the definition of "Conveyance Price" to deal with certain disagreements that had arisen. FERC approved the settlement agreement in a formal order. The settlement agreement itself is attached as Appendix B to the 2000 FERC Order. The 2000 FERC Order defined the Conveyance Price as follows:

> The term "Conveyance Price" shall mean the sum of: (a) the actual original cost of the project (including any additions and improvements thereto) less accumulated depreciation, as reflected in MPC's FERC accounts (as those accounts are maintained in accordance with routine Commission audit and compliance procedures), as of the [C]onveyance Date; (b) the original cost less accumulated depreciation as of the Conveyance Date, of any automatic control equipment located at MPC's dispatch center and not included in (a) that is being used as of the time of conveyance to control the operation of the project and for which MPC has no other comparable need after the conveyance; (c)(i) the cost to MPC of replacing any communications facilities that are among the project works conveyed to the Tribes, but that are, in addition, used and useful in the operation of MPC's integrated system, minus (ii) the original cost, less accumulated depreciation, of such equipment to the extent included in (a) above; and (e) the original cost of any flooding rights or other interests in realty outside the project boundary which interests, at the Conveyance Date, are used and useful in the operation of the project, remain effective at least until the termination of this joint license, and are assignable to the Tribes; provided, however, that the term "Conveyance Price" shall not include environmental costs incurred by MPC (regardless of the fact that it has not continued to be a co-licensee) that the Montana Public Service Commission has authorized MPC (regardless of the fact that it has not continued to be a co-licensee) to recover from its customers. 93 FERC at 64,390-64,391.

The definition of Conveyance Price in the 2000 FERC Order is identical to the definition contained in the 1985 FERC Order except for the final proviso, commencing with the words "provided, however."

G. The 2013 FERC Order: Guidance

On April 26, 2012, PPLM filed a Petition for Declaratory Order with FERC, asking FERC to decide certain issues related to the determination of the Conveyance Price. On October 15, 2013, FERC responded to this petition in *PPL Montana, LLC*, 145 FERC ¶ 61,043 (October 15, 2013). FERC declined to decide all of the accounting issues in the case, leaving resolution of these matters to the Panel as contemplated by the 1985 FERC Order. However, FERC did issue guidance on certain accounting issues in Paragraphs 22 and 23 of the 2013 FERC Order. That guidance is discussed later in this opinion.

III.
THE PARTIES' POSITIONS: PARTIAL AWARD

A. PPLM's Position

Pursuant to Ordering Paragraph (C)(3)(a) of the 1985 FERC Order, PPLM submitted its estimate of the Conveyance Price on September 4, 2012. In that submission, PPLM estimated the Conveyance Price as of the Conveyance Date to be $51,647,039. This estimate consisted of the following:

- Tangible Plant (original cost less depreciation): $16,562,540
- Intangible Plant (principally environmental mitigation costs): $34,184,429
- "Severance Costs": $1,105,250
- "Regulatory Cost Offset": ($205,180)

PPLM subsequently modified this estimate in certain respects.

After FERC issued its 2013 Order, PPLM reduced the Intangible Plant figure by $2,438,479, allegedly the amount of environmental mitigation costs that CSKT would be required to pay after it took over the Kerr Project. This reduced the Intangible Plant figure to $31,745,950.

PPLM reversed the Regulatory Cost Offset credit. This was originally PPLM's estimate of the amount of environmental mitigation costs that the Montana Public Service Commission had authorized MPC to recover from its customers. PPLM subsequently asserted that the Montana Public Service Commission had not authorized MPC to recover any environmental mitigation costs.

PPLM clarified the "Severance Costs" figure. The figure used in PPLM's estimate was $1,105,250. PPLM explained that this consisted of: (1) $15,250 of communications equipment; (2) flooding rights of $987,300; and (3) $102,700 of severance compensation for PPLM employees.

After these adjustments, PPLM's position at the time of the hearing was that the Conveyance Price as of the Conveyance Date would be $49,413,740, consisting of:

- Tangible Plant: $16,562,540
- Intangible Plant: $31,745,950
- Communications Equipment: $15,250
- Flooding Rights: $987,300
- Severance Compensation: $102,700

B. CSKT's Position

CSKT asserted that the Conveyance Price as of the Conveyance Date would be $14,674,428.

This figure consists of:

- Tangible Plant: $14,659,178
- Communications Equipment (called Automatic Control): $15,250

The difference in the "Tangible Plant" amount in CSKT's and PPLM's calculations relates to a disagreement regarding appropriate depreciation methodology. CSKT asserted that the "Intangible Plant," "Flooding Rights" and "Severance Compensation" amounts should be zero.

C. Partial Award

On January 29, 2014, the Panel issued a Partial Award determining the following elements of the Conveyance Price:

- Tangible Plant: $16,562,540
- Communications Equipment: $15,250
- Flooding Rights: $0
- Severance Compensation: $0

All members of the Panel concurred in these determinations. The parties' disagreement regarding the alleged Intangible Plant asset is the only issue remaining to be decided.

IV.
PRELIMINARY MATTERS

A. The Structure of This Opinion; Findings and Evidentiary Matters

Numerous factual matters were in dispute in the course of this proceeding. The Panel has necessarily been required to resolve many of these factual disputes. In light of the extensive record of this proceeding, this Final Award does not contain formal findings of fact regarding every matter in dispute. However, a majority of the Panel has resolved every factual dispute and credibility issue necessary to render this Final Award. In some cases, the factual determinations are expressly stated. In all other instances, the resolution of each factual and credibility issue necessary to a decision is implicit in this Final Award.

This Final Award will not normally make express reference to the specific evidence supporting the factual determinations made herein. However, every factual determination is based upon evidence presented during the course of the arbitration.

The members of the Panel extend their compliments to all counsel and parties for the professional and cooperative manner in which this proceeding was organized and presented. Nothing herein should be construed as a criticism of any counsel or witness who appeared in this proceeding.

B. The Burden of Proof

An initial question relates to the appropriate allocation of the burden of proof. For many issues before the Panel, the burden of proof is irrelevant. Questions of law and matters of statutory, regulatory and contractual interpretation are determined by the Panel *de novo*, without regard to burden of proof. However, allocation of the burden of proof can be significant with respect to some factual issues.

To the extent relevant to our determination, we hold that PPLM bears the burden of proof as to the historical accounting for the Kerr Project and the propriety of that accounting.

The FERC Orders do not expressly allocate the burden of proof. The 1985 FERC Order contemplates that MPC (now PPLM) will deliver an estimate of the Conveyance Price to CSKT "together with an explanation of how that estimate was derived." (1985 FERC Order at Ordering Paragraph (C)(3)(a).) This suggests, at least, that PPLM has the initial responsibility of calculating the Conveyance Price and providing a reasoned explanation for that calculation.

CSKT relies on 16 U.S.C. § 825(a), which states, in part:

> Every licensee and public utility shall make, keep, and preserve for such periods, such accounts, records of cost-accounting procedures, correspondence, memoranda, papers, books, and other records as the Commission may by rules and regulations prescribe as necessary or appropriate for purposes of the administration of this Act . . . . The Commission may prescribe a system of accounts to be kept by licensees and public utilities and may classify such licensees and public utilities and prescribe a system of accounts for each class . . . . The burden of proof to justify every accounting entry questioned by the Commission shall be on the person making, authorizing, or requiring such entry . . . .

The allocation of the burden of proof specified in § 825(a) is not directly relevant, since PPLM's accounts are being questioned by CSKT, not FERC. However, the statute does require PPLM to keep and maintain adequate books and records. This requirement suggests that PPLM has (or should have) books and records necessary to determine the Conveyance Price. Moreover, when a plant is sold, all accounting records relating to the plant "must be transferred to the new owners." (18 C.F.R. § 125.2(g)(2).) Therefore, PPLM is more likely than CSKT (and is arguably required) to have MPC's accounting records.

CSKT argues that PPLM, as the operating licensee of the Kerr Project, was required by FERC regulations to keep its books of account in accordance with the Uniform System of Accounts ("USofA") established by FERC, and this obligated PPLM to keep permanent records of the "original cost of the project." (18 C.F.R. Part 101, General Instruction 16.) PPLM is obliged to have in its possession the records necessary to establish the "original cost of the project" – the most significant element of the Conveyance Price. Because PPLM is required to have that information, PPLM should have the burden of establishing the facts relevant to determination of the Conveyance Price.

CSKT's position is reasonable. The Second Circuit has noted that "[b]urden-shifting where one party has superior access to evidence on a particular issue is a common feature of our law." *United States v. One Parcel of Property Located at 194 Quaker Farms Road*, 85 F.3d 985, 990 (2d Cir. 1996). *See also Securities and Exchange Commission v. Platforms Wireless International Corp.*, 617 F.3d 1072, 1096 (9th Cir. 2010) (placing burden on defendants when they "are more likely than the SEC to have access to evidence").

PPLM acquired the Kerr Project from MPC and has actually operated the Kerr Project for fourteen years. It unquestionably has greater access to accounting records and information regarding the Kerr Project than CSKT. PPLM bears the burden of proof as to the historical accounting for the Kerr Project and the propriety of that accounting.

V.
ISSUES PRESENTED

The sole remaining issue in this arbitration is the inclusion of the Intangible Plant asset in the Conveyance Price, and, if it is included, the amount to be included.

The principal component of the Intangible Plant asset relates to the costs of the environmental mitigation requirements imposed upon the licensee of the Kerr Project pursuant to the 1997 and 2000 FERC Orders. PPLM asserts that, in 1997, MPC estimated the total Section 4(e) environmental mitigation payments required through the expiration of the term of the Kerr Project license in 2035 and determined the net present value ("NPV") of those payments to be approximately $56.7 million. MPC recorded the NPV of the liabilities as long-term debt on its balance sheet and created a corresponding intangible asset in an equal amount. This intangible asset (amortized on a straight-line basis from 1997 through 2035) constitutes the bulk of the Intangible Plant asset in dispute. PPLM asserts that this NPV Intangible Plant asset (after

adjustments and amortization through the Conveyance Date) is $29,783,015, and that this amount should be included in the Conveyance Price.[1]

CSKT opposes this position on numerous grounds. It disputes whether the initial capitalization of the intangible asset ever occurred and suggests that, if it did occur, it was subsequently reversed. CSKT also argues that the environmental mitigation costs should never have been capitalized, because they were operating expenses, which should have been expensed as incurred. CSKT further argues that the 2013 FERC Order and basic principles of accounting require that the entire Intangible Plant asset be eliminated because the Intangible Plant asset as calculated by PPLM actually represents the environmental mitigation costs that CSKT will pay during the period of its operation of the Kerr Project subsequent to 2015. CSKT also argues that all, or a substantial portion, of the amount shown on PPLM's calculation must be excluded by the final proviso in amended Ordering Paragraph (C)(2) because the Montana Public Service Commission authorized MPC to recover that amount from ratepayers.

We perceive that the following issues must be addressed in order to determine the proper amount (if any) of the Intangible Plant asset to be included in the Conveyance Price.

First, whether CSKT agreed that the Intangible Plant asset corresponding to the Section 4(e) environmental mitigation costs was to be included in the Conveyance Price.

Second, whether, and to what extent, the NPV Intangible Plant asset was "reflected in MPC's [or PPLM's] FERC accounts . . . as of the Conveyance Date" within the meaning of the definition of Conveyance Price in the 2000 FERC Order.

Third, whether the Section 4(e) environmental mitigation costs were properly capitalized.

Fourth, whether adjustments must be made in the Intangible Plant amount in compliance with the guidance provided by the 2013 FERC Order and basic principles of accrual accounting.

Fifth, whether the Montana Public Service Commission authorized MPC to recover all or a portion of the Section 4(e) environmental mitigation costs from ratepayers.

Sixth, whether other elements of the Intangible Plant asset are properly included in the Conveyance Price.

VI.
WHETHER CSKT AGREED THAT THE INTANGIBLE PLANT ASSET WAS TO BE INCLUDED IN THE CONVEYANCE PRICE

PPLM argues that the 2000 FERC Order, which modified the definition of Conveyance Price, required the inclusion of the Intangible Plant asset in the Conveyance Price. This argument is incorrect.

The 2000 FERC Order approved a settlement agreement among CSKT, MPC, PPLM, the Department of the Interior and Trout Unlimited that modified the Section 4(e) environmental mitigation requirements in certain respects. It also modified the definition of the Conveyance Price by adding the following language at the end of the definition:

> provided, however, that the term "Conveyance Price" shall not include environmental costs incurred by MPC (regardless of the fact that it has not continued to be a co-licensee) that the Montana Public Service Commission has authorized MPC (regardless of the fact that it has not continued to be a co-licensee) to recover from its customers.

[1] The Intangible Plant amount shown on PPLM's 2012 estimate of the Conveyance Price was $34,184,429. However, this included $1,962,935 of intangible assets that did not relate to the NPV calculation. PPLM calculated the amount of Intangible Plant constituting the corresponding asset of the NPV liability as $32,221,494. PPLM reduced this figure by $2,438,479 in response to the 2013 FERC Order, leaving a balance of $29,783,015.

This language was agreed upon by the parties to the settlement agreement, and adopted by FERC.

PPLM argues that the necessary inference from this language is that any environmental mitigation costs that the Montana Public Service Commission did not authorize MPC to recover from its customers would be included in the Conveyance Price. PPLM reasons that there would be no point in excluding certain environmental mitigation costs from the Conveyance Price unless the other environmental mitigation costs were implicitly included.

In some circumstances, PPLM's argument might be valid. The exclusion of a particular subset of a category could give rise to a permissible inference that the remainder of that category is included. Not here. The evidence is clear that the parties did not agree that the Section 4(e) environmental mitigation costs would be included in the Conveyance Price – they reached an impasse on that issue in the negotiations and agreed to defer that issue for future resolution. However, they did agree that, regardless of the result on that general issue, certain environmental mitigation costs would not be included.

The parties have presented evidence regarding the negotiations that led to this language. CSKT has submitted the testimony of Brian Lipscomb, who participated in the negotiations on behalf of CSKT. PPLM has submitted the testimony of David Kinnard, who was Vice President and General Counsel of PPLM at the time, and participated in the negotiations on behalf of PPLM. These witnesses testified consistently that CSKT did not agree that the Section 4(e) environmental mitigation costs would be included in the Conveyance Price.

The essence of their testimony is as follows. At the time of the negotiations regarding settlement in 1999, CSKT was aware that MPC was exiting the utility business, and was selling its generating assets to PPLM. The parties also knew that Montana had passed a law deregulating electricity generation and the Montana Public Service Commission was holding hearings on whether utilities could recover so-called "stranded costs" or "transition costs" from their customers. MPC had filed proceedings with the Montana Public Service Commission to recover "stranded costs," including the Section 4(e) environmental mitigation costs imposed on the Kerr Project. CSKT also knew that MPC and PPLM took the position that the environmental mitigation costs could be included in the Conveyance Price.

The parties negotiated over whether PPLM could include the environmental mitigation costs in the Conveyance Price. They were unable to reach agreement on that issue. However, PPLM and MPC were willing to agree that the Conveyance Price would not include any environmental mitigation costs that MPC could recover from its customers pursuant to an order from the Montana Public Service Commission.

Lipscomb testified that any attempt by PPLM or MPC to recover the environmental mitigation costs from CSKT would have been "offensive and categorically rejected." (Lipscomb Direct Testimony, p. 29.) He further testified that the language regarding MPC's recovery of environmental mitigation costs from consumers "was not intended to suggest, in any way, that the cash payments for the Section 4(e) License Articles could be included in the Conveyance Price that CSKT would pay to PPLM in 2015 for the Kerr Project." (Lipscomb Direct Testimony, p. 31.)

Kinnard was even clearer. In response to a question whether the parties reached agreement regarding the inclusion of environmental mitigation costs in the definition of Conveyance Price, he stated: "Only partially, with respect to a subset of the EMCs." (Kinnard Rebuttal Testimony, p. 5.) Kinnard went on to state:

> The language of both the December 1999 Statement of Agreement and the April 2000 Agreement To Amend License Terms clearly reflect that the treatment of the EMCs was an open issue that the parties negotiated but only partially resolved. . . . . Even beyond this conditional exclusion of a subset of the EMCs, the Agreement is clear that the parties did not reach agreement on the inclusion of other EMCs, but rather reserved resolution of that issue for a later date.

(Kinnard Rebuttal Testimony, p. 6.) Kinnard also testified that the parties' agreement "did not fully resolve the Conveyance Price issue." (Kinnard Rebuttal Testimony, p. 8.)

In addition, the settlement agreement (Appendix B to the 2000 FERC Order) identifies certain environmental mitigation costs that MPC had incurred and for which it would seek reimbursement from consumers. The agreement then stated: "With respect to any future costs that PPLM may pay, the foregoing paragraph is without prejudice to the right of the Tribes and PPLM to adopt opposing positions regarding the inclusion of such cost payments, if any, in the calculation of the Conveyance Price." (93 FERC at 64,400.)

The foregoing makes clear that the Panel may not draw the inference that PPLM has asked it to draw. The exclusion of a certain subset of environmental mitigation costs from the definition of Conveyance Price was not an implied inclusion of all other environmental mitigation costs. Rather, the parties "agreed to disagree" on that issue. In the words of Mr. Kinnard, the parties "reserved resolution of that issue for a later date." (Kinnard Rebuttal Testimony, p. 6.) That date has come.

VII.
WHETHER THE INTANGIBLE PLANT ASSET WAS REFLECTED IN PPLM'S BOOKS

The definition of Conveyance Price refers to "the actual original cost of the project (including any additions and improvements thereto) less accumulated depreciation, as reflected in MPC's FERC accounts (as those accounts are maintained in accordance with routine Commission audit and compliance procedures), as of the Conveyance Date . . . ." In ordinary circumstances, the determination of the assets on the books of a licensee should be a relatively simple process. In this case, it is not.

MPC had no "FERC accounts . . . as of the Conveyance Date." MPC no longer exists. It ceased to be the licensee of the Kerr Project in 1999 and filed for bankruptcy in 2003. The only accounts for the Kerr Project that will exist "as of the Conveyance Date" are PPLM's. However, PPLM does not have "FERC accounts," as that term is generally understood. PPLM keeps its accounts on the basis of generally accepted accounting principles ("GAAP"), rather than the USofA mandated by FERC. PPLM has received a waiver from FERC of the requirement to file annual FERC Form 1, which is the financial and operating report that regulated entities prepare in accordance with the USofA and submit to FERC. Although PPLM does not regularly keep its accounting records on the basis of the USofA, it states that its accounting records contain sufficient information to comply with the requirements of the USofA.

The parties are in substantial agreement that we must use PPLM's accounts to determine the Conveyance Price because those are the only project accounts that will be in existence as of the Conveyance Date. However, we must apply USofA standards to those accounts, notwithstanding the fact that PPLM's accounts are not maintained on that basis. We agree, because no other practical alternative is available.

Although the parties are in conceptual agreement that we must use PPLM's accounts to determine the Conveyance Price, they disagree as to how to apply that principle in the present case. PPLM argues, in essence, that we should ignore PPLM's accounting treatment of the environmental mitigation costs while it was the licensee. Instead, we should use MPC's accounting treatment of the environmental mitigation costs and carry that treatment forward to the Conveyance Date. CSKT contends that we must look to PPLM's accounting treatment of the Section 4(e) environmental mitigation costs to determine whether the Intangible Plant account exists as of the Conveyance Date.

We shall examine the accounting treatment of the environmental mitigation costs by both MPC and PPLM and then discuss how these accounting treatments affect the Conveyance Price.

A. MPC's Treatment of the Section 4(e) Environmental Mitigation Costs

MPC's accounting records are sparse, and MPC did not turn over all of its accounting records for the Kerr Project to PPLM, notwithstanding FERC's requirement that it do so. However, the parties have provided sufficient information for us to determine MPC's treatment of the Section 4(e) environmental mitigation costs.

Based upon the 1997 FERC Order, MPC estimated the total Section 4(e) environmental mitigation costs payable during the license term to be approximately $135 million. It determined the NPV of these future payments to be $56,701,106. These calculations used a discount rate of 9.458% and an assumed inflation rate of 3% per annum. MPC booked $56,701,106 as a liability and created a corresponding intangible asset in the identical amount. MPC reported this accounting treatment in a footnote to the financial statements filed with its 1997 FERC Form 1:

> On June 25, 1997, FERC approved a mitigation plan, substantially adopting the Department's conditions. The mitigation plan calls for payments totaling approximately $135,000,000 over the 35-year term (sic) of the license. The net present value of the total amount, using an assumed discount rate of 9.5%, is approximately $57,000,000, which the Company recognized as license costs in plant and long-term debt in the Consolidated Balance Sheet during the second quarter of 1997.

Exh. PPL-086, p. CSKT0003869. Similar language appears in MPC's 1997 Form 10-K (Exh. PPL-089, p. PPLM000430), MPC's 1998 Form 1 (Exh. PPL-087, p. CSKT0004483) and MPC's 1998 Form 10-K (Exh. PPL-090, pp. PPLM000535-536).

B. PPLM's Treatment of the Section 4(e) Environmental Mitigation Costs

PPLM did not follow MPC's accounting treatment for the Section 4(e) environmental mitigation costs. Indeed, it appears that PPLM was unaware of MPC's treatment of the environmental mitigation costs until sometime in 2008 or 2009, when PPLM first began its effort to calculate the Conveyance Price.

PPLM's opening balance sheet for the Kerr Project contains no intangible plant asset. PPLM used different methods to account for the Section 4(e) environmental mitigation costs at different times. From 1999 to 2004, PPLM capitalized the environmental mitigation costs as those costs were incurred, and amortized the costs over the term of the license. These capitalized costs were apparently reflected in a "miscellaneous intangible plant" account on PPLM's books. Commencing in 2005, PPLM prospectively changed its methodology and thereafter expensed the environmental mitigation costs as they were incurred. Because of this change in accounting treatment, PPLM made no additions to the "miscellaneous intangible plant" account after 2004. Also in 2005, PPLM modified the amortization of the "miscellaneous intangible plant" asset so that the asset would be fully amortized by 2015. This amortization term was regarded as more appropriate because of the likelihood that CSKT would exercise its option to purchase the Kerr Project in 2015. At no time did PPLM's books for the Kerr Project show an NPV liability for estimated future environmental mitigation costs or a corresponding intangible asset based upon that NPV liability. The total capitalized amount of environmental mitigation costs shown as "miscellaneous intangible plant" on PPLM's books was approximately $11.5 million. Under PPLM's accounting method, this asset would be amortized to zero as of the Conveyance Date.

C. Discussion

The parties disagree about the effect on the Conveyance Price calculation of the differential treatment of the environmental mitigation costs by MPC and PPLM. CSKT asserts that we must use PPLM's accounting for the Section 4(e) environmental mitigation costs, in which event the Intangible Plant asset corresponding to the NPV liability is zero and not a factor in the Conveyance Price determination. PPLM contends that its own accounting for the

environmental mitigation costs is irrelevant, and we must use MPC's NPV accounting, updated to the Conveyance Date.

We have concluded that the Conveyance Price calculation must be based upon PPLM's books. Therefore, the Intangible Plant asset corresponding to the NPV liability is zero.

Although PPLM's accounts will be the only accounts existing on the Conveyance Date, PPLM argues that we should disregard its accounting treatment of the Section 4(e) environmental mitigation costs and utilize MPC's capitalized NPV accounting for those costs, even though that method was never used by PPLM. PPLM provides various rationales for this position.

First, PPLM argues that its treatment of the environmental mitigation costs is irrelevant because PPLM utilizes GAAP accounting, rather than USofA accounting. This argument is unconvincing because there is no difference between GAAP accounting and USofA accounting with respect to this issue. PPLM's expert witnesses testified that the NPV capitalization method used by MPC in 1997-1999 was consistent with GAAP. Thus, PPLM could have used the NPV capitalization method to account for the Section 4(e) environmental mitigation costs under GAAP accounting (as well as USofA accounting), but chose not to do so. Accepting PPLM's argument that it was proper for MPC to capitalize the future environmental mitigation payments on an NPV basis, no witness testified that this was the only appropriate way to treat those costs. The treatment of the environmental mitigation costs was a matter of accounting judgment. Under both GAAP and USofA, there were at least three potential methods of treating the Section 4(e) environmental mitigation costs: (1) the estimated future costs could have been capitalized on an NPV basis with a corresponding asset equal to the NPV liabilities; (2) the costs could have been capitalized as incurred with a corresponding asset equal to the amounts actually incurred; or (3) the costs could have been expensed as incurred. MPC chose the first method. PPLM chose the second and third methods at various times. All of those methods were proper under both USofA and GAAP. PPLM's argument that its accounting treatment of the environmental mitigation costs is irrelevant because it used GAAP accounting would only be valid if GAAP accounting prohibited the NPV capitalization method. It did not. PPLM simply chose not to use that method.

Second, PPLM contends that its accounting treatment of the Section 4(e) environmental mitigation costs was irrelevant because PPLM used purchase accounting in its acquisition of MPC's generation assets. This argument is also unpersuasive. The purchase method of accounting for an acquisition of assets cannot be used to determine "original cost," but that is not the issue before the Panel. The question is not how PPLM accounted for the acquisition, but how it accounted for the future environmental mitigation costs. When PPLM became licensee of the Kerr Project, it assumed the obligations of the licensee to pay the Section 4(e) environmental mitigation costs. Regardless of how PPLM accounted for the acquisition of MPC's assets, it assumed a specific obligation to pay the environmental mitigation costs; that obligation existed after the acquisition. PPLM could have capitalized the obligation to make those future payments on an NPV basis (as MPC had done), but elected not to do so. PPLM's method of accounting for the acquisition of MPC's assets did not prevent PPLM from capitalizing the environmental mitigation costs on an NPV basis. PPLM's decision to expense the environmental mitigation costs was an exercise of accounting judgment, not mandated by the manner in which it accounted for the acquisition.

Third, PPLM relies upon the definition of "original cost" in the USofA. As used in the USofA, "original cost" is "the cost of such property to the person first devoting it to public service." (18 C.F.R. Part 101, Definitions, ¶ 23.) PPLM correctly notes that "original cost" does not change with a transfer of ownership. From this premise, PPLM argues that, for purposes of determining "original cost," we must look to MPC's accounting treatment of the Section 4(e) environmental mitigation obligations because MPC was the entity that was initially subject to those obligations. As discussed below, we have concluded that "original cost" does not include

estimates of future costs not yet incurred. However, for present purposes, it is not necessary to resolve the "original cost" issue. Under the agreed-upon definition incorporated in the 2000 FERC Order, there are two independent requirements for inclusion of an item in the Conveyance Price: (1) it must be part of the "original cost" of the project; and (2) it must be reflected in PPLM's accounts. Here, the second requirement is not satisfied. The "original cost" which PPLM now asserts was never reflected in PPLM's accounts at any time. Therefore, it is not an element of the Conveyance Price.

Finally, PPLM argues that its 2005 decision to expense the Section 4(e) environmental mitigation costs was an error based upon a misreading of its obligations under the FERC license. That argument is irrelevant to our decision. PPLM never capitalized the Section 4(e) environmental mitigation costs on an NPV basis – the method it now advocates. Rather, PPLM initially capitalized the costs as incurred, and thereafter decided to expense those costs. PPLM's calculation of the Conveyance Price is not based upon the method that it used prior to its decision to expense the environmental mitigation costs, but upon a method that it never used. Even accepting PPLM's contention that its decision to expense the environmental mitigation costs was based upon a misunderstanding, reversing that supposed error would only result in applying the method that PPLM used prior to its decision to expense the environmental mitigation costs – capitalizing the costs as incurred. That modification would not assist PPLM. PPLM's amortization term for the "miscellaneous intangible plant" asset (which was not based on the alleged error) would have fully amortized that asset by the Conveyance Date, so reversing the alleged error would still result in a zero balance for the asset. Moreover, regardless of the rationale underlying PPLM's decision to expense the Section 4(e) environmental mitigation costs, it is clear that expensing those costs was a legitimate method of accounting for the environmental mitigation costs under both GAAP and the USofA.

In sum, we conclude that PPLM's "FERC accounts . . . as of the Conveyance Date" did not include an intangible asset corresponding to the NPV of the Section 4(e) environmental mitigation costs. Accordingly, the amount of the NPV Intangible Plant asset is zero.

We note that the result would be the same if we were to use MPC's FERC accounts. While the creation of an intangible asset based upon capitalization of NPV liabilities may be an appropriate method of accounting under the USofA, that method may not be used to determine "original cost" – an element of the Conveyance Price definition. The USofA defines "cost" as "the amount of money actually paid for property or services." (18 C.F.R., Part 101, Definitions ¶ 9.) "Original cost" is defined by reference to "cost." (*Id.* ¶ 23.) The intangible asset created by MPC's NPV method represented MPC's estimate of amounts to be paid in the future, not "the amount of money actually paid . . . ." Accordingly, the NPV method used in MPC's FERC accounts does not reflect "original cost" and cannot be the basis for determining the Conveyance Price. Even if MPC's "FERC accounts" did exist "as of the Conveyance Date," they could not be used in the manner in which they were maintained – a requirement of the Conveyance Price definition – because that method does not reflect "original cost" – also a requirement of the Conveyance Price definition.

The dissent contends that we are inconsistent because we used the "original cost" on MPC's books to determine the Tangible Plant asset, while we used PPLM's accounting with respect to the Intangible Plant asset. Not so. Both parties agreed that the Tangible Plant asset must be based upon MPC's actual cost, because that is required under the USofA definition of "original cost." That amount could not be shown on PPLM's books because it used the purchase method of accounting when it acquired the Kerr Project. As we explain in Section XI of this opinion, MPC's books must be used when they reflect "original cost" but the purchase method of accounting prevented PPLM from recording that cost on its books. That was the case with respect to the Tangible Plant asset. That is not true with respect to the NPV Intangible Plant asset shown on MPC's books because (1) it does not reflect "original cost," and (2) the purchase method of accounting did not prevent PPLM from capitalizing the Section 4(e) environmental mitigation costs on an NPV basis on its own books. Accordingly, we must use PPLM's books.

At one point, the dissent implies that the Conveyance Price should have been calculated using the approximately $80 million (a figure which we calculate to be closer to $77.1 million) that MPC and PPLM actually paid in environmental mitigation costs as the "starting point for calculating the Conveyance Price," and depreciating that amount over the license term. The Conveyance Price definition does not permit that result. The Conveyance Price definition requires that we use the licensee's accounts (either MPC's or PPLM's) "as those accounts are maintained . . . as of the Conveyance Date . . . ." The dissent suggests a Conveyance Price calculation based on a method that was not reflected in anybody's accounts. It is therefore impermissible under the definition of Conveyance Price. Moreover, if we were to create such an accounting method out of whole cloth – a method not used by either MPC or PPLM – that method would not amortize periodic payments over the entire license term. We may accept that the NPV liabilities could be amortized over the license term because those amounts estimated all of the environmental mitigation costs payable through 2035; the entire "purchase price" of the license was reflected in that NPV figure. Unlike the NPV method used by MPC, periodic payments of environmental mitigation costs (the $80 million figure used by the dissent) do not "buy" the license for the entire term. The periodic payments are the equivalent of rent – they only "buy" the license until the next payment is due. Accordingly, if we were to accept the dissent's suggested capitalization of the periodic environmental mitigation payments actually made (which we cannot do), we would not accept the notion that those capitalized periodic payments could be amortized over the entire license term. In this context, we note that when PPLM briefly capitalized the environmental mitigation payments as incurred (before it decided to expense them), it amortized those payments only through 2015, leaving a zero balance as of the Conveyance Date. That method accurately reflects the fact that the periodic environmental mitigation payments made by MPC and PPLM only kept the license in effect during their respective periods of ownership – they did not create any benefit for CSKT. CSKT must make its own periodic environmental mitigation payments to keep the license in effect during its period as licensee.

VIII.
WHETHER MPC PROPERLY CAPITALIZED THE SECTION 4(e) ENVIRONMENTAL MITIGATION COSTS

The previous portion of our opinion should dispose of the final remaining issue regarding the Conveyance Price, thereby rendering all other arguments moot. We have nonetheless determined to address each of the other principal arguments presented by the parties. The anticipated Conveyance Date is September 5, 2015. If we failed to decide the remaining issues and our decision based upon the foregoing issue were successfully challenged, the parties would be required to engage in a new arbitration to determine the Conveyance Price. In that event, the parties might not know the Conveyance Price at the time of the transfer of the Kerr Project. In fairness to the parties, we feel compelled to resolve each of the issues presented in order to avoid that unfortunate possibility.

We shall here address the question of whether MPC's decision to capitalize the Section 4(e) environmental mitigation costs was erroneous. This issue is relevant if (as PPLM contends), the Conveyance Price should be based upon MPC's accounting, rather than PPLM's accounting.

CSKT argues that the entire concept of the Intangible Plant asset is wrong. In CSKT's view, MPC should never have capitalized the future environmental mitigation costs. Rather, the Section 4(e) environmental mitigation costs were period costs that should have been expensed as incurred.[2] CSKT contends that the environmental mitigation costs are simply operating costs, no

[2] This is a slight oversimplification of CSKT's position. CSKT concedes that some of the environmental mitigation costs might be appropriately capitalized, *e.g.*, amounts expended to construct physical additions to the Project Works. However, PPLM never identified the amount of those expenditures. In the absence of that information, CSKT contends that all of the environmental mitigation costs must be expensed.

different than any other costs of operating the project. PPLM contends that, because the Section 4(e) environmental mitigation costs are conditions of the FERC license, they are actually costs of obtaining and maintaining the license. Therefore, PPLM argues that costs should be capitalized and amortized over the life of the license.

Both parties presented extensive expert accounting testimony on this issue. The accounting experts for both sides presented reasonable grounds for their positions. PPLM's expert accounting witnesses testified that MPC's decision to capitalize the environmental mitigation costs represented a legitimate accounting judgment because the Section 4(e) environmental mitigation costs were a condition of the FERC license for the Kerr Project. As such, they were, in essence, costs of the license and should be characterized as "Miscellaneous Intangible Plant" under Account 303 of the USofA Electric Plant Chart of Accounts, *i.e.*, "the cost of patent rights, licenses, privileges, and other intangible property necessary or valuable in the conduct of utility operations and not specifically chargeable to any other account." With one exception, CSKT's expert accounting witnesses disagreed with that analysis.[3] CSKT's experts emphasized the language in the USofA Chart of Accounts that Account 303 should be used if the item is "not specifically chargeable to any other account." They identified a number of other accounts in the USofA Chart of Accounts that, in their opinion, were more appropriate, and would have resulted in expensing the environmental mitigation costs. CSKT's experts rejected the argument that the Section 4(e) environmental mitigation costs should be capitalized because they were required by the FERC license. They noted that the FERC license imposed a number of requirements (*e.g.*, flow restrictions and maintenance obligations) that were obviously expense items and which PPLM did not capitalize. The mere fact that a FERC license required the licensee to incur costs did not make those costs a capital item.

After consideration, the Panel has determined that MPC's decision to capitalize the Section 4(e) environmental mitigation costs was an appropriate exercise of accounting judgment. Although MPC was not required by either GAAP or USofA accounting principles to create an NPV liability and corresponding asset for the Section 4(e) environmental mitigation costs, MPC had the option of doing so. Accordingly, MPC's initial creation of the NPV Intangible Plant asset was proper under USofA accounting principles.

Although we find that there was at least a reasonable basis for MPC to capitalize the Section 4(e) environmental mitigation costs (NPV liability with a corresponding intangible asset) based upon the available information in 1997, this is not intended to be a finding with respect to other elements of the MPC accounting treatment of those costs or how other elements of that accounting treatment would be relevant to determination of the Conveyance Price. As we have held, the intangible asset created by capitalization of the NPV liability does not reflect "original cost" as that term is defined in the USofA and may not be used to determine the Conveyance Price. Additionally, there are other elements of MPC's accounting treatment, apart from the issue of initial capitalization, that would impact determination of the Conveyance Price if the NPV method could be used for that purpose.

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[3] The one exception was Ernie Kindt, an accountant who testified on behalf of CSKT. Mr. Kindt was formerly the Chief Accounting Officer for MPC's utility division and approved MPC's decision to capitalize the Section 4(e) environmental mitigation costs. Mr. Kindt testified that he believed this decision was appropriate, although he strongly disagreed with the manner in which PPLM calculated the Conveyance Price.

IX.
WHETHER ADJUSTMENTS MUST BE MADE TO THE INTANGIBLE PLANT ASSET PURSUANT TO THE 2013 FERC ORDER AND PRINCIPLES OF ACCRUAL ACCOUNTING

If we were to accept PPLM's contentions that (1) MPC properly capitalized the Section 4(e) environmental mitigation costs, (2) the NPV method could be used to determine "original cost," and (3) the Conveyance Price calculation must be based upon MPC's accounting treatment of the environmental mitigation costs, rather than PPLM's accounting treatment of those costs, we would still be required to determine the amount, if any, of the NPV Intangible Plant asset that should properly be included as part of the Conveyance Price. PPLM contends that this amount is $29,783,015; CSKT contends that this amount is zero.

We are assisted in this endeavor by the 2013 FERC Order, in which FERC provided accounting guidance with respect to this issue. We shall set forth FERC's guidance, and the parties' response to that guidance. We shall then provide our conclusion.

A. FERC's Accounting Guidance

On April 26, 2012, PPLM filed a Petition for Declaratory Order with FERC, asking FERC to decide certain issues related to the determination of the Conveyance Price. On October 15, 2013, FERC responded to this petition in *PPL Montana, LLC*, 145 FERC ¶ 61,043 (October 15, 2013). FERC declined to decide all of the accounting issues in the case, leaving resolution of these matters to the Panel as contemplated by the 1985 FERC Order. However, FERC did issue guidance on certain accounting issues in Paragraphs 22 and 23 of the 2013 FERC Order. That guidance is as follows:

> 22. GI No. 11 requires utilities and licensees to keep their accounts on the accrual basis, which provides for the recognition of all known transactions of appreciable amount. Where the items being measured involve mandatory payments to be made over future periods it may be appropriate to recognize a liability on a present value basis. PPL Montana explains that it recognizes a liability and a corresponding asset for the present value of environmental mitigation payments required to be made by the licensee over the 50 year license term ending in 2035. However, we note that PPL Montana's obligation for environmental mitigation payments will cease to exist upon the conveyance of the Kerr Hydroelectric Project to the Tribes in 2015. Accordingly, there is no underlying basis for PPL Montana to recognize a liability for future environmental obligations it will not be obligated to pay.
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> 23. GI No. 11 also requires adjustments to a previously recorded liability when additional information is received. Since it is known that the Tribes will acquire the Kerr Hydroelectric Project in 2015, releasing PPL Montana from subsequent environmental mitigation obligations, it is inappropriate under the USofA for PPL Montana to continue to recognize a liability for obligations from which it will be released. This being the case, the environmental liability and corresponding asset should be eliminated from PPL Montana's books upon the conveyance of the Kerr Hydroelectric Project.

After the first sentence in Paragraph 23, FERC added footnote 17, stating as follows:

> "If bills covering . . . transactions have not been received or rendered, the accrued amounts shall be estimated and appropriate adjustments made when the bills are received." 18 C.F.R. Part 101, GI No. 11 (2013). The implementation of the accounting requirements under the License here presents a like circumstance where the accrual approach, without adjustment, would work an unjust and unreasonable result.

B. The Parties' Response to FERC's Guidance

The parties had very different interpretations of FERC's guidance. PPLM asserted that FERC's guidance had no bearing at all on the Conveyance Price or, alternatively, that the effect on the Conveyance Price was minimal. CSKT contended that FERC's guidance required elimination of the NPV Intangible Plant asset or, alternatively, reduction of that asset to a relatively small amount.

1. PPLM's Position

PPLM contended that FERC's guidance was irrelevant to determination of the Conveyance Price – it merely instructed PPLM how to treat the NPV liabilities after the transfer of the Kerr Project to CSKT:

> The Commission's instruction in paragraph 23—namely, that the environmental liability and corresponding asset should be eliminated from PPLM's books once conveyance has occurred—has **nothing** to do with the Conveyance Price. Conveyance cannot occur until the Tribes have actually paid the Estimated Conveyance Price. This guidance only applies if conveyance occurs.

(PPLM Pre-Hearing Brief, p. 20 (emphasis in original).)

PPLM's alternative contention was that FERC's guidance had a minimal effect on the Conveyance Price. PPLM asserted that the "corresponding asset" to be eliminated at the Conveyance Date was the amount of the NPV liability for the Section 4(e) environmental mitigation costs payable during the period 2016-2035 determined as of 1997 – the date when MPC first created the NPV liability. Utilizing this method, PPLM asserted that FERC's guidance would reduce the Conveyance Price by $2,438,479, the NPV (as of 1997) of the estimated environmental mitigation costs payable from 2016 to 2035.

2. CSKT's Position

CSKT presented three alternative interpretations of FERC's guidance.

First, CSKT asserted that the "corresponding asset" referred to in the FERC guidance is the NPV Intangible Plant asset. Since the FERC guidance requires that the "corresponding asset" be eliminated, this interpretation requires that the NPV Intangible Plant asset be eliminated.

Alternatively, CSKT suggested that the "corresponding asset" to be eliminated is the Intangible Plant asset equal to the NPV as of the Conveyance Date of the Section 4(e) environmental mitigation costs payable during the period 2016-2035, *i.e.*¸ the NPV of the environmental mitigation costs that CSKT would pay following the Conveyance Date. On this basis, CSKT asserts that the remaining Intangible Plant asset as of the Conveyance Date would be $3,395,656.32.

CSKT's third alternative interpretation is a variant of its second interpretation, but based upon the 2000 FERC Order, rather than the 1997 FERC Order. PPLM's calculation of the Intangible Plant asset was based upon the 1997 FERC Order, and was not adjusted to reflect the modifications to the Section 4(e) environmental mitigation obligations made by the 2000 FERC Order. CSKT notes that FERC's guidance states that the USofA "requires adjustments to a previously recorded liability when additional information is received." Utilizing this "additional information" (the 2000 FERC Order), and applying the methodology used in its second alternative, CSKT calculates that the remaining NPV Intangible Plant Asset (after reduction for the NPV of the Section 4(e) costs payable by CSKT during the period 2016-2035) as of the Conveyance Date would be $1,845,515.17.

C. Discussion

FERC's guidance is extremely helpful to our analysis regarding the inclusion of the Intangible Plant asset as a component of the Conveyance Price. However, FERC's holding that both the "environmental liability and corresponding asset" should be eliminated from PPLM's books did not definitively resolve the issue, because the parties have offered widely varying interpretations of what that "corresponding asset" is.

After considering the various interpretations offered by the parties, we have concluded that the amount of the NPV Intangible Plant asset to be included in the Conveyance Price is zero. This conclusion holds true under any reasonable interpretation of FERC's guidance. It is also consistent with basic principles of accrual accounting.

1. PPLM's Interpretations

We reject both of PPLM's alternative interpretations. PPLM's contention that FERC's guidance had "nothing to do with the Conveyance Price" is not credible; it ignores the language and context of the 2013 FERC Order. The 2013 FERC Order was in response to PPLM's Petition for Declaratory Order. That Petition specifically requested that FERC "issue a declaratory order interpreting certain provisions of the Project license . . . relating to the calculation of the Conveyance Price . . . ." (Petition for Declaratory Order, p. 1.) The sole purpose of PPLM's Petition for Declaratory Order was to obtain FERC's resolution of issues affecting the Conveyance Price. The language of the 2013 FERC Order clearly demonstrated that FERC was aware that its guidance was being sought for the purpose of determining accounting issues relevant to calculation of the Conveyance Price. To assert (as PPLM does) that FERC's guidance "has nothing to do with the Conveyance Price" is to say that FERC ignored the sole purpose for which its guidance was sought and rendered unsolicited advice on an irrelevant accounting issue that nobody asked it about. That interpretation defies credibility.[4]

PPLM's alternative interpretation is equally unacceptable. PPLM interpreted FERC's guidance as requiring it to reduce the "Intangible Plant" asset – valued as of 2015 – by the NPV of environmental mitigation payments for 2016-2035 – calculated as of 1997. Of course, this NPV amount is miniscule under PPLM's method, since (as of 1997) the first payment for the 2016-2035 period would not be due until nineteen years later. If the asset is calculated as of 2015 (as it must be under the definition of Conveyance Price), the corresponding liability must also be determined as of the same date. There is no justification for calculating the asset as of 2015 and the corresponding liability as of 1997. The unreasonableness of PPLM's interpretation is further demonstrated by the following facts:

- During their respective periods of operation of the Kerr Project, MPC paid approximately $33.6 million of environmental mitigation costs over the 14 years it held the license (approximately $2.4 million per year), PPLM will have paid approximately $43.5 million of environmental mitigation costs during the 16 years it will have held the license (approximately $2.72 million per year) and CSKT will pay approximately $65.5 million of environmental mitigation costs for the 20 years it will hold the license (approximately $3.275 million per year).[5]

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[4] PPLM argues that the FERC guidance would apply upon sale of the Kerr Project to CSKT, and it is not known whether this will occur. However, the Conveyance Price only has relevance if there is a sale. Accordingly, any determination of the Conveyance Price must assume that the sale will occur.

[5] PPLM disputes CSKT's estimate of the amount CSKT would pay during the period in which it will hold the license. PPLM estimates the gross amount of Section 4(e) environmental mitigation costs payable by CSKT during the period 2016-2035 to be $56.6 million. The difference between PPLM's estimate ($56.6 million) and CSKT's estimate ($65.5 million) relates to their assumptions regarding future inflation. CSKT assumed future inflation at 3% per annum (the assumption made by MPC in its initial calculation of the NPV Intangible Plant asset), while PPLM assumed a lesser rate of inflation based on recent history. Nobody knows what the inflation rate will be in 2016-2035. CSKT's estimate has the advantage of using the same assumptions as those used by MPC when it

Thus, without considering the effect of the NPV intangible asset, MPC/PPLM would have held the license for 60% of its term and paid approximately 54% of the Section 4(e) environmental mitigation costs, while CSKT would have held the license for 40% of its term and paid approximately 46% of the Section 4(e) environmental mitigation costs. This is the result one would expect. The proportion of environmental mitigation costs paid by each licensee is roughly equal to the proportion of time in which that licensee held the license.

- However, if PPLM's interpretation of FERC's guidance is accepted, the calculus becomes inexplicably skewed. CSKT will reimburse PPLM for $29.8 million of the $43.5 million of environmental mitigation costs it paid, meaning that the approximate net amount of environmental mitigation costs paid by PPLM would be $13.7 million ($856,250 per year), and the approximate amount of environmental mitigation costs paid by CSKT would be $95.3 million ($4.765 million per year). Similarly, if PPLM's interpretation of FERC's guidance is accepted, CSKT will have held the Kerr Project license for 40% of its term, but will have paid 66.83% of the total Section 4(e) environmental mitigation costs (95.3 / 142.6 = .6683).

It is inconceivable that FERC's guidance could be interpreted to produce these bizarre results. We believe that one of the principal purposes of FERC's guidance was to make clear that CSKT would not be required to pay the same liability twice – once when it actually paid the Section 4(e) environmental mitigation costs, and once when it paid PPLM for an intangible asset calculated in a manner that included those same future costs. Under PPLM's interpretation, CSKT would unquestionably be paying PPLM for an asset calculated to include obligations that CSKT will bear.

2. CSKT's First Interpretation

We believe that CSKT's first interpretation of FERC's guidance is correct, *i.e.*, the "corresponding asset" to be eliminated is the NPV Intangible Plant asset. This interpretation comports with basic accounting principles and the manner in which the NPV Intangible Plant asset was created. When MPC first implemented its NPV accounting, it recognized an NPV liability of approximately $56.7 million and then created a corresponding asset in the same amount – the NPV Intangible Plant asset. There is no question that the NPV Intangible Plant asset is the "corresponding asset" to the NPV liability; the sole purpose of its creation was to establish an offsetting asset account equal to the NPV liability. During the course of the license term, the asset and the liability may be reduced at different rates because of various accounting conventions, but they always begin at the same amount (in this case, $56.7 million) and end at the same amount – zero.[6] The asset was created to correspond to the NPV liability, and it

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initially created the NPV Intangible Plant asset, while PPLM simply assumed a lesser rate. Accordingly, we accept CSKT's calculation. Even if we accepted PPLM's estimate, our analysis would not be materially different.

PPLM also claims that it actually paid $80 million for the Section 4(e) environmental mitigation costs because it paid MPC $36.5 million for the FERC license when it purchased the Kerr Project assets. PPLM's assertion is not credible and we do not accept it. PPLM used the purchase method of accounting for the acquisition of the Kerr Project. If PPLM had paid MPC $36.5 million for the license, its opening balance sheet for the Kerr Project would have shown an intangible asset in that amount. The opening balance sheet did not show any intangible asset.

[6] The NPV liability and the corresponding asset do not remain equal throughout the license term because accounting conventions utilize different methods of reduction for the asset and liability. The intangible asset is amortized on a straight-line basis while the liability is modified annually as a result of two factors: (1) the liability is reduced by the principal amount paid during the year; and (2) the liability is increased by the interest accretion on the future liabilities due to the fact that the future liabilities are one year closer to being due. (See Eberhardt Direct Testimony, p. 14.) However, the NPV liability and the corresponding asset are always the same at the beginning and the end.

remains the "corresponding asset" at all times. Accordingly, we interpret FERC's statement that "the environmental liability and corresponding asset should be eliminated from PPL Montana's books" at the Conveyance Date to mean that the NPV Intangible Plant asset should be eliminated in determining the Conveyance Price.

3. CSKT's Second and Third Interpretations

Although we do not accept CSKT's second and third alternative interpretations of FERC's guidance, they represent reasonable efforts to interpret that guidance. Unlike PPLM's interpretation, CSKT's alternative interpretations attempt to deal with the issue that FERC addressed – the "double dipping" inherent in PPLM's assertion that CSKT should pay PPLM for an asset in an amount calculated to include liabilities that CSKT will bear. However, we believe that CSKT's calculations overstate the amount of the NPV Intangible Plant asset as of the Conveyance Date. Properly considered, the NPV Intangible Plant asset would be zero under both of CSKT's alternative interpretations.

The reason for our conclusion is that CSKT has erroneously accepted PPLM's amortization schedule. PPLM's amortization schedule unduly increases the amount of the NPV Intangible Plant asset as of the Conveyance Date, and is inconsistent with the rationale for creating the NPV Intangible Plant asset in the first place.

PPLM's justification for capitalizing the environmental mitigation costs is that these payments are really costs of acquiring the FERC license for the Kerr Project. (Eberhardt Direct Testimony, p. 10.) MPC created the Intangible Plant asset in 1997, because that is when the environmental mitigation costs became capable of estimation. It then structured the amortization schedule over the remaining 38 years of the license. Bruce Warner (a PPLM expert witness) stated that the Intangible Plant asset should be amortized over the life of the license. (Warner Direct Testimony, p. 11 ("The intangible plant balances should all be amortized over the FERC License life because the costs pertain to the License itself.").) However, PPLM did not amortize the NPV Intangible Plant balances "over the FERC License life" – it amortized the NPV Intangible Plant asset over the last 38 years of a 50 year license. That method leads to an anomaly; the first twelve years of the license period are ignored. If (as PPLM contends) the environmental mitigation costs are the cost of the license, then some of those costs should be attributable to (and amortized over) the period 1985-1997. Amortizing the Intangible Plant asset over only the last 38 years of the 50 year license leads to the peculiar result described by CSKT – PPLM and MPC will have held the license for 60% of the license term, but the NPV Intangible Plant asset would only be amortized by about 47% as of the Conveyance Date.

PPLM responds by noting that the NPV liability and corresponding Intangible Plant asset were established in 1997 because that was the first date upon which the Section 4(e) environmental mitigation liabilities were readily estimable. Since amortization may not be retroactive, PPLM had no choice but to amortize the NPV Intangible Plant asset over the remaining term of the license. That argument is correct as far as it goes. But it does not respond to the fact that the NPV Intangible Plant asset is unduly high under PPLM's own justification for including the asset in its calculation of the Conveyance Price – that the Section 4(e) environmental mitigation liabilities represent the cost of the license and should be capitalized and amortized over the term of the license.

In this instance, we rely upon FERC's guidance in footnote 17. In that footnote, FERC stated that adjustments should be made "where the accrual approach, without adjustment, would work an unjust and unreasonable result." In this case, strict application of the accrual approach, without adjustment, would result in a disproportionate imposition of the Section 4(e) environmental mitigation costs on CSKT in a manner inconsistent with the very rationale for capitalizing the environmental mitigation costs.

This result can be avoided by adjusting the amortization of the NPV Intangible Plant asset consistent with PPLM's justification for including the asset in the Conveyance Price, *i.e.*,

amortizing the asset over the entire 50 year term of the license, commencing in 1985. Utilizing that method, the initial amount of the asset would be $56,701,106 (the amount capitalized by MPC), the amortization on a straight line basis would be $34,020,664 and the unamortized balance of the asset would be $22,680,442 as of the Conveyance Date. As of the Conveyance Date, the NPV of the Section 4(e) environmental mitigation liabilities for the remaining term of the license would be $26,475,219, utilizing MPC's assumptions when it created the NPV liability. Since the NPV of the liabilities would exceed the unamortized balance of the NPV Intangible Plant asset as of the Conveyance Date, the amount of the NPV Intangible Plant asset included in the Conveyance Price would be zero under CSKT's second and third alternative interpretations of the FERC guidance.[7]

X.
WHETHER THE MONTANA PUBLIC SERVICE COMMISSION AUTHORIZED MPC TO RECOVER ALL OR A PORTION OF THE ENVIRONMENTAL MITIGATION COSTS FROM RATEPAYERS

Even assuming that PPLM is otherwise correct, CSKT contends that the Intangible Plant asset (and therefore the Conveyance Price) must be reduced by reason of the final proviso in the definition of Conveyance Price:

> provided, however, that the term "Conveyance Price" shall not include environmental costs incurred by MPC (regardless of the fact that it has not continued to be a co-licensee) that the Montana Public Service Commission has authorized MPC (regardless of the fact that it has not continued to be a co-licensee) to recover from its customers.

CSKT contends that the Montana Public Service Commission ("MPSC") authorized MPC to recover $33,605,364 of Section 4(e) environmental mitigation costs from ratepayers. Therefore, the Conveyance Price must be appropriately reduced. PPLM disagrees, and contends that the MPSC did not authorize any recovery of environmental mitigation costs from ratepayers.

Although the prior portions of our opinion render this issue moot, we shall nonetheless address it. After review of the relevant evidence, we conclude that PPLM is correct. The MPSC did not authorize recovery of the Section 4(e) environmental mitigation costs paid by MPC.

Both parties presented knowledgeable expert witnesses on this subject. PPLM's expert was John Alke, the lawyer who represented MPC in the relevant regulatory proceedings before the MPSC. CSKT offered the testimony of Ernie Kindt, MPC's principal accounting officer, who was the chief witness for MPC in the MPSC hearings, as well as Howard Axelrod, an expert on utility deregulation.

The facts underlying this issue are extremely complex. Our discussion will attempt to avoid delving too deeply into the technical questions involved.

A. The MPSC Proceedings

In the 1990's many states (including Montana) deregulated electric generation. Prior to deregulation, electric utilities were rate-regulated. In 1997, the Montana Legislature passed The Electric Utility Restructuring and Customer Choice Act. Pursuant to this statute, Montana deregulated electric generation, meaning that rates were no longer regulated, and the electric generation utilities would charge market rates and compete with other electric utilities. Rate regulation still existed for electric transmission (poles and wires), but not electric generation.

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[7] PPLM contends that the NPV of the Section 4(e) environmental mitigation liabilities would be $22.8 million as of the Conveyance Date, rather than the $26,475,219 calculated by CSKT. The difference is explained by PPLM's use of a lower assumed inflation rate for the period 2016-2035. In this case, the difference does not matter. Even under PPLM's calculations, the NPV of the liabilities would exceed the unamortized balance of the asset as of the Conveyance Date.

This created a problem for utilities. Many electric generating utilities had incurred substantial costs on the assumption that they would be able to recoup those costs from ratepayers pursuant to rates authorized by the regulators. In a number of instances, the regulators had mandated that the generators incur these costs. Since generation was no longer rate-regulated, the generators could not be assured that they would be able to recover those costs. In the parlance of the industry, these were referred to as "stranded costs" or "transition costs." Montana (and most other states) allowed the utilities to recover these transition costs through the rates they charged for transmission – transmission rates were still regulated. However, the regulators had to approve the recovery of those costs from the ratepayers.

MPC had two large categories of transition costs. The first category was so-called "Qualifying Facilities" costs or "QF" costs. These consisted of the cost of purchasing electricity at above-market rates from so-called "qualifying facilities," which were environmentally friendly electric generators. The MPSC, the regulatory authority in Montana, had required MPC to enter into these extremely expensive long-term contracts, with the assurance that the excess costs could be recovered from consumers in rates approved by the MPSC. However, this assurance was now meaningless, because the MPSC no longer regulated the rates for electricity, only the rates for transmission. These were therefore classic "stranded" or "transition" costs.

The other category of MPC's transition costs consisted of the environmental mitigation costs that FERC had imposed on the Kerr Project. These were also classic "stranded costs" because they were obligations imposed by a regulatory authority upon MPC's generation business.

In 1997, MPC instituted proceedings before the MPSC to recover these transition costs. These proceedings were lengthy, and did not conclude until 2002. The proceedings at issue here are referred to by the parties as the "Tier II" proceedings.

The MPSC issued its final order on the subject in January 2002 as Final Order 5986w. The order accepted $33,605,364 of MPC's environmental mitigation costs as transition costs. However, it did not directly authorize recovery of these transition costs from consumers.

By the time the MPSC issued its final order, MPC had agreed to sell its transmission assets to NorthWestern Energy. The MPSC's final order authorized MPC/NorthWestern Energy to recover the QF transition costs from the ratepayers. Its order with respect to environmental mitigation costs was less clear. The MPSC recognized about $33 million of environmental mitigation costs that MPC had paid to date as transition costs. However, rather than authorizing MPC to recover these costs directly from ratepayers, it allowed the environmental mitigation costs as a reduction of the basis of the assets that MPC had sold to PPLM. Total QF costs were $366.5 million, but the MPSC allowed recovery of only $244.7 million. The difference resulted from two offsets: (1) a reduction of $60 million to which MPC/NorthWestern Energy agreed in order to settle the issue; and (2) a credit for proceeds in excess of basis (*i.e.*, profit) resulting from MPC's sale of its generation assets to PPLM. Since the MPSC order reduced the recovery of MPC's transition costs by MPC's gain on the sale of its generation assets, the result of this order was to increase the amount of QF costs that MPC could recover from ratepayers by the amount of environmental mitigation costs that MPC had incurred.

B. The Parties' Positions

PPLM relies upon the precise language of the MPSC order to argue that the MPSC did not authorize the recovery of any Section 4(e) environmental mitigation costs from ratepayers. This is literally true – the environmental mitigation costs were applied against MPC's basis in the facilities sold to PPLM, not as part of the stranded costs authorized to be recovered pursuant to the Competitive Transition Charge imposed on ratepayers. Therefore, PPLM contends that the exclusion in the definition of Conveyance Price does not apply.

CSKT contends that PPLM's definition of "recovery" is too narrow. Although the environmental mitigation costs were not directly part of the Competitive Transition Charge that

the MPSC authorized to be imposed upon ratepayers, the MPSC's recognition of these costs as transition costs, and its application of the environmental mitigation costs against the basis of the assets sold, reduced MPC's net gain in the amount of the environmental mitigation costs, and thereby increased – in an equal amount – the amount of QF costs that MPC/NorthWestern Energy could recover from ratepayers. But for the MPSC's application of the environmental mitigation costs against basis, an equal amount of QF costs would have been applied against basis and would be ineligible for recovery from ratepayers. CSKT contends that this is the equivalent of authorizing recovery of the environmental mitigation costs from ratepayers:

> [I]n Final Order 5986w, MPSC approved the inclusion of the Project environmental costs as a recoverable cost in the calculation of the gain on the sale that offset stranded costs and authorized MPC to recover such environmental costs from its customers out of the gain on the sale, such that the net gain was reduced and the obligation of customers increased. CSKT Ex. 4-1 at 14:16-20. Inclusion of the Project environmental costs that were actually paid by MPC in the list of items to be included within transition costs to be deducted from the sale price, (i.e., it increased the amount of the sale proceeds retained by MPC) resulted in a reduction of the credit allocated to Montana consumers through the net gain. Id. at 15:1-4. Ultimately, this reduced credit (or net gain) was used to offset other outstanding transition costs, referred to as "out-of-market QF costs" that would be imposed on consumers. By reducing the amount of the credit that would be applied to offset the outstanding QF costs, the Competitive Transition Charge ("CTC") levied on customers was ultimately higher than it otherwise would have been by an amount equal to the Project environmental costs.

(CSKT Pre-Hearing Brief, p. 20.)

C. Discussion

The material facts are not in dispute. Both parties agree that the MPSC recognized MPC's environmental mitigation costs as legitimate transition costs, and both parties agree that the MPSC did not directly authorize recovery of these costs from customers in a rate surcharge. The only question is one of interpreting the meaning of the Conveyance Price definition as it applies to these facts.

This is a close and complex question. On balance, PPLM has the better of the argument. It is clear that the MPSC did not directly authorize recovery of the Section 4(e) environmental mitigation costs from ratepayers. The only question is whether the form of indirect recovery suggested by CSKT is within the contemplation of the Conveyance Price definition. We conclude that the proviso in the definition of Conveyance Price is not sufficiently broad to encompass that indirect recovery. The Conveyance Price definition contemplates a direct regulatory authorization of recovery for the Section 4(e) environmental mitigation costs. That did not occur.

XI.
WHETHER THE NON-NPV INTANGIBLE PLANT ASSETS ARE INCLUDED IN THE CONVEYANCE PRICE

One other issue must be decided. The vast majority of the Intangible Plant asset identified by PPLM in its estimate of the Conveyance Price consisted of the NPV Intangible Plant asset – the asset corresponding to the NPV liability established by MPC in 1997. However, PPLM's estimate also included two other intangible assets that were recorded separately and were not part of the NPV Intangible Plant asset – the "Kerr Wildlife" account in the amount of $1,450,927 and the "Kerr License" account in the amount of $512,008. We hold that these assets (with a slight modification) are properly included as part of the Conveyance Price.

The Kerr Wildlife account represents a $3 million environmental mitigation payment actually made by MPC (not an NPV estimate) and recorded by MPC in Account 303.5. PPLM has provided little information on the Kerr License account, but it appears to represent the customary costs of obtaining a FERC license, such as filing fees and attorney fees incurred in the license application process. This was recorded in Account 303.

These amounts were recorded on MPC's books, but were never recorded on PPLM's books. That fact alone would normally exclude these items from the Conveyance Price. However, the facts peculiar to these assets suggest that they should be included because PPLM's use of the purchase method of accounting for the acquisition of the Kerr Project prevented them from being recorded on PPLM's books.

In our discussion of the NPV Intangible Plant asset, we rejected PPLM's contention that its use of the purchase method of accounting made its accounting treatment of the NPV liabilities irrelevant because the purchase method of accounting did not prevent PPLM from capitalizing the NPV liabilities and creating a corresponding asset. That is not true with respect to these two assets. These two accounts represent amounts actually paid and separately recorded prior to PPLM's acquisition of the Kerr Project. As such, they would have been subsumed in the recalculation of asset values necessitated by the purchase method, and could not have been carried over onto PPLM's books. Accordingly, we believe that these two assets should be included as part of the Conveyance Price.

One adjustment is necessary. PPLM calculated the amount of the Kerr Wildlife asset (like all other assets based on environmental mitigation costs) on the basis of a 38 year amortization, when it should have been calculated on the basis of a 50 year amortization. Adjusting the asset amount on the basis of a 50 year amortization reduces the Kerr Wildlife asset to $1.2 million.

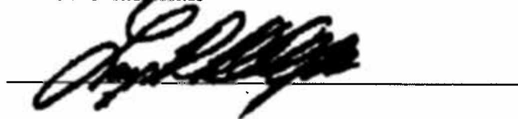
ORDER

IT IS HEREBY ORDERED: Based upon the evidence and argument presented by the parties, we hold that the Estimated Conveyance Price as of the 30th anniversary of the Effective Date is $18,289,798, consisting of (1) Tangible Plant – $16,562,540, (2) Communications Equipment – $15,250, and (3) Intangible Plant – $1,712,008.

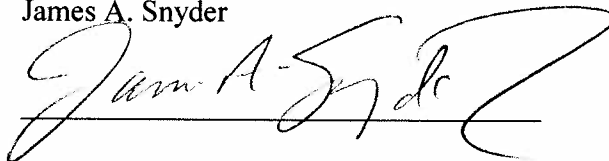
Pursuant to Ordering Paragraph (C)(3)(e) of the 1985 FERC Order, this decision is final and binding on the parties.

Dated: March 3, 2014

Layn R. Phillips
Former U.S. District Judge
Panel Chairman



James A. Snyder



David B. Raskin, Dissenting.

The Majority has improperly rejected the recovery of almost $80 Million in Environmental Mitigation Costs (“EMCs”) that CSKT agrees will have been incurred prior to the 2015 projected date of conveyance of the Kerr Project to CSKT and that were capitalized by MPC on its FERC books on a Net Present Value (“NPV”) basis, even though the Majority has determined that these costs were properly capitalized under the FERC’s Uniform System of Accounts (“USofA”). The Majority’s findings are based on a misapplication of the Conveyance Price formula in the Kerr Project License and misinterpretations of FERC’s October 15, 2013 Order and the USofA. I conclude that PPLM’s estimate of the EMCs includable in the conveyance price should be reduced by approximately $10.5 Million.

Like the Majority, I do not provide citations for every factual statement contained in this Dissent. However, all of the following facts are either in the record or (in a few cases) a matter of public record.

I. Additional Background Facts

The Kerr Project license includes a formula for calculating the price at which CSKT has an option to purchase the Kerr Project beginning in 2015 ("Conveyance Price"). The formula provides that the Conveyance Price will be based on the depreciated original cost of the Kerr Project as of the date of conveyance to CSKT, calculated pursuant to Montana Power Company’s (“MPC”) FERC books that are subject to standard FERC audit and compliance procedures. This language remained the same even after the Parties and MPC modified the Conveyance Price formula following PPLM’s acquisition of the Project.

No party disagrees with the fact that the reference to FERC books means the FERC USofA, which is the specialized accounting system promulgated as FERC regulations (18 CFR Part 101) for the purpose of providing a foundation for utility cost-based ratemaking. MPC was subject to the USofA because it was a vertically-integrated utility with a monopoly franchise to serve captive customers. However, in the late 1990s the State of Montana chose to follow the course of deregulation and ordered MPC to divest its generation and acquire power to meet the needs of captive retail customers in the State in the wholesale power market.

Consistent with Montana's intentions, PPL-Montana (“PPLM”), the buyer of MPC's generation portfolio, is not a traditional utility. It purchased MPC's generating assets, including the Kerr Project, at a market price, and it must obtain its revenues from sales at market-based rates in the competitive wholesale market. In industry parlance, PPLM is a merchant generator that must bear market risk. For this reason, the USofA are not applicable to the wholesale sales it makes from its Montana generating portfolio, and PPLM has no reason to maintain a separate set of USofA books and records for most regulatory purposes. As the Majority notes, PPLM obtained a waiver from FERC of the obligation to make FERC Form 1 filings.

PPLM interpreted the Conveyance Price formula as requiring it to use the original cost of the Kerr Project as shown on MPC's USofA books, not its own original cost as purchaser of this asset, which is much higher. It therefore took the plant values from MPC's FERC books and then

depreciated or amortized them (as appropriate) to establish the Conveyance Price as of 2015. Under standard FERC rules, if PPLM were a utility selling to captive customers at cost-based rates, it would have been obligated to use the plant values on MPC's books as its own initial plant costs under the USofA; FERC does not, other than in exceptional circumstances, permit utilities to include an "acquisition premium" in books used for ratemaking purposes.[8] So, the methodology that PPLM used to calculate the Conveyance Price was consistent with FERC accounting and ratemaking requirements.

II. Calculation of the Conveyance Price

The Parties agreed on the record that MPC and PPLM combined will have spent approximately $80 Million between 1997 and 2015 on Environmental Mitigation Costs ("EMCs")[9] in order to satisfy their FERC license requirements (Tr. 780). The Majority finds in Section VIII of its decision that MPC properly capitalized these payments on an NPV basis under the USofA. The unamortized balance of this amount as of 2015 is therefore recoverable under the Conveyance Price formula in the FERC license. The Majority also finds that the EMCs should be amortized over the full term of the Kerr license. The use of NPV accounting complicates the calculation of the amount includable in the Conveyance Price as of 2015, but no reasonable accounting can convert the amount to zero.

The Majority turns to two exhibits containing pieces of PPLM's non-FERC accounting records to determine that none of the EMCs incurred by MPC and PPLM should be recoverable. However, this analysis is inconsistent with the methodology used to determine the value of the Tangible Assets that were authorized for recovery by the full Panel. In calculating the conveyance price for the Tangible Assets, PPLM took the amounts directly from the 300 series Plant accounts on MPC's FERC books in 1997, depreciated them (together with the costs of post-1997 replacements and additions) until the 2015 projected conveyance date. No one disputed the use of MPC's FERC books for this purpose, and this use was consistent with the language of the Conveyance Price formula. The $16,562,540 of Tangible Assets approved by the entire Panel in an earlier decision was derived from plant account values taken directly from MPC's FERC books.

PPLM used *the same methodology and accounting source data* to calculate the value of the EMCs in the Conveyance Price as it used for the Tangible assets. It took the value in Account 303 directly from MPC's FERC accounts (which were based on the NPV of the estimated $135,000,000 of EMCs), and amortized it on a straight line basis over the remaining license term. The Majority decision acknowledges that the Account 303 values (together with an explanation of the accounting for this item) were contained in two FERC Form 1 filings by MPC in 1997 and 1998, and they were therefore values represented on MPC's FERC books and subject to audit and compliance procedures at FERC as the Conveyance Price formula provides.[10]

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[8] *E.g., Public Service Company of New Mexico*, 142 FERC ¶ 61,168 at P 25 (2013); *Montana-Dakota Utilities Co.,* 23 FERC ¶ 61,151 at 61,335 (1983).

[9] The Majority also refers to as the EMCs as the Section 4(e) costs.

[10] CSKT claimed that PPLM should have used updated 1999 values commensurate with the date of its acquisition of the Project, which were more precise. However, PPLM provided testimony of Mr. Eberhardt showing that using

Nonetheless, the majority bases its decision to eliminate all of the EMCs on the fact that a separate set of non-FERC accounting records contained different, and lower, values for the EMCs that PPLM amortized only over its term as licensee. However, no one argues that PPLM's records were maintained in accordance with the USofA, that they were filed with FERC, or that they were subject to compliance and audit procedures at the FERC. PPLM's records, only snippets of which were entered into the record by CSKT, were those of a merchant generator.[11] Putting aside the inconsistency in changing methodologies for only one FERC Account, use of PPLM's books for the EMCs did not satisfy the definition of the Conveyance Price set forth in the Kerr license. Significantly, even though the Conveyance Price formula was changed after PPLM became the licensee, the Parties did not change the reference to MPC's FERC books as the source of the calculation of depreciated original cost. The Majority does not explain why it thought it was appropriate to make changes to the formula that the parties to the 2000 settlement did not make.

Moreover, the use of Account 303 values *alone* from PPL's non-FERC records is demonstrably inappropriate. If one sums the values for the *entire* 300 series Accounts from the portion of PPLM's books in the record, including the lower value for Account 303 that the Majority uses, the depreciated cost of the Kerr Plant in 2009 was $59,726,000, which is much higher than the Conveyance Price calculated by PPLM based on MPC's FERC books. (CSKT Exhibit 69 page 13). PPLM did not take the position that these higher values from its own books should be used to calculate the Conveyance Price, and it was utterly inappropriate for the Majority to use PPLM's records, which reflect its purchase price for the Project, *solely* to calculate the value in Account 303, effectively choosing the lower of two sets of inconsistent accounting records to calculate different components of the Conveyance Price.

The Conveyance Price should have been calculated using a consistent methodology applied to all of the USofA Plant accounts. The record contained the evidence required to make this consistent calculation using MPC's FERC accounts as the foundation. Once the Parties agreed that the reference to "original cost" in the Conveyance Price formula was to the original cost on MPC's books as the first owner, and then agreed on the methodology for calculating the Tangible Assets using MPC's FERC books prior to the sale of the Kerr Project to PPLM as the starting point, the same methodology, using the same FERC books, should have been used to calculate the EMCs.

Finally, the Majority concludes that the definition of "original cost" in the USofA precludes the use of NPV values to calculate the Conveyance Price, so MPC's FERC accounts could never have been used to establish the value of the EMCs. It cites no precedent for this conclusion. The FERC's October 15, 2013 Order ("FERC Order") holds to the contrary. It states that NPV

1999 estimates as the starting point would have increased the Conveyance Price by approximately $1 Million above its estimate based on 1997 estimated costs, so it does not appear that PPLM's use of 1997 data prejudiced CSKT's interests in this proceeding.

[11] In its Pre-Hearing Brief, PPLM pointed out that: "CSKT Ex. 69 is nothing more than a small part of PPLM's internal GAAP accounting records and that the amounts expressed in this document were taken from an appraisal of the Kerr Project, not from records prepared in conformance with the USOA. CSKT Ex. 71 also has nothing to do with the Conveyance Price. Further, is it unclear who prepared the document, and the document shows purchase method financial accounting, not FERC accounting under the USOA." PPLM Initial Brief at 16, n. 61. These are the exhibits that the Majority relies on to calculate the Conveyance Price.

accounting "may be appropriate" and then goes on to describe the change that PPLM must make to MPC's NPV calculation to eliminate CSKT's post-2015 share of the EMCs from the Conveyance Price. If FERC had intended to prohibit the use of NPV accounting altogether it would have said so, and it would have had no reason to provide its further accounting guidance on how the NPV should be calculated in this case.

III. The Majority's Misinterpretation of the FERC Order

The Majority also finds that the FERC Order holds that the entirety of the EMCs should be eliminated from the Conveyance Price. I strongly disagree with this interpretation. FERC's concern in the Order was that the NPV calculation used by MPC and adopted by PPLM was based on the NPV of the entirety of the EMCs for the remainder of the license term ($135 Million), including approximately $55 Million of EMCs that would be incurred by CSKT after it acquires the Project. FERC directed PPLM to remove those EMCs that would be CSKT's responsibility and to recalculate the NPV for purposes of calculating the Conveyance Price. Otherwise, CSKT would be paying twice for the same EMCs. That is the reason that $80 Million in EMCs, rather than the much higher $135 Million that includes the portion of the EMCs that CSKT will bear, was the correct value to use as the starting point for calculating the Conveyance Price.

The majority adopts CSKT's interpretation that the last sentence in Paragraph 23 of the FERC Order requires that the entirety of the EMCs must be removed from the Conveyance Price. The Majority states that FERC intended that the intangible asset and associated liability be removed from PPLM"s books "at the Conveyance Date" and that this means they must also be removed from the Conveyance Price. First, I do not understand the grounds on which FERC would make such a ruling; the $80 Million of EMCs was spent by MPC and PPLM and excludes the amounts to be paid by CSKT. Also, FERC did not object in the Order to the capitalization of these costs. Therefore, some portion of the EMCs is CSKT's responsibility under the Conveyance Price formula. The last sentence in Paragraph 23 means nothing more than what it says. PPLM must eliminate the liability and unamortized balance of the associated asset "upon conveyance" of the Project to CSKT. This is logical because PPLM will no longer have any liability for the remaining EMCs once it sells the Project. To interpret this sentence to mean that PPLM was required to eliminate the entire Account 303 value *prior* to conveyance, such that it cannot be included in the Conveyance Price, would make superfluous the remainder of Paragraphs 22 and 23, in which FERC explained why only *the CSKT portion* of the total should be removed.

My interpretation is also consistent with the conclusion reached by the Majority that the EMCs should be amortized over the entire license term. With 20 years remaining in the amortization period accepted by the Majority, there must be a positive value in Account 303 that still remains to be amortized. Moreover, the EMCs incurred by MPC and PPLM as licensees before the 2015 conveyance date represent an intangible asset benefitting CSKT because those expenditures made it possible to retain the license so it eventually could be transferred to CSKT.

The FERC issues many orders disallowing the recovery of costs. My experience is that when FERC intends that a party cannot recover costs, it so states directly. FERC did not say that

PPLM is not permitted to recover any portion of the EMCs. If FERC did intend to disallow any cost recovery, Paragraphs 22 and 23 of the FERC Order were certainly an unusual way to say it.

Although I agree with the Majority that the EMCs should be amortized until the end of the current license term, I disagree with the Majority's position that they should have been amortized beginning with the first year of the license, long before the EMCs became a license requirement. PPLM appropriately amortized the EMCs beginning at the time they came into existence pursuant to the FERC's 1995 order imposing the Section 4(e) license conditions; the EMCs were not a license requirement before that date and therefore no liability (and corrresponding asset) could have existed before that time.[12]

The Majority also references footnote 17 in the FERC Order, which alludes to just and reasonable rates, as the basis for finding that it would be inequitable for CSKT to pay any of the EMCs in the Conveyance Price.[13] The Majority has no basis for making this subjective value judgment. One could debate endlessly the equities associated with cost responsibility for the EMCs, and both Parties could (and have) come forward with strong arguments why cost responsibility should be shifted to the other Party. But, weighing the overall equities, which requires consideration of factors outside the calculation of one component of one portion of the deal struck in 1995 and 2000, is not the Panel's job. Our job is to apply the Conveyance Price formula in the license.[14]

That being said, the Majority's assertion in Section IX.C of its decision that CSKT would be unfairly bearing a disproportionate percentage of the EMCs disregards several facts. First, CSKT's right to sell very low cost energy from the Project does not end with the current license period, so comparisons based on this period alone are not valid. Indeed, the record established that CSKT has determined, via an outside engineering firm, that the Project will run long past the current license term. Second, the Majority's determination, that zero dollars should be included in the Conveyance Price, hardly represents a balance. Its concerns about fair allocations ring hollow in these ears. Third, it is axiomatic that CSKT's percentage portion of the total EMCs will exceed its share of the total based on what it has to spend during its tenure as licensee, because that is how the Conveyance Price formula was constructed. Under the Conveyance Price formula, CSKT is responsible for the depreciated value of the capitalized asset covering expenditures during MPC's and PPLM's tenures as licensees in addition to its own later expenditures. There is no double charging in this. The Majority's conclusion that it is fair for CSKT to pay only approximately for the percentage share of EMCs incurred when it is the

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[12] For the same reason, I disagree with the Majority's downward adjustment in Section XI of the "Non-NPV Intangible Plant Assets" based on using the full fifty year license term.

[13] The FERC's reference to "just and reasonable" rates in footnote 17 was merely an analogy to support its reasoning in Paragraphs 22 and 23. This standard is from Part II of the Federal Power Act, and it is not found anywhere in Part I, which governs hydroelectric licenses. Counsel for both Parties agreed at the hearing that the just and reasonable standard does not apply to this proceeding, and therefore the Majority erred in using it.

[14] The Majority also finds in the last paragraph of Section IX.C.3 that the liabilities associated with the Intangible Asset in Account 303 are higher than the unamortized portion of the asset, and therefore the amount includable in the Conveyance Price is zero. This is one more example of the Majority's rewriting of the Conveyance Price formula in the license, which refers to depreciated original cost and does not provide for or permit using offsetting liabilities to calculate the Conveyance Price.

licensee effectively converts the EMCs into expenses for accounting purposes (contrary to its own finding that capitalization was appropriate).

IV. Calculating the Effect of the FERC Order

The FERC did not explain in its Order the methodology it expected to be used to recalculate the NPV without the amounts forecast to be incurred during CSKT's tenure as licensee. PPLM witness Warner performed a revised NPV calculation by removing the CSKT portion of the EMCs from the original NPV calculation performed by MPC in 1997. As the Majority notes, by doing the calculation in this manner, the effect of removing the CSKT portion of the EMCs was minimized because CSKT's portion of the EMCs would be incurred long in the future. Therefore, Mr. Warner's calculation reduced the NPV by less than 10% of the total ($2.4 Million) even though CSKT will be responsible for $55 Million of the EMCs after the 2015 conveyance date.[15] On the other hand, CSKT's calculation of the effect of the FERC Order is also one-sided, and CSKT did not do the calculation that FERC directed at all. Its Exhibit 4-3 is based on Mr. Kindt's theory that most of the EMCs could not be recovered even before the FERC Order, and Mr. Kindt calculated a reduction in the EMCs from the FERC Order alone that is smaller than Mr. Warner's reduction.

The record therefore does not contain a revised NPV calculation for the Intangible Asset with which I am comfortable. I would have preferred re-opening the record or requesting additional briefing to explore this issue further, but the Majority's decision makes the calculation immaterial. In order to meet the spirit of the FERC Order, I conclude that the most appropriate resolution based on the current record would be to reduce the Intangible Plant (NPV) of the Conveyance Price proposed by PPLM prior to the FERC Order ($32,221,494) by the ratio of CSKT's portion of the EMCs ($55 Million) over the entire EMC amount estimated in this proceeding ($135 Million), or 41percent, in order to equitably reflect in the calculation FERC's determination that the NPV should not include any of the EMCs that CSKT will incur after it acquires the Kerr Project. This calculation, admittedly imperfect, produces an Intangible Plant (NPV) amount of $19, 010,681, which is approximately $10.5 Million below the value PPLM proposed in this proceeding following the FERC Order.

David B. Raskin

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[15] The Majority finds that the combined PPLM/MPC share is actually lower than $80 Million and that CSKT's share is over $65 Million. With all due respect, the Parties agreed on the record that the combined PPLM/MPC share is $80 Million (Tr. 780). There also was never a dispute over the $135 Million MPC estimate for the total. The difference is $55 Million.