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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 REPLY TO COMMISSION STAFF'S POST-HEARING BRIEF**

OAK TREE ENERGY, LLC'S REPLY TO COMMISSION STAFF'S POST-HEARING BRIEF

I. INTRODUCTION

Oak Tree Energy, LLC (Oak Tree), acting by and through counsel, and pursuant to the South Dakota Public Utility Commission's (PUC) Post-Hearing Procedural Order entered on April 10, 2012, hereby submits its Reply to Commission Staff's Post-Hearing Brief. At the outset, Oak Tree wishes to thank the PUC Staff for its contributions to this proceeding. Although Oak Tree does not agree with PUC Staff on all of its positions, Oak Tree appreciates the thoughtful and fair-minded analysis that has gone into PUC Staff's work in this proceeding. The primary issue where Oak Tree would appear to part company with Staff's recommendation is whether or not Oak Tree can afford to wait to have one or more additional proceedings in order to establish avoided cost to a degree that would satisfy the Staff that Oak Tree's proposal is within the reasonable range of avoided cost for NorthWestern Energy (NWE). Oak Tree can wait, but it and NWE's South Dakota ratepayers will lose the tax advantages that expire as of December 31, 2012, namely the ability of generators such as Oak Tree to use bonus depreciation and the production tax credits. These favorable tax benefits have enabled Oak Tree to offer a levelized rate of $65.12 per megawatt hour (MWH) over the 20-year life of the project, including transfer of the renewable energy credits (RECs) to NWE Oak Tree. Recall that Oak Tree witness Lauckhart's forward-looking estimate of the "brown power" avoided costs as of February 25, 2011 was $79.92/MWH without conferring the RECS on NWE. This means the effective difference between Mr. Lauckhart's "brown value" avoided cost and Oak Tree's offer is roughly $20/MWH. Therefore, to produce an avoided cost lower than the $65.12/MWH offered by Oak Tree, one would have to assume that the adjustments proposed by Staff would produce a rate roughly 25 percent lower than the $78.92/MWH rate plus RECs that Oak Tree is entitled to at present under Mr. Lauckhart's calculations. There is no record basis for such an assumption. Further assuming that the tax benefits expire and Oak Tree continues to press for an avoided cost rate that does not reflect that favorable tax treatment, NWE's avoided cost as ultimately determined by the Staff may prove substantially *higher* than the full avoided cost of $78.92/MWH levelized over 20 years as calculated by Mr. Lauckhart.

Oak Tree also specifically disagrees with many of the Staff's recommendations. Some of them are completely unsupported on the record, others are contrary to established principles of avoided cost and violate the Public Utility Regulatory Policies Act of 1978, 16 USC § 824-a3 (PURPA). Primarily, Oak Tree disagrees that NWE's Power Cost Adjustment (PCA) clause is an appropriate reason to not attribute the full value of economy sales by NWE of Oak Tree's power into the market. The result is that consumers will be hurt, thus violating the principles of avoided cost. If the PCA clause is the reason NWE is including the value of power purchase agreements (e.g., Rolling Thunder's Titan Wind project) and intends to put Oak Tree in the PCA clause, the Commission should step in and prevent NWE from profiting while refusing to pass on to the ratepayers the value of the proceeds from resale of power. This issue is much broader than Oak Tree; the PCA clause is not an appropriate mechanism to utilize in recovering the costs of power purchases because of the language of the tariff and because it violates well established principles of cost of service ratemaking. Allowing a practice to continue that may be economically damaging NWE's ratepayers by not permitting its ratepayers to share in the benefits of economy sales is a travesty. To use this as a basis to reduce avoided cost payments to Oak Tree would violate PURPA.

II. EXECUTIVE SUMMARY OF ARGUMENT

- The Staff appears not to agree with the Oak Tree market estimate avoided cost methodology for several reasons. The primary reason is that Staff does not believe NWE's PCA clause permits NWE to pass through the value of economy power sales in the market to its ratepayers when NWE is long on generation. This is problematic as: (1) the PCA clause does not appear on its face to permit NWE to recover the costs of known and fixed costs through PCA clauses (which necessarily includes both Titan and Oak Tree which are fixed price contracts); (2)

if NWE is indeed making economy sales from rate based generation assets into the market and not crediting the sales to customers (without taking out the cost of the generation in the PCA clause), this would appear to violate the principles of cost of service ratemaking; and (3) the failure to pay Oak Tree full avoided cost based on an arcane construction of the PCA clause requirements would violate PURPA's "full avoided cost" principle and be a failure on the part of the PUC to implement PURPA in South Dakota.

- Staff seems to believe that ratepayers are not benefitted by the Oak Tree purchase when NWE is long since no generation is displaced. This is untrue; ratepayers would save money by getting the benefit of market sales whenever Oak Tree's generation occurs at a time when NorthWestern has base load surplus power. This is NWE's current practice, and there is no evidence in this record to the contrary. Therefore, the purchases from Oak Tree would create those sales and thus provide those benefits to ratepayers. Black & Veatch's Energy Market Perspective for the Midwest Region assigns the value of those sales at market prices, irrespective of what they are. In fact, Oak Tree's proposal would pay Oak Tree less in hours where NWE is long and the market price is below the incremental cost of operating NWE's coal plants. In that situation, NWE simply applies the general rule that when it is long Oak Tree only gets the incremental cost of NWE's coal generation, roughly $20/MWH. Mr. Lauckhart only assigned the projected market cost, irrespective of whether it is lower or higher than the incremental cost of NWE's plant.
- Staff also seems to believe that the inputs to the Black & Veatch forecast are

incorrect in that Black & Veatch did not take into account that the Energy Information Administration (EIA) forecast for recoverable natural gas reserves increased substantially between the fall of 2010 and February 2011. If true (there is no cite to the record), this does not explain whether this would have an effect on marginal gas prices since it does not explain whether, for example, the costs associated with increasing reserves would also increase.

- Staff also does not agree with Black & Veatch's Greenhouse Gas (GHG) cost assumptions. However, Staff witness Brian Rounds did not even recall that Black & Veatch had provided a part of the Energy Market Perspective that dealt with potential cap and trade legislation designed to limit GHG emissions. Now, in its brief, Staff says it thinks Black & Veatch's GHG estimates are too high. However, as with the gas price forecast, there is no evidence in this record that Black & Veatch's GHG assumptions were flawed as of February 25, 2011.
- As stated previously, Staff prefers the "hybrid" peaker/market method which is, as far as Oak Tree is aware, not used elsewhere in the United States. It is not one of the five recognized methods set forth in NWE witness Mr. LaFave's testimony. However, Oak Tree agrees with Staff that NWE's electric price forecast suffers from significant flaws. First, Staff is correct that NWE's assumption that there will be no real increase in natural gas prices between 2015-2031 is insupportable. Second, Staff correctly notes GHG emissions should be a part of the avoided cost calculation in this proceeding.
- This proceeding has been going on for more than a year. The Black & Veatch Energy Market Perspective, all 259 pages of it, was available pursuant to NWE

discovery requests as of September 28, 2011. Staff now proposes, despite a year's worth of a proceeding, with dozens of discovery requests and a two day evidentiary hearing, that the PUC should now attempt to get the avoided cost "right" regardless of the potential consequence of such an action. The PUC must recognize by now that the PUC Staff has no more expertise than Black & Veatch or Mr. Lauckhart. The PUC should recognize that it is no more capable of developing a *perfect* avoided cost forecast than anyone else. There is certainly sufficient information in the record in this proceeding for the PUC to make a determination that the Oak Tree offered rate (well below the Lauckhart forecast of Avoided Cost) will likely result in benefit to South Dakota ratepayers. The only thing that would be accomplished by delaying resolution of this matter will be to ensure that ratepayers do not get the benefit of the tax benefits that expire at the end of this year.

III. ARGUMENT

A. The "Hybrid" Peaker/Market Method is Not An Avoided Cost Methodology and, as Implemented by NWE, would Appear to Violate Both PURPA and Traditional Ratemaking Principles

Although Staff prefers NWE's "hybrid" Peaker/Market methodology, the reasons for this are not entirely clear. It appears from its brief that the reasons that Staff prefers the non-fundamentals approach of NWE is because: (1) it reflects the way NWE actually operates its system and (2) NWE's PCA clause precludes the sharing of revenue generated from economy sales from NWE coal-fired generation with NWE ratepayers.

First, it is important to note that NWE's "hybrid" approach does not reflect the manner in which NWE actually operates or values its own power. When NWE evaluates its own long-term assets, it looks at the value for that asset over its useful life. Whether the asset exists in South Dakota, Montana or elsewhere, it is often the case that there may be hours during the life of the asset when the asset's generation is not really needed to meet its native load. However, when a utility does its economic analysis of the value of that asset, it will typically attribute to the project the value of the spot sales on those hours. This is the only legitimate way to analyze the value of the project to ratepayers over its life. NWE approaches the economics of its own plants this way. For example, it may be that the Big Stone coal plant (or Spion Kop) ends up causing NorthWestern to be surplus in some light load hours, but when NorthWestern decides if it should retrofit the Big Stone coal plant (or build Spion Kop), it will assign to the surplus hours the value of the sales in spot markets, rather than only attributing the value of the incremental cost of its coal plants. As set forth below in Section III.b.1, *supra*, to value Oak Tree differently from the manner in which NWE values its own facilities would be illegally discriminating against Oak Tree.

When NWE is long on power, it does not back down its generation in order to avoid having excess generation. Indeed, for a variety of perfectly rational operational and economic reasons, NWE makes sales into the market when market is higher than the incremental cost of operating its coal plants. In other words, when market is $35/MWH, and the incremental cost of operating the coal plants is $20/MWH, NWE makes the sale and incurs a profit of $15/MWH. So, Staff is incorrect that the "hybrid" method proposed by NWE in this proceeding is anything like the manner in which NWE operates its system. NWE does not back down its generation when it is long but instead makes sales of that excess generation into the market. Thus, paying Oak Tree only $20/MWH in hours where NWE is long and market is higher is significantly understating the value that NWE would receive in those hours. When

NWE makes purchases in those hours from Oak Tree, it permits NWE to make market sales. To pay Oak Tree less than the market price in this circumstance would be to pay Oak Tree less than full avoided costs in violation of PURPA.

Circumstances where NWE is long on power and market is lower are rare, but apparently it has happened. However, in this circumstance, NWE proposes to pay the same $20/MWH to Oak Tree that it pays Oak Tree in hours when market is higher than the incremental cost of Oak Tree's generation. In contrast, Mr. Lauckhart's market estimate approach simply provides the value, whatever that value is, of the market in those circumstances, irrespective of the incremental cost of operating NWE's coal plants. If it is $5/MWH, that is the value that Mr. Lauckhart's analysis assigns to Oak Tree.

It is important to remember that Mr. Lauckhart's calculations utilized some 175,200 hours over the 20 years, and he calculated the average "brown power" value of the Oak Tree plant over that time based solely on a projection of market prices in those hours. These calculations are irrelevant to NWE's incremental cost of running its coal plants. In other words, in circumstances where NWE's incremental cost of coal generation is higher than market, Mr. Lauckhart may be actually attributing less value to Oak Tree's project than the $20/MWH proposed by NWE. Mr. Lauckhart took each hour into account and assigned a value to Oak Tree's power. When NWE might be required to back down its own generation in order to purchase power from Oak Tree, it would be appropriate to assign $20/MWH in those hours to Oak Tree. It is not, however, appropriate to ignore the market value benefits to ratepayers when NWE makes economy sales as a result or power provided by Oak Tree.

Staff's main reservation with Mr. Lauckhart's approach seems to be that the PCA clause prohibits the sharing of revenue with ratepayers. As stated in Oak Tree's opening brief, the PCA tariff language does not appear to permit the recovery of wholesale power contracts (such as Titan or Oak Tree) through these sorts of clauses. Since long term PPA prices are not supposed to be included through the PCA mechanism, the fact that spot market revenues are also not reflected in the PCA is irrelevant when it comes to a proper calculation of avoided cost. The ability to use automatic fuel adjustment clauses, such as power cost adjustment clauses, are an exception to normal utility ratemaking principles, which require rates to be adjusted after review by a regulatory authority on a prospective basis only. *See e.g., Gordon v. Council of City of New Orleans,* 9 So.3d 62, 91 (S.Ct. La. 2009) (dissenting opinion of Judge Johnson). The regulatory compact is the fundamental basis for utility regulation. *PacifiCorp v. Public Serv. Com'n of Wyo.,* 103 P.3d 862, 871 (Wyo., 2004).[1] "In general, the compact is a theoretical agreement between the utilities and the state in which, as a quid pro quo for being granted a monopoly in a geographical area for the provision of a particular good or service, the utility is subject to regulation by the state to ensure that it is prudently investing its revenues in order to provide the best and most efficient service possible to the consumer. In exchange, the utility is allowed to earn a fair rate of return on its rate base." *Id. (*citing generally *United States Gypsum, Inc. v. Indiana Gas Co.,* 735 N.E.2d 790, 797 (Ind. 2000)).

The ability of a utility to collect rates for fuel adjustments must remain a narrow exception to ensure the traditional principles of rate making are not swallowed whole by the "exception" of fuel adjustment clauses. Indeed, "a utility company is allowed to charge fuel costs directly to its customers on a monthly basis[2] with only a retrospective review by the

[1] The Wyoming equivalent of NWE's PCA clause is called a "pass on mechanism."
[2] Oak Tree recognizes that NWE's tariff only permits such adjustments on a quarterly basis. However, the manner in which fuel clause adjustments, including power cost adjustments, operate is essentially the same.

Commission. "*This procedure is allowed because the cost of fuel fluctuates, cannot reasonably be predetermined, and therefore, cannot be pre-set by the Commission.*" *Entergy Gulf States v. Louisiana Pub. Serv. Comm'n,* 726 So. 2d 870, 873 (S.Ct La. 1999)(emphasis added). In the *Entergy* decision, the Louisiana Supreme Court affirmed the Louisiana Public Service Commission's decision to disallow certain fuel related costs because:

> … these expenses were not truly fuel expenses although they are related to fuel, are not properly recoverable through the use of the fuel clause. Rather, because these costs are considered *predictable, known, or measurable* costs, they are properly base rate charge items and the Company is required to bring the expenses before the Commission for its approval and inclusion in the base rate in an annual base rate proceeding. The Commission evaluates the Company's total revenue requirements and determines if such expenses warrant an increase in rates only in base rate proceedings. *The Commission explained that to allow the Company to use the fuel clause to pass through these costs directly to customers would allow the Company to circumvent the rate making process.*

Id. at 890 (emphasis added).

Apparently, the Staff feels that the NWE PCA clause permits NWE to recover "predictable, known, or measurable" costs such as the Titan Wind contract, or the proposed Oak Tree contract. This is contrary to the aforementioned principles of utility rate regulation. NWE's South Dakota customers deserve to have such costs recovered through a rate case, whereby all of NWE's costs can be fully explored and the utility's actual and requested rate of return can be simultaneously reviewed. Moreover, if the NWE PCA clause does not permit NWE to pass on the revenue from economy sales of baseload generation into the market then NWE's ratepayers should be gravely concerned about their rates. Ratepayers paid for these rate based assets, and they are entitled to at least share in the revenue generated by them.

The PUC should direct its staff to examine the NWE's PCA clause filings and reject any NWE filing with a long term contract price that includes a price that is known, predictable and measureable, including contracts such as those for Titan Wind or Oak Tree. As discussed in Oak Tree's opening brief, there appears to be no allowance for these costs to be included in NWE's PCA clause. If these contracts are instead included in a general rate case, the outcome of such a general rate case will necessarily recognize and credit to ratepayers the value of spot market sales. Second, even if the PUC has previously allowed contracts with prices that are known, predictable and measurable, the PUC should order that such costs in the future not be included in NWE's PCA clause.

In conclusion, not only does NWE's "hybrid" approach not reflect the way that NWE actually operates its system and deprives Oak Tree of a "full" avoided cost rate in violation of PURPA, the use of this hybrid approach (assuming it is used in the way NWE claims) fundamentally violates traditional concepts of ratemaking. There is no basis for NWE to attempt to recover the costs associated with a known measurable and predictable cost such as Oak Tree's proposed contract in the PCA clause. Not permitting Oak Tree to recover "full avoided cost" based on such a strained reading of NWE's PCA clause would be a failure on the part of the PUC to implement PURPA in South Dakota. Perhaps more importantly, it may prevent NWE from meeting its renewable energy objective of 10 percent of NWE retail sales by 2015.

B. There is No Reason to Believe that Additional Hearings Will Significantly Decrease Oak Tree's Offer Rate of $65.12/MWH

It is admirable that the PUC staff wants to hold additional proceedings in order to properly calculate an avoided cost for Oak Tree. However, holding additional proceedings on an avoided cost rate and GHG costs would not likely accomplish anything other than Oak Tree being paid a higher rate. As stated previously, Oak Tree's offer of $65.12/MWH for 20 years is significantly lower than Mr. Lauckhart's "brown value" avoided cost of

$79.82/MWH over the same period. Mr. Lauckhart's "brown value" avoided cost rate does not include RECS, which NWE has valued at somewhere in the $7/MWH range.[3] Consequently, in order for any additional proceedings to produce a lower result than Oak Tree's offer, the Staff's proposed changes would have to produce a reduction of approximately 25 percent in the avoided cost rate. There is no record basis in this proceeding for assuming that this is remotely possible.

Instead, it is equally likely that based on an LEO date of February 25, 2011, additional investigations will only produce a rate that is higher (perhaps significantly) than Oak Tree's offer of $65.12 with the RECs being transferred to Oak Tree. Oak Tree has testified it could only do the project assuming a reasonable return on investment at the $65.12/MWH number because of the existence of both the PTC and the ability of Oak Tree to use bonus depreciation. In the absence of those favorable tax treatments, Oak Tree's proposed rate would likely have been consistent with Mr. Lauckhart's "brown value of avoided cost" of $78.92 without the transfer of REC's to NWE. There is no basis in this record for concluding otherwise.

Oak Tree does not believe that PUC Staff's instincts are entirely wrong. However, all the effort and energy that would go into holding additional hearings on Oak Tree's avoided cost rate would likely be better spent on establishing a generic long-term avoided cost for NWE in South Dakota. In this way, future QFs will have a precedent on how to submit an offer to NWE that is consistent with NWE's long term avoided costs. Make no mistake: whatever long-term avoided cost rate is set by the PUC should include a presumption that the costs of economy sales when market is higher than the incremental cost of NWE's coal

[3] The value of RECs is estimated by Mr. Tim Guldseth of NWE in his testimony in the Montana *Spion Kop* proceeding, D2011.5.41. See Oak Tree Exhibit 2, Attachment 2, p. TAG-8. He estimates the value of RECs as approximately $7.48/MWH.

generation are to be included in NWE's avoided cost as discussed in Section III.A., *infra*.

1. Staff's Criticism of Black & Veatch's Gas Price Forecast is Unfounded and Contrary to the Record

The PUC Staff takes issue with Mr. Lauckhart's failure to increase his gas price forecast input from what appeared in the Black & Veatch Energy Market Perspective as of November 2010 and what Mr. Lauckhart utilized in preparing his "brown power" avoided cost calculation for Oak Tree as of February 2011. The apparent basis for Staff's concern is that the EIA increased its estimate of recoverable gas reserves as of early 2011. However, the PUC Staff has not actually compared how the revised EIA estimate of recoverable reserves compares to the estimate of recoverable gas reserves in the Black & Veatch gas price forecast utilized in its Fall 2010 Energy Market Perspective.

Staff's criticism also appears unfounded in that Staff has not prepared its own forecast of natural gas prices as of February 2011 and continuing for 20 years. Nor has the Staff provided guidance to the PUC on how to deal with fundamental issues specifically addressed by Black & Veatch in its Energy Market Perspective such as: (1) increased demand for natural gas caused by a decision on the part of utilities to switch to natural gas generation instead of complying with expensive pending environmental regulations by the U.S. Environmental Protection Agency (EPA); (2) costs associated with environmental concerns over "fracking" and increased cost due to exhaustion of potential slant drilling into "sweet spots" which contain value hydrocarbon based liquids; and (3) EIA's estimate of the cost of developing and extracting its increased estimates of recoverable gas. The PUC must consider these fundamental issues before deciding whether or not one gas price forecast is superior to another.

Staff has not on this record compared the EIA forecast of natural gas in February 2011 with the Black & Veatch forecast to determine the potential increase in EIA's forecast had EIA decided to replace retired coal plants with natural gas fired generation. Although Staff suggests additional proceedings by the PUC would finally resolve such issues, there is no reason to think that if the PUC took the time to investigate and analyze all these issues that the PUC's determination of a gas price forecast of February 2011 would vary significantly from the Black & Veatch gas price forecast utilized in its November 2010 Energy Market Perspective. The Staff has not provided any evidence or analysis that would suggest otherwise.

If the Staff and the PUC believe that the Black & Veatch gas price forecast from November 2010 is excessive, then the staff and PUC will necessarily need to take issue with the Otter Tail Power Company (Otter Tail)/NWE natural gas price forecast submitted in Docket EL12-027. *See* http://puc.sd.gov/Dockets/Electric/2012/el12-027.aspx. In attachment 3, page 380 of that filing, Otter Tail provides an analysis of the fuel cost for a new combined cycle combustion turbine of $66.44/MWH. A new combined cycle combustion turbine has a heat rate of approximately 7000 btu/kilowatt hour (KWH). Consequently, using simple math, Otter Tail is assuming the cost of gas is roughly $9.50/MMBtu over 20 years.[4] Although it is unknown whether NWE agrees with this exact estimate, presumably NWE would have substantial input on whether Otter Tail's justification for retrofitting the Big Stone plant makes economic sense as opposed to retiring that plant and building gas generation instead. One would assume that if NWE truly believed Mr. Lewis's gas price forecast in this proceeding of $5.14/MMBtu over 20 years was accurate, it would not advocate retrofitting Big Stone and instead switch to natural gas combined cycle generation.

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[4] The gas price forecast of $66.44/MWH is described as a 20-year levelized busbar fuel cost and therefore the $9.50/MMBtu gas price is also a levelized number. The $9.50/MMBtu is produced by multiplying 7000 btu/kwh to equal $66.44/MWH.

It appears that NWE is simply attempting, again, to have it both ways in two different proceedings. When NWE wishes to demonstrate that retrofitting Big Stone to meet pending EPA standards makes economic sense, NWE claims the gas price over 20 years will be almost double than the gas price than in it utilized in this proceeding where NWE wishes not to purchase output from Oak Tree. This is similar to the apparent contrast between NWE's positions in the *Spion Kop* proceeding and its position in this proceeding. Such treatment is contrary to express directives in PURPA, which prohibits discrimination against QFs and requires an equivalent treatment of QFs and utility-owned generation. *See e.g. Niagara Mohawk Power Corp. v. FERC*, 162 F.Supp.2d 107, 111 (N.D.N.Y. 2001) ("Section 210(b) of PURPA required that the rates utilities paid for power purchased from QFs be 'just and reasonable to the electric consumers'" and "'not discriminate' against QFs. 16 U.S.C. §824a-3(b)"). Whether such discrimination is intentional or not is unknown to Oak Tree, but discrimination is clearly what it is if the PUC and Staff ignore NWE's starkly different gas price forecasts in the two different proceedings.

Finally, Oak Tree wishes to note that, compared to the Otter Tail filing, the November 2010 Black & Veatch gas price forecast of approximately $8.12/MMbtu levelized over 20 years appears quite reasonable. In short, there is no basis for assuming that NWE's gas price forecast, or the EIA forecast, after an additional proceeding, would prove to be substantially different or better than the forecast utilized by Mr. Lauckhart to develop his "brown power" avoided cost forecast as of February 2011.

2. <u>Staff's Concern about the Black & Veatch GHG Forecast is Unfounded and Additional Hearings are Unlikely to Resolve Differing Policy Views.</u>

At the outset, Oak Tree wishes to thank the Staff for considering that GHG prices or "adders" should be taken into account in this proceeding. Oak Tree believes this is a prudent approach to take, given Mr. Guldseth's testimony in Montana. See Oak Tree Exhibit 2, Attachment 2. There is no credible reason to assume carbon legislation, whether it is cap and trade, or any other approach, would apply to Montana and not South Dakota.

However, Staff has concerns about the Black & Veatch carbon price forecast. Oak Tree believes this concern is unfounded and a bit unfair to Oak Tree. First, when Oak Tree filed this complaint on April 28, 2011, the complaint included an affidavit by Mr. Lauckhart that referred to the Black & Veatch Fall 2010 Energy Market Perspective. NWE requested the Black & Veatch Energy Market Perspective for fall of 2010 in NWE's first discovery requests submitted on July 15, 2011. On Aug 15, 2011, Oak Tree responded that a 259 page power point slide deck of the Black & Veatch Fall 2011 Forecast would be provided to parties that signed a non-disclosure agreement (NDA). On or about, September 28, 2011, after being advised that Staff and NWE had signed the NDA, the Black & Veatch 259 page slide deck was provided to both Staff and NWE. On December 13, 2011, Mr. Lauckhart submitted his direct prefiled testimony which included, as attachment 5, the 259-page Black & Veatch Energy Market Perspective 2010 slide deck.

At hearing, Staff Witness Rounds did not appear to be aware that there was a calculation of prospective GHG price forecast in the 259 page slide deck.

> Q. [Mr. Uda] Okay. If you had those spreadsheets would it have helped you better understand what they were doing?
>
> A. [Mr. Rounds] I think definitely. I think the biggest question I have is what is their assumption for carbon prices. That's not in there that I can see.

EL11-006 Hr'g Tr. at 468:1-5.

The Black & Veatch GHG assumptions and methodology are liberally sprinkled throughout the 259-page Electric Market Perspective available to Staff since roughly September 28, 2011. In particular, the assumptions are spelled out very clearly on pages 72-82 of that report, including the fact the Black & Veatch assumptions were based on something similar to House Resolution 2454 (also known as "Waxman/Markey"), which passed the U.S. House of Representatives. Black & Veatch assumed as of fall of 2010 that such GHG legislation would not come to pass until 2016 and that GHG/Carbon prices would start at $23 per ton in 2016 and increase to $67/ton by 2035. *See* e.g., Oak Tree Exhibit 2, Attachment 5, p. 119. Staff now appears to believe these prices are too high. This appears to be a bit unfair to Oak Tree as it had little to no opportunity to answer Staff's questions about the assumptions or methodology or to mitigate Staff's concerns.

Certainly, the Black & Veatch Fall 2010 forecast made certain assumptions and, as with any forecast, those assumptions may later be proven wrong. However, this was the best information available to Mr. Lauckhart as of February 2011, and there is no reason to believe that another proceeding that takes a forward look at potential GHG prices as of February 2011 would produce a substantially different result than that contained in Black & Veatch's forecast. Further, Black & Veatch performed considerable detailed fundamental analysis of what GHG prices would be needed in 2016 to meet the Waxman/Markey Caps for GHG emissions. The PUC would probably use similar methods of analysis as of February 2011 and would likely have developed prices very similar to the Black & Veatch prices.

As of February 2011, the best estimate of how Congress might deal with GHG legislation was Waxman/Markey. As of February 2011, Black & Veatch believed that this legislation or something similar to it would go into effect as of 2016. It would be difficult for the PUC (or anyone else for that matter) to travel back in time to February 2011 and conclude that some different sort of carbon legislation would be implemented after 2016. There is simply no record evidence to suggest that any other assumption was reasonable or prudent. Black & Veatch also prepared a very detailed fundamental analysis of what GHG prices would be needed in 2016 to meet the Waxman Markey Caps for GHG emissions. In taking a retrospective look back to February 2011, it is unimaginable that the PUC would use a different methodology to determine the likely future effect of national carbon price estimates than those developed in the Black & Veatch forecast. There is no evidence in this record to the contrary that a different methodology was superior or more accurately calculated a GHG price as of February 2011. In fact, the Staff has no real estimate of its own, EL11-006 Hr'g Tr. at 462:17-463:4. NWE did not utilize the carbon price forecast, developed by Mr. Lewis, in calculating its 20-year electric price forecast of $35.80/MWH.

To its credit, Staff believes some GHG price would be appropriate to include in the avoided cost for NWE. The Staff, however, is not yet sure what that price would be. It is concerned that Oak Tree's price is too high, but it has not really taken the opportunity from almost the outset of this proceeding to explore that issue in more detail with Oak Tree. Now, after the hearing, Staff believes the record is sufficiently incomplete such that only holding another proceeding on this issue would shed new light.

However, there is no basis for an assumption that an additional proceeding, necessarily retrospective to February 25, 2011, would produce a better or more accurate GHG forecast than that produced by the experts at Black & Veatch. Instead, there is every likelihood that the result would be the same.

The real issue is, as with any forecast, what are the risks associated with getting the avoided cost forecast for Oak Tree wrong as opposed to getting it right? The Oak Tree project will provide substantial benefits to South Dakota ratepayers, including, according to Staff, the avoidance of some potential for GHG legislation that impacts South Dakota. This was certainly a consideration in Mr. Guldseth's testimony in the *Spion Kop* proceeding, MPSC Docket D2011.5.41. There is no evidence in this proceeding that Black & Veatch's forecast is too high, much less any basis for a methodological attack on Black & Veatch's GHG forecast as of February 25, 2011.

In contrast, it is very unlikely $65.12/MWH will prove to be higher than NWE's avoided costs in South Dakota over the proposed 20-year period of Oak Tree's sale to NWE. There is simply no record evidence to suggest that Oak Tree's project will not actually save NWE ratepayers money if it is approved in time for Oak Tree to take advantage of the PTCs and bonus depreciation.

If there exists a fundamental disagreement among the parties on GHG prices, it is unlikely that a new or additional proceeding will change those differences of opinion. Instead, because of the expiration of the PTCs and the ability to use bonus depreciation, the outcome of such a proceeding may in fact produce an avoided cost for NWE that is higher than Oak Tree's proposed cost of $65.12 levelized over 20 years. This proposed rate was approximately 25 percent below Mr. Lauckhart's "brown power" avoided cost of $79.82/MWH plus RECs, which is roughly a rate of $86/MWH over the life of the project. Even assuming that the PUC held additional hearings and requested additional testimony and evidence on both natural gas price inputs and GHG costs, achieving a better rate than $65.12/MWH over 20 years seems unlikely. As pointed out in Oak Tree's opening brief, Oak Tree's proposed rate is very similar to the rate NWE agreed to with Titan Wind. There is no record reason to think the rate should have been calculated at less than $65.12 for 20 years as of February 2011.

IV. CONCLUSION

Oak Tree is grateful for the Staff's considered views on the issues in this proceeding. Where Oak Tree parts company with Staff is on the assumption that NWE's "hybrid" method should or does accurately reflect how NWE operates its system, that NWE does not avoid any costs by purchasing from Oak Tree, or that the PCA clause does or should prohibit NWE from sharing the benefits of economy sales with Oak Tree. Staff's belief that another hearing is needed on gas price and GHG forecasts hinges on the assumption that another hearing would produce a different or better result than this proceeding. In addition, it presumes that Oak Tree's project will not become more expensive over time as favorable tax treatments expire at the end of this year. Oak Tree commends staff for the suggestion that it make an effort to get a better understanding of gas and GHG prices, but Oak Tree believes this effort would be better spent on trying to develop a long-term avoided cost rate for NWE that applies to projects greater than 100 kilowatts in design, such that future cases brought by QFs are based on a fundamental avoided cost methodology and pricing structure. Oak Tree respectfully requests that the PUC grant Oak Tree's request for a 20-year avoided cost forecast at $65.12/MWH, with the RECs transferred to NWE.

Respectfully submitted this 24th day of April, 2012.

<u>/s/ Yvette K. Lafrentz</u>

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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 24th day of April, 2012, upon the following:

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