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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	**DOCKET NO. EL11-006** **OAK TREE ENERGY, LLC'S ANSWER TO NORTHWESTERN ENERGY'S APPLICATION FOR RECONSIDERATION OF FINDINGS AND CONCLUSIONS IN INTERIM ORDER ISSUED ON MAY 15, 2012**

OAK TREE ENERGY, LLC'S ANSWER TO NORTHWESTERN ENERGY'S APPLICATION FOR RECONSIDERATION OF FINDINGS AND CONCLUSIONS IN INTERIM ORDER ISSUED ON MAY 15, 2012

I. INTRODUCTION

Oak Tree Energy, LLC (Oak Tree), by and through counsel and pursuant to ARSD 20:10:01:30.02, hereby submits its Answer to NorthWestern Energy's (NWE) Application for Reconsideration of Findings and Conclusions in Interim Order Issued on May 15, 2012, as follows:

1. That the South Dakota Public Utilities Commission (Commission) properly decided that NWE failed to "incorporate projected carbon cost inputs" and "also may have utilized unjustifiably low natural gas inputs and electric market inputs." (Interim Order, Finding 2)
2. That the Commission properly found that a legally enforceable obligation (LEO) was created as of February 25, 2011. (Interim Order, Finding 4)

NWE's arguments on the proper method for calculating avoided cost are inconsistent with PURPA in that they are an attempt to pay less than full avoided cost to Oak Tree and impermissibly discriminate against Oak Tree in violation of PURPA. With respect to the LEO issue, there is simply no basis for NWE's factual assertions, which are based on a selective misreading of the record in this docket and consist largely of statements taken out of context.

II. EXECUTIVE SUMMARY OF ARGUMENT

- NWE's position that the Commission erred in including any carbon costs in a proper calculation of avoided costs is contrary to PURPA. If a utility includes carbon costs in the calculation of the value of its own generation resources, those same costs must be included in a proper calculation of avoided costs. To properly determine a utility's avoided costs, there must be a determination of the costs that will be avoided. If those costs include carbon costs, they must be included in avoided costs so as to accurately reflect the utility's avoided costs. Moreover, permitting a utility to value its own resources differently by including carbon costs in the calculations for the utility's own resources, but not for those of QFs, would run afoul of PURPA's proscription against adopting rates that discriminate against QFs. 18 C.F.R. § 292.304(a) (ii).

- NWE's position on the creation of a legally enforceable obligation (LEO) is illogical and contrary to well-established FERC authority. Without negotiation by the utility, a QF cannot submit a power purchase agreement (PPA) that is acceptable to the utility. The QF and the utility may disagree over the proper rate or the proper terms in the contract, but the LEO is created when a utility and a QF are unable to reach an agreement, the QF commits to sell its output to the utility, and seeks state regulatory enforcement of PURPA. This is precisely what happened here. The fact that NWE refused to negotiate at all resulted in the submittal of an LEO letter to NWE on February 25, 2011. That LEO letter included a proposed PPA. If NWE did not like the terms, it could have suggested changes. Instead, it refused to negotiate at all, has decided instead to litigate every possible issue in this proceeding, and now blames Oak Tree because NWE did not like the PPA but never said a word about it until this proceeding commenced. If NWE does not like the PPA, it should have negotiated in good faith with Oak Tree to resolve NWE's concerns.

III. ARGUMENT

A. FAILURE TO INCLUDE CARBON COSTS VIOLATES THE AVOIDED COST PRINCIPLE AND WOULD BE DISCRIMINATORY IF NWE WERE PERMITTED NOT TO INCLUDE IT IN AVOIDED COST.

At the outset, it should be obvious that, despite the strained interpretation of NWE to the contrary, there is nothing remotely improper about including carbon costs in an estimate of avoided costs that a utility is likely to experience. The Federal Energy Regulatory

Commission (FERC) implementing rules state that avoided cost is "the incremental costs to an electric utility of electric energy or capacity or both which, but for the purchase from the qualifying facility or qualifying facilities, such utility would generate itself or purchase from another source." 18 C.F.R. § 292.101(b) (6). If NWE will, by purchasing from Oak Tree, avoid the costs associated with any legislation imposing limitations on the use of fossil fuels for generating electricity (i.e., carbon costs), NWE will be avoiding those costs and thus it is appropriately included in any definition of avoided costs. In fact, to not include carbon costs in a calculation of avoided costs would violate PURPA's requirement that the rate not discriminate against QFs. *See e.g.,* FERC Order 69, 45 Fed. Reg. 12214, 12215 (1980)("For such purchases, electric utilities are required to pay rates which are just and reasonable to the ratepayers of the utility, in the public interest, and which to do not discriminate against cogeneration or small power producers.").

Oak Tree does not disagree that calculating the costs of any proposed carbon legislation is a highly technical process that involves substantial expertise and prognostication. There is always a risk of error in any forecast. This is why Black & Veatch performed considerable analysis and employed experts to prepare its Fall 2010 Energy Market Perspective. *See* Oak Tree Exhibit 1, Attachment 5. However, in contrast to the position it has taken in this proceeding, NWE offered a very different view of the prudence of incorporating carbon costs in its electric forecast submitted with its Electric Supply Resource Planning and Procurement Plan (EPP)[1] than that which NWE has offered in this proceeding:

[1] For the Commission's convenience, Oak Tree is attaching Volume I, Chapter 4 in its entirety to this Answer brief as Exhibit 1, hereto. It appears obvious that NWE's intention in promoting this differential treatment of its own resources and QFs is purely discriminatory. As explained further below, there is no other rational basis for NWE's argument for differential treatment of Oak Tree in this proceeding.

> The issue of climate change is not going to go away and GHG regulations are likely to occur at some point in NorthWestern's planning future. Although NorthWestern does not anticipate that there will be comprehensive climate change legislation or control of GHG through EPA regulations in the near term, environmental responsibility and prudence dictate that NorthWestern should make future resource decisions consistent with some expected level of GHG regulation. … *[S]ound business decision-making dictates that NorthWestern proceed under the assumption that some level of regulation will occur in the future*. Decisions made today consistent with anticipated regulation will make the transition to a renewable energy structure more efficient for NorthWestern in the future. This approach suggests that resource decisions should be influenced by the long-term goal of reducing CO2 emissions in both resource development and resource contracting.

EPP, Volume 1, Chap. 4, at pp. 85-86 (emphasis added). Note that this most recent EPP was submitted on December 15, 2011, some 97 days before the hearing in this matter, and *just 29 days before* NWE submitted its direct/rebuttal testimony in this Docket on January 13, 2012.

How did NWE describe its approach to including carbon costs in its electric price forecasts in the EPP? "This uncertainty suggests a 'middle of the road' policy will provide NorthWestern with the flexibility to respond to future developments in a manner that protects our customers and the company from unanticipated consequences." *Id.* at 86. Thus, NWE believed it was prudent in Montana, when considering the potential impact on costs of national carbon cost policy, to adopt a "middle of the road" approach to estimating the future effect of potential carbon cost legislation. What was this "middle of the road" approach?

> With the current uncertainty about carbon regulation or costs and in the absence of better information, NorthWestern will continue to use the NWPCC's carbon tax assumptions in developing its 2011 RPP.[2] NorthWestern uses the NWPCC carbon tax assumption to represent the cost of potential federal carbon tax legislation and also as a proxy for the cost of complying with EPA GHG regulations. NorthWestern's 2011 Plan base case pushes out the date of implementation as discussed below with implementation beginning in 2015 at the earliest, and being fully realized in 2032. In the interim between

[2] NWE is referring to the Northwest Power Conservation Council's Sixth Resource plan which performed a calculation of potential carbon costs.

> plans, NorthWestern has found no better information that would cause it to move away from using the NWPCC's forecast values. However, due to the uncertainty surrounding adoption and implementation of GHG regulations or taxes, NorthWestern has moved the Council's base case carbon costs out in time.

Id. at 87.

In other words, NWE's "middle of the road" approach utilized the Northwest Power and Conservation Council's Sixth Plan forecast of potential carbon costs, and then adjusted it to reflect that no legislation had been adopted by moving implementation further out. The values derived by NWE in the EPP are as follows:

Table No. 10

Carbon Cases Under Potential Scenarios		
Year	Base Case 2013 Legislation 2015 Implemented	Delay Case 2017 Legislation 2019 Implemented
2012	$0.00	$0.00
2013	$0.00	$0.00
2014	$0.00	$0.00
2015	$9.55	$0.00
2016	$12.63	$0.00
2017	$16.20	$0.00
2018	$19.34	$0.00
2019	$22.17	$10.54
2020	$25.70	$18.44
2021	$29.85	$26.34
2022	$34.16	$34.24
2023	$38.67	$42.14
2024	$43.18	$50.04
2025	$48.27	$57.94
2026	$53.83	$65.84
2027	$58.78	$73.74
2028	$64.29	$81.64
2029	$69.10	$89.54
2030	$74.36	$97.44
2031	$80.41	$105.34
Levelized	**$24.67**	**$23.40**

EPP, Volume I, Chap. 4, at 87.

Moreover, NWE relied on this carbon cost estimate in preparing an electric price forecast to calculate the value of the Spion Kop project in Montana in Docket D2011.5.41. *See* Oak Tree Exhibit 2, Attachment 2, p. TAG-8. In that proceeding, Mr. Guldseth stated that "NorthWestern believes that carbon legislation in some form will exist in the future and has included a carbon penalty in the market forecasts beginning in 2017 and escalating over the 25-year forecast period." *Id.* The results of adding the carbon forecast makes Spion Kop look like a relative bargain:

Total Cost of Alternative Energy Resources

(All 25-year levelized $/MWh except Hypothetical Wind and 2009 RFI PPA are 20-year)

Resource Type	Energy	RECs	Sub-Total	Integration	Total
			Energy + RECs		Comparati
					Cost
1. Market + RECs	$83.89	$7.48	$91.37	$0.00	$91.37
2. Sensitivity Market Scenario + REC	$68.04	$7.48	$75.52	$0.00	$75.52
3. Market Only	$83.89	$0.00	$83.89	$0.00	$83.89
4. Sensitivity Market Scenario Only	$68.04	$0.00	$68.04	$0.00	$68.04
5. QF-1 Option 3: Wind Only Rate	$61.73	$7.48	$69.21	$14.99	$84.20
6. Hypothetical Wind in 2009 RPP	$59.34	$7.48	$66.82	$14.99	$81.82
7. 2009 RFI Second Lowest PPA	$57.40	$7.48	$64.88	$14.99	$79.87
8. Spion Kop Wind Project	$46.29	$7.48	$53.78	$14.99	$68.77

Oak Tree Exhibit 2, Attachment 2, p. TAG-8.

This analysis was performed for the express purpose of NWE making a demonstration to the Montana Commission that the cost of Spion Kop was less costly than other alternatives as required by Montana Code Annotated § 69-3-2007. In other words, in order to demonstrate that the Spion Kop project was the best alternative, NWE had to make a demonstration where carbon costs should be prudently considered. Here, NWE is taking the contradictory and

self-serving position that carbon costs should play no role in its resource procurement decisions.

Mr. Guldseth testified that Spion Kop provided a hedge against the incurrence of carbon penalties at the hearing of Spion Kop:

> Second is the risk of green house gas ("GHG") emissions regulation, either by the Environmental Protection Agency ("EPA") or legislated by Congress. While it appears that congressional legislation is on the back-burner for the time being, the EPA is moving forward, albeit slowly, with regulations addressing GHG emissions via the Clean Air Act. If, or when, this happens, thermal generating plants will be impacted while resources that do not emit GHGs will provide price stability to supply portfolios that contain them. To give an idea of the degree of penalty a portfolio may experience by substituting market purchases for wind energy, the levelized difference between the 2009 RPP Base Case Delay Carbon market forecast used in the alternative resource comparison table, which included a carbon penalty beginning in 2017 and was based on the proposed Waxman-Markey legislation, and the no-carbon market forecast used in the 2009 RPP is $11.06/MWh. Multiplying this levelized penalty rate by Spion Kop's expected annual production of 138,000 MWh equals annual carbon risk mitigation of $1.5 million.

Oak Tree Exhibit 2, Attachment 2, pp. TAG-12:16--TAG-13:8.

When questioned at hearing, Mr. Guldseth reiterated his belief in the prudence of including carbon costs in NWE's resource procurement process:

> And I think it would be imprudent for us, as planners, to not consider, not necessarily legislation that might be passed that could impact a price forecast such as I've developed here, but there could be other factors, capital costs to bring existing resources into compliance. And it may not be legislative, it may be the threat of legislation that causes utilities to act in that manner. But the resulting impact will flow through to a forecast to prices in consumer retail rates.

Cross Examination of Todd Guldseth, Montana PSC Docket D2011.5.41 Hr'g Tr. 46:24-47:8.

In other words, it would be "imprudent" for NWE, both in resource planning and in acquiring its own resources to not consider the potential effects of carbon costs in calculating the costs of building or owning its own resources in Montana, but somehow it becomes wildly

unpredictable and impractical to do so when determining an avoided cost in South Dakota. Although the contradiction seems obvious, it becomes more obvious when one considers that any carbon tax or carbon costs will be the result of a national policy, either implemented by Congress or the U.S. Environmental Protection Agency (EPA). How it could possibly be "imprudent" to fail to consider the risks of such a carbon cost in Montana but somehow unreasonable or too speculative to consider in South Dakota is unclear when the policy will undoubtedly be national in scope and affect South Dakota as much if not more so than Montana. One might actually expect the reverse situation to be true, given the current uncertainty regarding the need to retrofit certain South Dakota resources (i.e., Big Stone) to comply with EPA regulations.

NWE attempts to explain away this obvious, glaring and self-serving contradiction by saying it is appropriate to incorporate carbon costs in planning documents but not in calculating avoided cost. Just as a matter of logic, this position makes little sense. First, in order to know what a utility's avoided costs are it must first determine what resources it will be "avoiding." In order to know what resources are being avoided, the utility must determine the costs of varied generation alternatives, including alternatives that will require costs associated with the use of carbon emitting resources. Such an examination must necessarily examine the risks of various alternatives, with the potential for carbon costs evaluated as reasonably as possible. The resource planning process is thus an integral part of calculating an avoided cost. In other words, resource planning is resource planning, no matter how NWE chooses to characterize it. Although South Dakota does not require an integrated resource plan type process, it makes no sense to say that it is prudent for a utility to consider carbon costs in resource planning (and thus, what resources it may invest in at some point in the

future), but not to consider those same carbon costs in determining the avoided cost to be paid to a qualifying facility. The analysis is precisely the same.

Moreover, considering carbon costs in deciding the utility's resource planning and acquisition alternatives and failing to do so with respect to avoided costs is discriminatory and thus violates PURPA. Recent history shows that when NWE does resource planning and resource acquisition activities, it calculates a quite robust carbon cost by relying on the Northwest Power Conservation Council's sixth plan's estimates of carbon costs. Here, NWE is taking the position that it would too unreliable and no carbon costs should be considered. Regardless of whether NWE's position is merely self-serving (and it is), it would also discriminate against QFs by permitting NWE to calculate avoided costs in manner that does not apply to its own resource acquisition activities.

NWE essentially offers two separate cases for the proposition that other jurisdictions, Montana and Utah, have not seen fit to include carbon costs in the calculation of avoided costs and therefore there is nothing wrong with including carbon costs in utility planning (used to make its own resource decisions) but excluding those same calculations from a determination of avoided cost to be paid to a qualifying facility. This chain of logic founders on the shoals of reality for several reasons. First, both Utah and Montana require the use of the integrated resource plan (in Montana's case, the EPP), in determining a utility's avoided costs. In Montana, the Montana Supreme Court held:

> The PSC requires utilities to submit avoided cost data every other year within thirty days of submitting an integrated least cost resource plan. Admin. R.M. 38.5.1905, 2012. *Thus, under both state and federal law, rates for purchases from qualifying facilities must be reasonable and based on current avoided least cost resource data*. *Independent Energy Producers Ass'n v. California Pub. Utils. Comm'n,* 36 F.3d 848, 851-852 (9th Cir.1994); 18 C.F.R. § 292.304; § 69-3-604, MCA

355 Mont. 15, 19, 223 P.3d 907, 919 (2010) (emphasis added).

The Utah Public Service Commission has also required that avoided costs be based on the utility's integrated resource plan: "PacifiCorp's avoided costs should be determined in a manner consistent with the Plan. This means a systems planning approach to the determination of avoided costs should be used; that is, one based on the Integrated Resource Plan itself." *In re PacifiCorp*, Docket No. 909-2035-01, 1991 WL 535230, at *4 (Utah P.S.C. September 3, 1991).

Consequently, in both jurisdictions referred to by NWE in its Application, if the utility bases its resource acquisition activities on certain costs included in its integrated resource plan, the utility must also base its avoided cost on those very same costs. In this case, since NWE is utilizing a carbon cost estimate in its EPP (which is NWE's integrated resource plan), then it must also include carbon costs in the calculation of avoided costs. This is required by Montana law as held by the Montana Supreme Court. The Utah Public Service Commission reached the same result when it adopted its integrated resource planning protocols.

This puts in the proper context the quote from the Utah Commission in 1991 offered by NWE in its Application for Reconsideration at p. 3. The Utah Commission merely ordered consideration of externalities in the integrated resource planning process, but reserved judgment on whether or how to incorporate externalities in rates. This was a sensible approach, considering that the debate over what constitutes an "externality" is typically a robust one, as is the consideration of how to quantify those externalities. The Utah Commission did not say, nor could it, that it would never consider any environmental externalities in rates. Nor did the Utah Commission say that if the utility included carbon

costs in its calculation of the various resource acquisitions the utility might make in the future, that the Utah Commission would not also require avoided costs to be calculated in precisely the same fashion. If the Utah Commission had done so, it would have run afoul of the requirement that avoided cost rates not discriminate against QFs as set forth in 18 C.F.R. §292.304(1)(a)(ii). A utility cannot, under PURPA, pay more for its own resources than it pays to QFs. To do so is not only discriminatory, but it places the utility in the position of being able to overcharge for its own resources while simultaneously using its monopoly power to thwart independent power generators.

Note also then, if avoided cost rates are to be based on the utility's integrated resource plan (and in both Montana and Utah, they are), and the utility bases its resource planning on an assumption that includes resource acquisition decisions designed to avoid the impact of carbon legislation, then the avoided cost rates must also incorporate those carbon costs. This is an active dispute in Montana Public Service Commission Docket D2012.1.3, wherein intervenor Hydrodynamics has argued that avoided cost must include the same carbon cost calculations used in NWE's EPP as well as utilized by NWE to justify its decision to purchase Spion Kop in Docket D2011.5.41.

Nor does the Utah Commission's decision in *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) support NWE's position that Utah has decided against including carbon costs in avoided costs. Instead, PacifiCorp (d/b/a Rocky Mountain Power) submitted avoided cost tariffs to the Utah Commission which included carbon cost adders in the calculation of avoided cost. The Utah Commission ruled that PacifiCorp's submittal was inconsistent with its prior order on calculation of avoided cost and

PacifiCorp had provided no explanation or justification for this departure from the Utah Commission's prior avoided cost orders:

> The Company specifies the environmental adders are comprised mainly of a carbon tax. The Company provides no explanation for this change nor why it is in the public interest to include a potential carbon tax in avoided costs payments to qualifying facilities.
>
> *Lacking supporting evidence or discussion, we find the Company's inclusion of environmental adders to the variable O&M costs used in the avoided cost calculation constitutes a deviation from the previously-approved methodology*. 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. *Absent explanation from the Company and comments from parties we decline to approve this change.*

Id. (emphasis added). PacifiCorp ultimately decided not to explain its inclusion of carbon costs in its avoided cost forecast in Utah, choosing instead to not include those costs in its filing.

First, note that the Utah Commission did not say that it would be appropriate for PacifiCorp to include carbon costs in the estimates of the costs of its own resources (as NWE did with Spion Kop), but inappropriate to include carbon cost estimates in the calculation of avoided costs. Second, the Utah Commission did not say it would *never* approve a carbon cost element in avoided cost rates; it just wanted evidence and explanation from PacifiCorp and other parties before deciding the matter. PacifiCorp, for its own reasons, decided not to pursue the matter. This is hardly evidence that it is appropriate, logical, fair or lawful for this Commission to exclude carbon costs only in utility planning documents (upon which, presumably, the utility will base its own resource acquisition decisions), but exclude these same considerations from a proper calculation of that same utility's avoided costs.

Finally, NWE's argument that a calculation of carbon costs is too unreliable and speculative makes little sense. There are many factors that go into an electric price or avoided cost forecast that are uncertain, including future gas prices, but those estimates are necessarily made all the same. As a result, the parties and the regulatory commissions attempt to do the best they can to determine what the potential range of gas prices might be and include those costs in avoided cost rates. As NWE stated in both its EPP and the Spion Kop proceeding, it would be imprudent for a utility planner to not take into account potential carbon costs in calculating resource planning decisions. The avoided cost determination is necessarily related to the resource planning process, as in order to know what resources might be avoided, the Commission must know the relative costs of those resources. There is simply no basis for NWE's argument that inclusion of carbon costs in avoided cost would violate PURPA and considerable authority that failing to include it when the utility is basing its own resource decisions on carbon costs would violate PURPA. There is also no basis for NWE's argument that carbon costs are too speculative and uncertain to be included; when confronted with its own resource acquisition decisions in other proceedings, NWE took precisely the opposite position. The Commission should not reconsider either finding 2 or finding 3 from its Interim Order of May 15, 2012, as requested by NWE.

B. THE COMMISSION RULING THAT AN LEO WAS CREATED AS OF FEBRUARY 25, 2011 WAS SOUNDLY SUPPORTED BY THE FACTS IN THIS MATTER AS THEY RELATE TO BOTH PUPRPA'S REGULATIONS AND FERC'S DECISIONS.

The determination as to whether and when an LEO is created is, for the most part, left up to the individual states. PURPA's regulations and FERC decisions, however, provide direction as to what an LEO is and what a QF must do to create one.

The fact that Oak Tree and NWE had yet to agree on a contract price does not mean that an LEO was not created. The phrase "legally enforceable obligation" is much broader than just a contract between a utility and QF. *Cedar Creek Wind, LLC*, 137 FERC ¶ 61,006 at P 36 (Oct. 4, 2011). FERC regulations and specifically Order No. 69[3] use the terms "contract" and "legally enforceable obligation" disjunctively to reinforce that a LEO includes, but is not limited to, a contract. *Id*. at P 35. Consequently, the fact that Oak Tree offered a price that NWE claims is above their avoided cost does not mean an LEO was not created; rather the price was a term of contract that was yet to be specified.

On February 25, 2011, Oak Tree committed to providing energy to NWE. It is the QF's decision whether to sell output to the utility pursuant to an LEO. As PURPA specifically states, "[e]ach qualifying facility shall have the option … to provide energy or capacity pursuant to a legally enforceable obligation over a specified term …" In this matter, Oak Tree sent a signed contract obligating itself to sell its entire output to NWE. Thus, as of February 25, 2011, Oak Tree was committed to selling to NWE.

The key under PURPA regarding an LEO is the commitment to sell – not the terms of the commitment. NWE mischaracterizes Oak Tree's refusal to agree with NWE's obviously artificially low, posted short-term rate of $20/MWH as a lack of commitment to sell. However, under PURPA, Oak Tree is only required to commit to sell its generation to NWE, which is what Oak Tree did on February 25, 2011 by sending its LEO letter and proposed Power Purchase Agreement (PPA) to NWE. The proposed agreement itself does not have to be fully acceptable to the utility, otherwise a utility could prevent the creation of an LEO simply by refusing to agree to the terms of the agreement. If NWE had actually attempted to

[3] FERC Stats. & Regs. ¶ 30,128.

negotiate the agreement, as Oak Tree requested several times spanning the period from June of 2010 until March of 2011, NWE might have been able to correct any perceived deficiencies in the proposed agreement that Oak Tree tendered to NWE. Instead, following its usual pattern, NWE refused to discuss the avoided cost issue or the proposed contract at all, and is now complaining that the contract was somehow unsuitable. If it were somehow unfair to NWE or ratepayers, NWE should have at least attempted to negotiate those terms. The uncontested evidence at hearing was that NWE did not choose to negotiate at all on either the price term or the contract terms.

FERC has made it absolutely clear that a utility may not avoid its PURPA obligations by refusing to sign an agreement with a QF. As FERC stated in the *Cedar Creek Wind* case, "the phrase [legally enforceable obligation] is used to prevent an electric utility from avoiding its PURPA obligations by refusing to sign a contract, or …, from delaying the signing of a contract, so that a later and lower avoided cost is applicable." *Cedar Creek Wind, LLC,* 137 FERC ¶ 61,006 at P 36. In short, finding that an LEO was not created because the offered price was not acceptable to NWE is allowing NWE to completely violate their obligations under PURPA – and is exactly what the PURPA regulations were designed to prevent.

Oak Tree's actions constitute the creation of an LEO. Oak Tree spent a considerable amount of time, energy, and money researching and implementing the Oak Tree wind project. Oak Tree has no other market for its electricity and therefore, on February 25, 2011, sent a signed contract obligating itself to sell its entire output to NWE. This was all Oak Tree was required to do under PURPA. Whether NWE found the terms of the proposed PPA acceptable is, as stated earlier, irrelevant as to whether an LEO was created.

When an LEO was created is an issue completely separate from a utility's avoided cost. NWE spends a considerable amount of space in its *Application for Reconsideration* stating that Mr. Michael Makens' testimony "proves" an LEO does not exist. *NWE's Application for Reconsideration of Findings and Conclusions in Interim Order Issued on May 15, 2012*, p. 8-9. In fact, Mr. Makens' testimony relates to the financing of the Oak Tree project, not Oak Tree's commitment to provide energy to NWE. Unfortunately, for whatever reason, NWE fails to understand that the economic feasibility of the project is a completely different issue than whether an LEO was created. In point of fact, Mr. Michael Makens at hearing made it very clear that the Oak Tree project had done everything it could do short of commencing construction[4] but needed the Commission to resolve the avoided cost pricing dispute: "So we're exercising our right to seek fair, good-faith negotiations coming to a fair price and see this project realized. It's ready to go, and we're in a spot where time is of the essence." EL11-006 Hr'g Tr. 141:23-142:1.

What a utility may *not* do under PURPA is simply refuse to negotiate with a QF. In this case, however, that is precisely what NWE has attempted. Because NWE absolutely refused to negotiate at all, Oak Tree exercised its right, as a QF, under PURPA to establish an LEO. An LEO is created by a QF committing to sell its output to the utility – period. NWE's argument that the "terms" of Oak Tree's proposed PPA are not acceptable, in addition to their refusal to negotiate those terms, does not negate the reality that an LEO was created. As stated previously, if a utility could prevent the formation of an LEO simply by arguing over the terms of the PPA, there would be no reason to even have an LEO. Obviously, if the

[4] Mr. Makens indicated that Oak Tree had performed environmental studies, collected and analyzed wind data, prepared power curve analyses, did pre-construction siting, had land control, and had completed the interconnection process. EL 11-006 Hr'g Tr. 138: 22-140: 8.

parties agree on contract terms, a contractual LEO is created. A non-contractual LEO may be created without agreement on the terms of the PPA, and FERC has made it exceedingly clear that if a utility refuses to enter into a contract, a QF may seek state regulatory enforcement under PURPA and an LEO will be created:

> Thus, under our regulations, a QF has the option to commit *itself to sell* all or part of its electric output to an electric utility. While this may be done through a contract, if the electric utility refuses to sign a contract, *the QF may seek state regulatory authority assistance to enforce the PURPA-imposed obligation on the electric utility to purchase from the QF, and a non-contractual, but still legally enforceable, obligation will be created pursuant to the state's implementation of PURPA*.

Cedar Creek Wind, 137 FERC ¶ 61,006 at P 32 (citing *New PURPA Section 210(m) Regulations Applicable to Small Power Production and Cogeneration Facilities*, FERC Order No. 688, FERC Stats. & Regs. ¶ 31,233 at p. 212 (2006); *order on reh'g,* Order No. 688-A, FERC Stats. & Regs. ¶ 31,250 at p. 136-137, aff'd sub nom. *American Forest and Paper Association v. FERC*, 550 F.3d 1179 (D.C. Cir. 2008))(Emphasis added).

There is no merit to NWE's arguments that Oak Tree did not commit itself to sell its output to NWE as of February 25, 2011. NWE's argument, looked at from a logical standpoint, is that the utility may absolutely refuse to negotiate at all, and despite this, the QF must nonetheless (without knowing the utility's position) tender a PPA that the utility agrees with, including an avoided cost rate acceptable to the utility. If this ludicrous approach were adopted, there would never be any QF contracts. The utility has an obligation to negotiate in good faith with the QF, and if the utility and the QF cannot reach agreement after the QF has committed to sell its output to the utility, the QF may seek state regulatory commission enforcement of PURPA in order to overcome utility intransigence. This is what Oak Tree did

in this case, and FERC precedent is absolutely clear this is sufficient to create an LEO. There can be no other result.

Oak Tree has provided ample legal argument and case law in this matter supporting the creation of an LEO as of February 25, 2011. See *Oak Tree Energy, LLC's Post-Hearing Brief*, p. 37-45 (filed April 19, 2012). Furthermore, the facts of this matter support the creation of an LEO as of February 25, 2011. On February 25, 2011 Oak Tree sent a letter to NWE committing to sell its entire output to NWE. In that letter, Oak Tree specified a term of 20 years and provided its calculation of NWE's avoided cost. Following the March 21-22, 2012 hearing and filing of Post-Hearing Briefs, the Commission determined that an LEO was created as of February 25, 2011. This was a decision properly supported by law and fact and should be upheld. The Commission should not reconsider finding 4 from its Interim Order of May 15, 2012, as requested by NWE.

IV. CONCLUSION

There is no merit to either of NWE's contentions in its *Application for Reconsideration*. First, contrary to NWE's suggestion, failing to include carbon costs would violate PURPA as those costs are costs that would be avoided by purchasing Oak Tree's output. Second, NWE has made these arguments regarding the LEO several times, and these arguments continue to be contrary to FERC precedent. Oak Tree obligated itself to sell its output to NWE, and that was all Oak Tree was required to do under PURPA to create an LEO. If NWE had concern about the terms of Oak Tree's proposed PPA, it had every opportunity to negotiate those terms. Instead, NWE refused to negotiate at all, and now seeks to blame Oak Tree for NWE's own failure to negotiate. NWE's Application for Reconsideration should be rejected.

Respectfully submitted this 5th day of July, 2012.

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing document was served electronically on this 5th day of July, 2012, upon the following:

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