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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 MOTION
FOR PARTIAL RECONSIDERATION
OF INTERIM ORDER**

**OAK TREE ENERGY, LLC'S MOTION FOR PARTIAL
RECONSIDERATION OF INTERIM ORDER**

Oak Tree Energy, LLC (Oak Tree), by and through counsel, and pursuant to Section 20:10:01:30.01 of the South Dakota Public Utilities Commission (PUC) Administrative Rules, hereby submits its Motion for Partial Reconsideration of the PUC's Interim Order entered May 15, 2012. Oak Tree respectfully asks that the PUC reconsider: (1) the use of the hybrid method identified by NorthWestern Energy (NWE) in this proceeding to determine the appropriate avoided cost; (2) the use of "current market conditions and projections" in determining proper natural gas inputs and proper electric market rates; and (3) the use of

Lands Energy's carbon emission cost estimate of \$5/ton starting in 2015, increasing to \$10/ton starting in 2020, and \$15/ton starting in 2025.

PROCEDURAL BACKGROUND

In the PUC's Interim Order; Order For and Notice of Further Hearing dated May 15, 2012, the PUC concluded:

1. That, given NWE's status as a vertically integrated utility with predominant reliance on its own internal generation at this time, the hybrid method is the proper method to calculate avoided costs for NWE's South Dakota system.
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.
3. That the carbon emission cost values of \$5/ton starting in 2015, 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.
4. That NWE is obligated to purchase Oak Tree's output because a legally enforceable obligation was created by Oak Tree on February 25, 2010.
5. That Oak Tree is entitled to capacity credit for the facility's output commencing in 2012 with the capacity contribution to be determined and adjusted in accordance with the method NWE is using for the Titan I project, and such capacity credit shall be incorporated into the hybrid method beginning in 2012.

6. That the proper avoided cost contract term is 20 years.

Furthermore, the PUC directed the parties to file additional analyses to assist the PUC in determining:

1. The proper application of the hybrid method.
2. The proper natural gas input(s) to use in the hybrid method based on current market conditions and projections.
3. The proper electric market rates that the parties may deem warranted to reflect current market conditions and projections, taking into consideration the carbon emission costs previously approved and any adjustments to gas prices.
4. The proper capacity contribution and resulting capacity credits to be included in the avoided cost and added into the hybrid method under the Titan I method.
5. NWE's avoided cost levelized over a 20 year period.
6. The parties may file rebuttal testimony on or before June 13, 2012.

Oak Tree believes that the use of the "hybrid" method violates PURPA in two respects: (1) it does not appropriately calculate NWE's avoided cost; (2) it is unduly discriminatory in that it creates a "heads we win/tails you lose" scenario where Oak Tree only receives the pricing based on NWE's coal resources during low load hours rather than the value of the market, but not the benefit of NWE's peaking units (gas fired) in the hours when market prices are lower than the cost of operating NWE's peaking units. Oak Tree believes a more appropriate method would be either to: (1) use a market estimates approach in all hours, wherein Oak Tree would receive that value, whatever it is, in all hours; or (2) to use a method that relies entirely on the projected incremental cost of operating NWE's resources, regardless of the hour. Instead, the "hybrid method" creates discrimination by only assigning the

market value to Oak Tree during high load hours when NWE's resources are more expensive, but then depriving Oak Tree of the market value during low load hours when NWE's resources cost incrementally less to operate than market. Whatever else the "hybrid" approach is, it is not an appropriate method to calculate avoided cost as it is designed to systematically understate avoided cost.

A second issue is the Commission's decision to permit the parties to use "current" gas prices and market information in the determination of NWE's avoided costs. 18 C.F.R. § 292.304(d) expressly permits the qualifying facility or "QF" to choose between a rate that is calculated at the time of delivery, or a forecast rate over a specified term. For the QF to choose a specified term, it has to have a beginning and ending date. It cannot be based on information totally unknown to the QF at the time the commitment was made. Furthermore, case law, as explained below, makes it plain that avoided costs are established from the date that the QF incurs a legally enforceable obligation (LEO). There is simply no authority for the proposition that a state commission can establish avoided costs on a date well past the LEO date.

ARGUMENT

1. The Hybrid Method Does Not Comport with PURPA and Systematically Understates NWE's Avoided Costs

The PUC's decision to adopt NWE's "hybrid" avoided cost methodology is inconsistent with the principle of avoided cost established in Section 210 of the Public Utility Regulatory Policies Act of 1978, 16 U.S.C. §824a-3(b)(PURPA). In reviewing the Federal Energy Regulatory Commission (FERC) rules implementing PURPA, the United States Supreme Court noted that "[t]he utility's full avoided cost is 'the cost to the electric utility of the electric energy which, but for the purchase from such cogenerator or small power

producer, such utility would generate or purchase from another source.’ PURPA § 210(d), 16 U.S.C. § 824a-3(d) (Supp. V). *See* 18 CFR 292.101(b) (6) (1982) (the term ‘full avoided costs’ used in the regulations is the equivalent of the term ‘incremental cost of alternative electric energy’ used in § 210(d) of PURPA).” *American Paper Institute, Inc. v. American Elec. Power Service Corp.*, 461 U.S. 402 (1983). Subsequent to the U.S. Supreme Court’s decision in *API*, federal circuit courts of appeals and federal district courts have held that a state commission’s failure to ensure that utilities pay QFs for energy at a rate equal to the utilities’ full avoided cost “is a failure to comply with a regulation implementing PURPA.” *See Conn. Valley Elec. Co. v. FERC*, 208 F.3d 1037, 1043 (D.C.Cir.2000); *New York State Elec. Gas Corp. v. FERC*, 117 F.3d 1473, 1476 (D.C.Cir.1997); *Indep. Energy Producers Ass’n v. Cal. Pub. Utils. Com’n*, 36 F.3d 848, 858-59 (9th Cir.1994); *Occidental Chemical Corp. v. Louisiana Public Service Com’n*, 494 F.Supp.2d 401, 406 (M.D. La., 2007).

Thus, what a state commission may not do under PURPA is pay less than full avoided costs to a QF. The PUC’s adoption of the “hybrid” method violates the PURPA full avoided cost principle by assigning a market price value to Oak Tree in hours where market is less than the cost of NWE meeting its loads with its own resources (particularly natural gas peaking units). This produces a lower rate to Oak Tree than the incremental cost of NWE’s own resources in high load hours. In low load hours, the hybrid method again understates avoided cost by inconsistently failing to utilize the market price in those hours, even though NWE can and does sell generation in hours where market exceeds the incremental cost of NWE’s coal fired resources.

To help further explain, attached hereto is Exhibit “1,” which is a demonstrative exhibit depicting two hypothetical days (i.e. 48 hours of data). The first 24 hours indicate a

light load day and the second 24 hours indicate a heavy load day. The figure shows the hourly loads on each hour, the capability of low variable cost coal, and the additional capability of higher cost peakers. If there were no market available to the utility in this scenario, the utility would be running only its coal on lower load hours and would need to run both its coal and its higher cost peakers on higher load hours. However, if there is a market that the utility can utilize, and the utility can include market purchases in its economic dispatch stack, then the utility is able to make market purchases in order to avoid running its high cost peaking units, if the market price is below the avoided cost of those high cost peaking units. In addition, the utility would not back down its coal plant when its loads were down because the utility could run the coal plants and sell the power in the market, if the market price was above the variable cost of its coal. However, if the market price was below the variable cost of the coal, the utility would purchase from the market and back down its coal plant.

In other words, instead of consistently using either the market in all hours (as proposed by Oak Tree expert J. Richard Lauckhart), or using the incremental cost of NWE's generation in all hours, the "hybrid" method adopted by the PUC understates avoided cost in all hours by using the market as a ceiling in high load hours, but not utilizing it in low load hours. Thus, Oak Tree would not be paid "full avoided cost" by the "hybrid" method because Oak Tree only gets the benefit of the market in hours where doing so reduces the payment to Oak Tree, but only gets the benefit of NWE's generation resources when it is less than the market price.

In reality, Oak Tree never receives the full avoided cost under the structure proposed by the "hybrid model" because the payment to Oak Tree is based on selectively choosing the lower of market or incremental costs in high load hours and low load hours. This is plainly

unlawful under PURPA.

In fact, the whole design and structure of the “hybrid” method necessarily results in a lower avoided cost by not considering in heavy load hours the utility’s otherwise avoided generating resources (particularly expensive peaking units) and using the market instead, and in low load hours, by using the incremental cost of NWE’s coal generating resources as a ceiling on the price that will be paid to Oak Tree (regardless of the value of that generation in the market). Simply put, the “hybrid” methodology is designed to understate avoided cost in a “heads we win/tails you lose” set up that only assigns market value to Oak Tree’s project in hours where avoiding NWE’s incremental cost of generating resources lowers the avoided cost to Oak Tree. To be consistent with the full avoided cost principle, the PUC should reconsider its decision to use the “hybrid” methodology in this proceeding, and instead either use a pure “market approach” (which pays Oak Tree the estimated market price in each hour for the 20-year term of the agreement), or it should use a traditional avoided cost analysis, which calculates avoided cost based on the incremental cost of NWE’s generating resources in all hours.

The “hybrid” methodology is also discriminatory in adopting an avoided cost rate that does not reflect how NWE operates and systematically pays Oak Tree less than NWE is paid in those same hours. When market exceeds the incremental cost of operating NWE’s coal generation, NWE does not back down its generation, but rather sells that generation into the market to make a profit. Similarly, NWE does not operate its peaking resources during peak hours, but rather buys from the market because that alternative is less expensive. The “market estimates” approach advocated by Mr. Lauckhart recognizes these salient facts. He advocated recognizing both that NWE only pays market prices when the utility is in peak hours, but also

recognizes that NWE does sell its generation in low load hours to make a profit whenever market is higher than the incremental cost of operating that generation. In this way, Mr. Lauckhart's approach reflects only the market value that NWE could reasonably be expected to receive for generation in all hours, and then treats Oak Tree in precisely the same way.

The "hybrid" methodology does not reflect these realities and does not treat Oak Tree in the same manner as NWE. Indeed, the "hybrid" method chooses to ignore reality in low load hours when NWE is receiving market value for its generation. One assumes that NWE would purchase Oak Tree's output and sell it into the market at a gain whenever possible. Thus, Oak Tree is systematically being paid less in reality than NWE would be paid for an identical transaction. This is plainly discriminatory, and also violates the full avoided cost principle that underpins PURPA and its implementing regulations.

There is also the concern expressed during the hearing that NWE does not *avoid* anything when it gets QF power in hours when its coal plant is already sufficient to meet its load. That concern is then used to justify an argument that a spot market sale in those hours cannot be considered an avoided cost. This concern is based on a misunderstanding of the PURPA avoided cost concept. From a load/resource balancing perspective, it is clearly the case that when additional power is injected into the system, some other resource or source of generation needs to be backed down. In this scenario, some resource or source of generation on the system is plainly avoided by the spot market purchase. When a utility is interconnected with a larger grid, the universe of resources that can be backed down is greater than the sum of the utility's own generation. What a prudent scheduler would do in that instance is recognize that more costs can be avoided if a different resource on the grid is backed down rather than only backing down NWE's coal plant. What a utility is actually

avoiding in that situation *is the operating cost of that alternative resource*. The only reason a generating entity that buys generation from NWE in those hours is able to back down its resource is because NWE provided that generating entity with additional power. As a matter of economics and fiscal prudence, NWE will not provide power to that generating entity unless the value of the avoided cost on that generating entity's system is transferred to NWE.

This transfer of avoided cost value from a generating entity to NWE is accurately captured by calculating NWE's avoided cost using the spot market price for that hour. The generation costs being avoided when NWE gets additional power on hours when its coal plants are sufficient to meet its load occurs from the backing down of non-NWE generation on the grid. NWE realizes the benefit of that avoided cost by providing its power to that entity in exchange for the spot market price. If the avoided cost determination is to reflect the existence of the market in heavy load hours, it needs also to reflect the existence of the market in the light load hours. As previously stated, a failure to do so does not comport with the full avoided cost principle.

The question on reconsideration for the PUC is, therefore, did the PUC intend to adopt a method that is designed to systematically pay a QF less than full avoided cost? Did the PUC understand that by choosing to use the forecast market value only in high load hours (instead of assigning the value of NWE's peaking units), and using the incremental cost of NWE's generation only in low load hours, that this would produce a result that necessarily understated NWE's full avoided costs? As a corollary, did the PUC understand that using the "hybrid" approach would result in differential treatment of QFs from NWE's own generating resources because NWE does not back down its generation in hours where market exceeds NWE's incremental generation costs, but rather sells that generation into the market at a gain?

Oak Tree strongly urges the PUC to reconsider its decision to utilize the hybrid methodology. It is simply inconsistent with the full avoided cost principle mandated by FERC, and it discriminates against QFs by paying QFs less than the utility receives for generation in the same hours. The PUC should either adopt the “market estimates” approach, or order the use of an avoided cost based entirely on the incremental cost of operating NWE’s generating resources on all hours.

2. Utilization of Current Market Conditions and Projections to Determine Proper Inputs for Avoided Cost Calculations Violates PURPA

PURPA is very specific regarding when avoided costs are calculated. 18 C.F.R. § 292.304(d) (2) states:

Purchases “as available” or pursuant to a legally enforceable obligation. Each qualifying facility shall have the option either:

(1) ...

(2) To provide energy or capacity pursuant to a legally enforceable obligation for the delivery of energy or capacity over a specified term, in which case the rates for such purchases shall, at the option of the qualifying facility exercised prior to the beginning of the specified term, be based on either:

(i) The avoided costs calculated at the time of delivery; or

(ii) The avoided costs calculated at the time the obligation is incurred.

Thus, a QF has two options – it may calculate avoided costs at the time of the delivery or at the time the obligation [LEO] is incurred. But there is nothing in the regulations that permits or even contemplates that such a determination can be forwarded months or years into the future, at a date well past the time the LEO is incurred. FERC itself has described the QF’s right to avoided cost forecast at the time the LEO is incurred:

The Commission’s regulations, from the beginning, have given QFs the option of choosing to have rates calculated at the time the obligation is incurred. *The intention of the Commission was to enable a QF “to establish a fixed contract price for its energy and capacity at the outset of its obligation.”* The Commission recognized that:

[I]n order to be able to evaluate the financial feasibility of a cogeneration or small power production facility, an investor needs to be able to estimate, with reasonable certainty, the expected return on a potential investment before construction of a facility.

The Commission recognized that avoided costs could change over time, and that the avoided costs and rates *determined at the time a legally enforceable obligation was incurred could differ from the avoided costs at the time of delivery. The Commission has, since then, consistently affirmed the right of QFs to long-term avoided cost contracts or other legally enforceable obligations with rates determined at the time the obligation is incurred, even if the avoided costs at the time of delivery ultimately differ from those calculated at the time the obligation is originally incurred.* Rates based on avoided costs at the time the obligation is originally incurred are consistent with the requirements of PURPA, and we see no impediment to accurately determining such rates for QFs powered by intermittent resources.

JD Wind 1, LLC, 130 FERC ¶ 61,127, at P. 23 (emphasis added, citations omitted).

Including current market conditions (post LEO conditions) for electricity and natural gas prices is therefore inconsistent with an avoided cost calculation based on a forecast created at the time an LEO is created. Although it is plain that market conditions can and do change frequently, QFs must necessarily attempt to obtain financing for their projects based on an estimate of future avoided costs. Just as it would be unfair and contrary to the concept of an LEO establishing the date of the avoided cost for a QF to argue that current *rising* market conditions should be considered in an avoided cost rate, it is also unfair and contrary to PURPA to utilize *lower* current market conditions to establish an avoided cost rate well after the date the LEO was incurred.

Case law confirms that avoided cost is determined as of the date an LEO has been incurred pursuant to 18 C.F.R. § 292.304(d) (2). See *Pennsylvania Elec. Co. v. Pennsylvania Public Utility Com'n*, 677 A.2d 831, 544 Pa. 475 (1996); *Armco Advanced Materials Corp. v. Pennsylvania Public Utility Commission*, 579 A.2d 1337, 135 Pa.Cmwlth 15 (1990); *Empire*

Lumber Co. v. Washington Water Co., 755 P.2d 1229, 1242, 114 Idaho 191, 204 (1987). The date a QF obligates itself to deliver its energy, which is the date of the LEO, is the date on which the avoided costs are determined. *Armco*, 579 A.2d at 1346. Thus, requiring Oak Tree to calculate an avoided cost utilizing inputs based on any date other than February 25, 2011 would violate PURPA.

The PUC has already determined that an LEO was created on February 25, 2011. Consequently, the PUC must now utilize that same date in its calculation of the avoided cost. This result is obvious from the language of the regulation, FERC's interpretation of that regulation, and all judicial decisions that Oak Tree is aware of which have directly considered the issue.

While the PUC has discretion in determining when an LEO was created, it does not have the ability to require the use of another date by which to calculate avoided cost. "In the name of implementing the FERC regulations, the PUC may not adopt a policy that is contrary to those regulations." *Armco*, 579 A.2d at 1347. Since the regulation is clear, avoided costs are to be calculated at the time the obligation is incurred; any substantive deviation would be contrary to the regulation.

Ordering the parties in this case to utilize "current market conditions and projections" requires the use of a date other than the date the LEO was incurred to calculate avoided cost. The use of current market conditions for inputs into the avoided cost calculation is inappropriate. Current market conditions necessarily require the use of information that was not available at the time the LEO was incurred – not available when Oak Tree obligated itself to provide energy to NWE. Thus, making such an order would be not only unfair to Oak Tree; it would be contrary to PURPA and its Implementing regulations.

3. The Carbon Tax or GHG Emission Costs Are Based on Insufficient Evidence and Evidence That Was Created After the Date of the LEO.

The PUC also chose to use Lands Energy's calculation of carbon emission costs of \$5/ton starting in 2015 until 2019, \$10/ton starting in 2020 and continuing until 2024, and then \$15/ton starting in 2025 and continuing until the end of the Oak Tree power purchase agreement. The PUC found that this was a reasonable estimate of carbon costs in the present environment.

The Lands Energy carbon cost estimates are based on an extremely shaky evidentiary foundation. First, Mr. Lewis of Lands Energy testified at hearing as follows:

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 discussions and came up with a forecast considerably lower than we had used previously. And by "we" I mean the consultants at Lands Energy Consulting.

EL11-006 Hr'g Tr. 413:16 – 414:8.

The experts at Lands Energy therefore disregarded earlier forecasts that had been used, internally discussed the reasonable range of carbon prices, and came up with an agreement that the \$5/\$10/\$15 range was reasonable. There is no other explanation in the record for how or why this number was developed. The PUC should recall that the experts at Lands Energy also concluded a number of things that were simply not reasonable: a decision not to use any real increase in the price of natural gas starting from 2015 forward, a decision not to use the EIA natural gas price forecast instead of NWE's own internal gas price forecast,

and a decision that the historical “heat rate” (i.e., the relationship between natural gas prices and electricity prices) would hold constant for the entirety of the Oak Tree contract. It is not lost on Oak Tree that all these decisions seem designed to lower the price that NWE would have to pay for Oak Tree’s generation, including the decision to use a much lower carbon cost estimate than any other forecast that Oak Tree is aware of in the time frame of January-February 2011.

Meanwhile, in December of 2011, while this case was being litigated, NWE submitted its Electricity Supply Resource Procurement Plan (EPP) in Montana PSC Docket N2011.12.96. In that plan, prepared months after Lands Energy prepared its forecast for NWE in this proceeding, NWE utilized the following carbon costs:

Carbon Cases
Under Potential Scenarios

Year	Base Case 2013	Delay Case 2017
	Legislation 2015	Legislation 2019
	<u>Implemented</u>	<u>Implemented</u>
2012	\$0.00	\$0.0
2013	\$0.0	\$0.0
2014	\$0.0	\$0.0
2015	\$9.55	\$0.0
2016	\$12.63	\$0.0
2017	\$16.20	\$0.0
2018	\$19.34	\$0.0
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

Volume 1, Chap. 4, p. 87, Table No. 10.

For this December 2011 forecast, NWE chose to rely on the 2009 Northwest Power and Conservation Council’s (NWPCC) projections for carbon costs per ton. *Id.* at pp. 86-87. “In the interim between plans, NorthWestern has found no better information that would cause it to move away from using the NWPCC’s forecast values.” *Id.* at 86-87. Until, apparently, it came to determining an avoided cost forecast for Oak Tree, wherein NWE chose to ignore the NWPCC forecast and instead relied on experts at Lands Energy who systematically made adjustments to their forecast in order to lower the price to be paid to Oak Tree as a QF.

As is readily observed, the values contained in NWE’s 2011 EPP submitted in Montana in December of 2011 are substantially higher than that prepared by Lands Energy in October of 2011. This is yet another example of discriminatory treatment by NWE. There is no rational reason why a forecast prepared by NWE months after the Lands Energy forecast would be significantly higher, and no rational explanation why NWE would ignore the NWPCC’s judgments in this proceeding when carbon legislation is a national policy issue that will affect Montana and South Dakota in substantially similar ways. In short, NWE was again attempting to have it both ways.

The standard of review for agency decisions in South Dakota is summarized as

follows:

We will overrule an agency's findings of fact only when they are clearly erroneous. The question is not whether there is substantial evidence contrary to the agency finding, but whether there is substantial evidence to support the agency finding. In other words, even if there is evidence in the record which tends to contradict Department's factual determination, so long as there is some "substantial evidence" in the record which supports Department's determination, this court will affirm. Great weight is given to the findings made and inferences drawn by an agency on questions of fact. Conclusions of law are given no deference and are fully reviewable. When reviewing evidence presented by deposition, we do not apply the clearly erroneous standard but review that testimony as though presented here for the first time.

Hendrix v. Graham Tire Co., 520 N.W.2d 876, 879 (S.D.1994) (citations and quotations omitted).

In this case, there is a very thin evidentiary record that supports the carbon cost calculations performed by Lands Energy in this proceeding. In contrast, there is a very substantial carbon cost analysis performed by NWE in another proceeding that was prepared subsequent to the Lands Energy analysis. This later, better, analysis was prepared and filed before the Montana commission significantly before the hearing in this matter. NWE was undoubtedly aware of this EPP forecast at the time it submitted testimony in this proceeding, yet NWE chose not to use *any* carbon forecast in this proceeding in setting rates for Oak Tree.

As is easily observed, the carbon prices adopted by NWE in its 2011 EPP forecast are considerably higher than the \$5/\$10/\$15 values. Nor is NWE's 2011 EPP carbon price forecast unrealistically high as evidenced by analysis performed by the Energy Information Agency of the U.S. Department of Energy (EIA). A reasonable point of reference for comparing reasonable carbon cost values would be the carbon price forecast that EIA prepared based on the assumption that the Waxman-Markey cap and trade legislation is eventually passed. Exhibit "2" to this *Motion for Reconsideration* shows the carbon prices

projected by EIA under Waxman-Markey under a variety of possible futures. As can be observed by comparing the NWE 2011 EPP carbon prices to the EIA forecasts, the NWE EPP carbon prices fall reasonably within the range of prices forecast by EIA. Further, it is important to note that these are in the range of prices that will be necessary to accomplish any meaningful reduction in carbon emissions and therefore a meaningful impact on climate change. See discussion of Waxman-Markey cap and trade legislation at Attachment 5 to Oak Tree Hearing Exhibit 1. The Lands Energy forecast of \$5/\$10/\$15 per ton will not have any meaningful impact on climate change.

The PUC has decided to use the Lands Energy carbon cost calculation, which has very little evidentiary support in the record. The PUC should reconsider its reliance on the \$5/\$10/\$15 per ton carbon cost calculation prepared by Lands Energy. It is simply insupportable based on any reasoned analysis and is also contradicted by the Black & Veatch analysis, which is Attachment 5 to EL11-006 Hr'g Ex. OT 1.

Another issue is that the Lands Energy forecast, including its carbon cost forecast, was prepared in October of 2011, approximately seven months after the LEO date in this matter. If the forecast rate for Oak Tree is to be calculated at the time the LEO was created – and FERC decisions and judicial opinions all state that the rate is to be calculated at the time the LEO was created – then the Lands Energy carbon cost forecast should not be utilized in this proceeding. Instead, the PUC should rely on information that was available as of February 25, 2011, and some of those sources are the 2009 NWPCC forecast (which NWE used in the Montana EPP proceeding), the EIA 2011 forecast (Exhibit “1”), and the 2010 Black & Veatch forecast (Exhibit 1; EL11-006 Hr'g Ex. OT 1, attachment 5). The PUC should reconsider the use of the Lands Energy carbon cost forecast because it was not information that was

available to anyone, including Oak Tree, as of February 25, 2011, and the range of that forecast is far lower than any forecast available to the parties as of that date.

CONCLUSION

Oak Tree appreciates the PUC's efforts in this matter. However, Oak Tree believes the PUC's decision to use the hybrid avoided cost methodology is inconsistent with the principle of avoided costs that underpins PURPA. The rates produced by a hybrid method systematically understate NWE's avoided costs and discriminates against Oak Tree in violation of PURPA. The PUC's decision to require the parties to use current natural gas and electric market information in the testimony to be submitted on avoided cost calculations for Oak Tree also violates PURPA. The forecast rate for a QF is to be based on a forecast based on information at the time the LEO was created. In this case, that was February 25, 2011. Thus, the forecast must be based on information available as of that date. Finally, the \$5/\$10/\$15 per ton carbon cost information is based on insufficient evidence, and is contrary to what was reasonably available to the parties as of February 25, 2011. Since the Lands Energy forecast was not prepared until the Fall of 2011, it should not be used to calculate a forecast that PURPA requires be based on information available as of February 25, 2011

Respectfully submitted this 27th day of May, 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 27th day of May, 2012, upon the following:

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