BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF SOUTH DAKOTA

In the Matter of the Complaint by Oak Tree Energy LLC against NorthWestern Energy for refusing to enter into a Purchase Power Agreement	EL 11-006 **NorthWestern Energy's Application for Reconsideration of Findings and Conclusions in Interim Order Issued on May 15, 2012**

Introduction

COMES NOW NorthWestern Corporation, d/b/a NorthWestern Energy ("NorthWestern" or "NWE") and, pursuant to ARSD 20:10:01:29 and 20:10:01:30.01, applies to the Public Utilities Commission ("Commission") for reconsideration of certain findings and conclusions made by the Commission in its Interim Order; Order for and Notice of Further Hearing dated the 15th of May, 2012 in this docket ("Interim Order"). Specifically, NorthWestern requests that the Commission reconsider the following findings and conclusions:

> 2. That NWE did not, however, incorporate projected carbon cost inputs into its use of this method and also may have utilized unjustifiably low natural gas inputs and electric market inputs, and as a result, the Commission cannot reliably determine the proper avoided cost with the data and analyses currently in the record. ("Finding 2")
>
> 3. That the carbon emission cost values of $5/ton starting in 2015 and shifting to $10/ton starting in 2020 and rising to $15/ton in 2025 as estimated by Lands Energy are reasonable carbon emissions cost estimates in the present environment and are the appropriate carbon emissions cost values to be included in the parties' respective hybrid method analyses of avoided cost. ("Finding 3")
>
> 4. That NWE is obligated to purchase Oak Tree's output because a legally enforceable obligation was created by Oak Tree on February 25, 2011. ("Finding 4")

Under federal law, the Commission cannot require NorthWestern to purchase the energy and capacity from Oak Tree for more than NorthWestern's avoided costs. But that is precisely the effect of Finding 2 and Finding 3. Finding 4 is contrary to the legal requirements for a legally enforceable obligation ("LEO").

Argument

A. The Commission cannot require NorthWestern to purchase the energy and capacity from Oak Tree for more than NorthWestern's avoided cost.

Federal statute prohibits requiring a utility to pay more to a qualifying facility ("QF") than the incremental cost of alternative energy and capacity.[1] "Incremental cost of alternative energy" means "the cost to the electric utility of the electric energy which, but for the purchase from such [QF], such utility would generate or purchase from another source."[2] Any rate to be paid a QF that exceeds a utility's avoided cost is illegal. The failure of the Commission to ensure that the rate NorthWestern pays to Oak Tree does not exceed NorthWestern's avoided cost is a failure to comply with the Federal Energy Regulatory Commission's ("FERC") regulations.[3] Any future carbon cost is too speculative to be included in current rates to be paid to Oak Tree.

1. Possible future carbon cost is appropriately considered for resource planning but is not appropriate for inclusion in determination of avoided cost.

The issues of environmental risk and carbon cost have bedeviled utilities for many years. Utilities' treatment of the issues illustrates the distinction between resource planning and calculation of avoided cost. In the 1980s, utilities began to engage in least-cost planning to address the issues of volatility, uncertainty, energy conservation, and end-use efficiency. Least-cost

[1] 16 U.S.C. § 824a-3(b) (2006 and Supplement V).
[2] 16 U.S.C. § 824a-3(d) (2006 and Supplement V).
[3] *See Connecticut Valley Elec. Co., Inc. v. FERC* 280 F.3d 1037, 1034 (D.C. Cir. 2000); *New York State Elec. & Gas Corp. v. FERC*, 117 F.3d 1473, 1476 (D.C. Cir. 1997).

planning evolved into integrated resource planning, as that term was defined in the National Energy Policy Act of 1992.[4] Environmental issues, including carbon cost, have been a risk factor that utilities have considered in their resource planning since at least the development of integrated resource planning. For example, in 1991 the Utah Public Utility Commission stated:

> Consideration of environmental externalities and attendant costs must be included in the integrated resource planning analysis.
>
> Federal and state environmental regulations have attempted to internalize some of the "external costs" of producing and distributing electricity. External costs occur when the production of electricity causes uncompensated damages to society (for example, adverse health effects from resultant air pollution). Environmental regulations can account for, i.e. internalize, these external costs by requiring the installation of emission reduction technology, the acquisition of emissions permits, the taxation of emissions and the mitigation of wildlife impacts. This process is likely to continue and expand. Therefore, it is reasonable to explicitly include these considerations in the Company's Integrated Resource Plan because it will affect the evaluation and perhaps the ranking of resource alternatives. The Commission recognizes the uncertainty of assessing and quantifying externalities. Therefore, a range of estimates of external costs should be considered in the Company's Integrated Resource Plan. The Commission is not prepared at this time to determine policy of how or if external costs should be addressed in the ratemaking process, but feels that it is reasonable to require their inclusion in the analysis of the Integrated Resource Plan.[5]

Similarly, in 1992, the Montana Public Service Commission ("MT PSC") adopted Integrated Least Cost Planning Guidelines.[6] The MT PSC rules required utilities to consider environmental costs and the uncertainty and risk associated with future environmental regulations in their resource plans.[7]

---

[4] *See* 16 U.S.C. § 2602(19) (2006 and Supplement V).
[5] *In re PacifiCorp*, Docket No. 909-2035-01, 1991 WL 535230, at *4 (Utah P.S.C. September 3, 1991).
[6] *See* ARM 38.5.2001 through ARM 38.5.2012.
[7] ARM 38.5.2003.

However, consideration of the risk of environmental policy changes and carbon cost is not the same as adding a speculative carbon cost to calculate an avoided cost. As the Utah Public Service Commission stated:

> While in our June 28, 1992, Report and Order on Standards and Guidelines in Docket No. 90-2035-01 we directed the Company to include an assessment of environmental risks in the IRP planning process, we have not approved the inclusion of an estimate of the cost of complying with future carbon legislation in the avoided cost calculation.[8]

Likewise, the MT PSC has not included carbon cost in the calculation of avoided costs. The parties in MT PSC Docket No. D2008.12.146 vigorously disputed the inclusion of possible carbon cost in QF rates. Recognizing that some form of carbon cost was a possibility, but not a certainty, the MT PSC approved QF rates that did not include any adder for carbon, but did provide that if the QF chose to convey all Renewable Energy Credits to NorthWestern, then the QF rate would be adjusted upward at the time that a state or federal law resulted in actual costs for carbon.[9]

Despite their requirements that utilities consider carbon cost in their resource planning activities, the regulatory commissions refused to include possible carbon cost in calculating avoided cost rates. While the decisions of the Utah Public Service Commission and the MT PSC are not binding on this Commission, their approach is persuasive.

---

[8] *In re Schedule 37 Avoided Cost Purchase from Qualifying Facilities*, Docket No. 09-035-T14, 2009 WL 5436080, at *4 (Utah P.S.C. September 30, 2009) (footnote omitted).

[9] *In the Matter of the NorthWestern Energy's Application for Approval of Avoided Cost Tariff for New Qualifying Facilities*, Docket No. D2008.12.146, Order No. 6973d, ¶ 136, (MT PSC May 6, 2010) ("Second, contracts between NWE and non-CO_2-emitting QFs that select Option 1 rates must include provisions that explicitly address the disposition of RECs for the entire length of the contract. Non-CO_2-emitting QFs may convey all RECs to NWE for the entire length of the contract, in which case NWE must adjust the Option 1 rates at the time a state or federal law or regulation results in actual costs to NWE for C4 CO_2 emissions.").

2. The scope, timing, and amount of any carbon cost are too speculative for inclusion of carbon cost in determination of avoided cost.

Currently, no carbon cost is imposed on utilities' emissions of carbon. This is true even though there have been numerous failed attempts to impose such a cost. The McCain-Lieberman Climate Stewardship Act failed to pass the U.S. Senate in 2003, 2005, and 2007. The Waxman-Markey American Clean Energy and Security Act failed to pass in the 111th Congress (2009–2010). There has not been any significant movement toward passage of a federal bill subsequent to the change of party control of the U.S. House of Representatives in January 2011.

The prior major bills proposed a cap-and-trade system, not a carbon tax. Under these bills, utilities would have been granted a certain quantity of allowances, would have been able to purchase additional allowances, and would have been able to sell unneeded allowances. The effect of such a system on NorthWestern's avoided cost would have depended on the allowances granted to it, the cost of additional allowances in the market place, and the number of allowances that NorthWestern would have needed. There is no evidence as to the actual effect of any of these speculative proposals on NorthWestern.

None of the witnesses in this proceeding offered any definitive opinion about when a carbon cost **would** be imposed by the federal government. About the timing, Mr. Lauckhart stated, "Although now we're thinking it's going to be delayed so implementation will be after 2016."[10] Mr. Rounds made two statements that, at least tangentially, relate to the timing of any carbon cost:

> Well , although today's carbon cost is zero dollars a ton in South Dakota, I think the Commission could find that including some price for carbon over the next 20 years would be reasonable.[11]

[10] *Transcript,* Vol. I, 89:10-12.
[11] *Transcript*, Vol. II, 462: 19-22.

> I think, you know, there's definitely a probability that we're going to see a carbon tax or a cap and trade type of legislation passed in the future.[12]

Mr. Lewis stated, "The commencement of any sort of emission cost adder has been speculative and difficult to forecast for some time now due to the political nature of the proposed regulations."[13]

None of the witnesses in this proceeding offered any opinion about the amount of any carbon cost that would be imposed on a utility like NorthWestern that generates most of its electricity and purchases only a small portion in the spot market. With respect to the amount of any carbon cost, Mr. Lauckhart stated the following:

> Our forecast really is built around the Waxman-Markey bill that was passed by the House of Representatives a couple of years ago.[14]
>
> Suffice it to say, we do a considerable amount of work showing, . . . what we think a market clearing price will be that allows us to meet the cap.[15]
>
> I agree with Mr. Rounds that forecasting the price of CO2 is very difficult.[16]

Mr. Rounds stated the following with the respect to the amount of any carbon cost:

> I don't have a reasonable price that I can testify to. I think that determining that type of a price is completely speculative.[17]
>
> Staff is taking a position in another case right now that includes a price on carbon, and I would say our basis is not that well developed.[18]

Mr. Lewis, who came closest to providing a specific carbon cost forecast, stated, "Our carbon projection was $5/ton starting in 2015 and shifting to $10/ton starting in 2020 and rising to $15/ton in 2025.[19] Mr. Lewis described the development:

---

[12] *Transcript*, Vol. II, 483:22-25.
[13] *Prefiled Direct and Rebuttal Testimony of Steven E. Lewis*, NWE Exhibit 6, 6:11-12.
[14] *Transcript*, Vol. I, 89:5-7.
[15] *Transcript*, Vol. I, 89:13-19.
[16] *Oak Tree Energy, LLC's Rebuttal Testimony of J. Richard Lauckhart*, Oak Tree Exhibit 2, 25:9.
[17] *Transcript*, Vol. II, 462:24-463:1.
[18] *Transcript*, Vol. II, 494:10-13.
[19] NWE Exhibit 6, 6:5-6.

> As we had [*sic*] in the testimony, estimating the carbon price adders has been relatively challenging. We had a number of carbon priced forecasts that we used in our prior forecasts back in '09 and '07 when there appeared to be much more active legislation coming down the pike and some conversations with people back east about what the likelihood was.
>
> Those price forecasts we had a low, medium, and high carbon forecast. All of them had assumed legislation in effect and carbon price adders in effect already now. And obviously that hasn't come to pass. When we created this forecast we had to go back and relook what we thought was reasonable in terms of the carbon price. And obviously the activity at the federal legislative level has slowed down considerably on that topic.
>
> So we did have some discussion and came up with a forecast considerably lower than we had used previously. And by "we" I mean the consultants at Lands Energy Consulting.[20]

In summary, Mr. Lauckhart recognized the difficulty of estimating carbon prices, based an estimate of the market clearing price on a legislative proposal that did not pass, and did not analyze the effect of a cap-and-trade system on NorthWestern. Mr. Rounds did not offer a carbon price and described the estimation of such a price as speculative. Mr. Lewis supplied his firm's best estimate of carbon costs but did not state that they would be the costs incurred by NorthWestern.

Given the record in this matter, any carbon cost is too speculative to be imposed on NorthWestern's consumers and should not be included in the calculation of NorthWestern's avoided cost. NorthWestern respectfully requests that the Commission reconsider and reverse its decision with respect to Finding 2 and Finding 3 and exclude any estimate of potential carbon costs in the avoided cost rate to be paid to Oak Tree at this time.

[20] *Transcript*, Vol. II, 413:15-414:8.

B. The Commission erred in concluding that Oak Tree had incurred an LEO because Oak Tree had not unconditionally committed to deliver any energy and capacity to NorthWestern.

The LEO concept is a creation of FERC. It allows a QF to unilaterally bind a utility to purchase the QF's energy and capacity. By binding itself to deliver energy and capacity, the QF binds the utility to purchase. The actions of the QF are relevant to determining the existence of an LEO; the action or inaction of the utility are irrelevant. As the MT PSC stated, "Upon review of the statutes and their implementation by our sister states, the Commission is persuaded that the touchstone of a legally enforceable obligation is an absolute, unconditional commitment to deliver energy, capacity, or energy and capacity at a future date. Any commitment that is conditional fails to establish an LEO."[21] An offer to sell electricity at a rate that exceeds a utility's avoided cost does not establish an LEO.

1. Oak Tree's response to Chairman Nelson's proposal shows that Oak Tree did not make an absolute, unconditional commitment to deliver energy, capacity, or both to NorthWestern.

The most glaring indication that Oak Tree did not make an absolute, unconditional commitment is its response to Chairman Nelson's proposal offered at the Commission's April 26, 2012 Ad Hoc Meeting. First, at the meeting Oak Tree's representative, Mr. Michael Makens, stated, "I'd love to say, yes, let's do it. I'm not a financial expert on a 20-year $40 million commitment. So I need to crunch these numbers and make sure that we can build it at this price. And I think there's a hopeful possibility that we can go with this, and if we can, we absolutely will.

[21] *In the Matter of the Petition of Whitehall Wind, LLC, for QF Rate Determination*, Docket No. D2002.8.100, Order No. 6444e, ¶ 45 (MT PSC June 4, 2010).

But we need to talk to our financial consultants."[22] Mr. Makens's response was inconsistent with an absolute, unconditional commitment to deliver.

Second, on April 30, 2012, Oak Tree filed its Response to Chairman Nelson's Question ("Proposal Response"). In its Proposal Response, Oak Tree rejected Chairman Nelson's proposal and stated, "Oak Tree proposes to inflate the Chairman's calculations of the B&V Market estimate commencing in 2013 at 2% per year for each year of the Oak Tree power purchase agreement (PPA) with NWE which produces a rate of $53.74/MWH over 20 years."[23] Oak Tree requested an increase of $7.27/MWh or 15.7% ($53.74 compared to $46.47). Oak Tree also stated, "Oak Tree believes it will not be able to finance and build its project without a modification to Chairman Nelson's calculation."[24] Oak Tree's Proposal Response was inconsistent with an absolute, unconditional commitment to deliver energy and capacity to NorthWestern. Even in late April 2012, the only commitment Oak Tree can make to deliver energy and capacity to NorthWestern is that it might be able to do it. If Oak Tree cannot make this commitment at this late stage of these proceedings, Oak Tree could not have made an absolute, unconditional commitment on February 25, 2011.

2. The Power Purchase Agreement that Oak Tree sent to NorthWestern on February 25, 2011, does not contain an absolute, unconditional commitment to deliver energy and capacity to NorthWestern.

Furthermore, the terms in the Power Purchase Agreement offered to NorthWestern by Oak Tree ("Offered PPA") do not establish an absolute, unconditional commitment to deliver energy and capacity to NorthWestern. The Offered PPA did not provide for a date certain Commercial Operation Date. The Offered PPA defined Commercial Operation Date as "Begins

[22] *April 26, 2012 Transcript*, 85:6-12.
[23] *Proposal Response* at 2.
[24] *Id.*

at 12:01 a.m. on the day following the day all equipment and interconnection on NorthWestern's side of the Point of Interconnection have reached a degree of completion and reliability, such that in NorthWestern's judgment, Facility is capable of operating continuously and simultaneously to produce and receive power." The Offered PPA provided, "This Agreement will be terminated if the Facility has not reached a Commercial Operation Date within three years of this Agreement's Effective Date." Nothing in the Offered PPA required Oak Tree to actually build the Facility, provided damages to NorthWestern if Oak Tree did not build, or even required effort on the part of Oak Tree in attempting to build the Facility. Clearly, if Oak Tree could not obtain financing at a rate equal to NorthWestern's avoided cost, Oak Tree could abandon the project and walk away without any liability. If a QF can abandon a project without any liability, the QF has not created an LEO that the utility can enforce.[25]

Given that Oak Tree did not make an absolute, unconditional commitment to deliver energy and capacity, NorthWestern respectfully requests that the Commission reconsider and reverse its decision with respect to Finding 4 and find that Oak Tree has not incurred any legally enforceable obligation.

Conclusion

For the reasons explained above, NorthWestern respectfully requests that the Commission reconsider Finding 2, Finding 3, and Finding 4. NorthWestern further requests that the Commission find that speculative, potential carbon costs should not be included in the calculation of avoided cost and that Oak Tree has not incurred a legally enforceable obligation.

[25] *See South River Power Partners, LP v. Public Util. Comm'n*, 696 A.2d 926 (Pa. Commonw. Ct. 1997); *Pennsylvania Electric Co. v. Public Util. Comm'n*, 677 A.2d 831 (Pa. 1996).

Dated at Sioux Falls, South Dakota, this 14th day of June, 2012.

NorthWestern Corporation d/b/a
NorthWestern Energy

Timothy P. Olson
3010 West 69th Street
Sioux Falls, SD 57108
(605) 978-2924
Tim.Olson@northwestern.com

and

Al Brogan (admitted *pro hac vice*)
208 N. Montana Avenue, Suite 205
Helena, MT 59601
(406) 443-8903
Al.Brogan@northwestern.com

Attorneys for NorthWestern Corporation d/b/a NorthWestern Energy