

TO: COMMISSIONERS AND ADVISORS
FROM: BRIAN ROUNDS AND KAREN CREMER
SUBJECT: EL13-025 STAFF RECOMMENDATION
DATE: AUGUST 7, 2013

STAFF MEMORANDUM

OVERVIEW

On July 15, 2013, NorthWestern Energy (NWE) filed a Petition for Declaratory Ruling with the Commission regarding a Power Purchase Agreement (PPA) it entered into with B & H Wind, LLC. In its filing NWE requests the Commission issue a declaratory ruling that (1) the price, terms and conditions of the PPA comply with PURPA and (2) the costs NWE will incur as a result of the PPA are prudent, efficient, economical, reasonable and necessary. As explained below, Staff believes the PPA complies with PURPA, and NWE's resulting costs are recoverable through rates. However, we caution the Commission in setting precedent in this matter by declaring that the costs NWE will incur as a result of the PPA are prudent, efficient, economical, reasonable and necessary.

PURPA

Staff agrees with NWE's assertion that the Commission is responsible for setting avoided cost rates as a result of PURPA. The Commission did just that in its Decision and Order (Order), Docket F-3365, *In the Matter of the Investigation of the Implementation of Certain Requirements of Title II of the Public Utilities Regulatory Policy Act of 1978 Regarding Cogeneration and Small Power Production*, issued December 14, 1982¹. In that Order, the Commission differentiated between small and large Qualifying Facilities (QF). Small QFs (those under 100 kW) were to be paid a "standard rate" which would be developed and filed in each utility's tariff. Rates paid to larger QFs, such as in this case, were to be set by a negotiation between the QF and the utility with disputes being heard by the Commission. Specifically, in the Commission Findings, page 11, the Order states:

The Commission finds that rates for purchases from QF's with a design capacity of more than 100 KW should be set by contract negotiated between the QF and the electric utility. The Commission agrees with the recommendations of all parties that the Commission should play a minimal role in the negotiation of such contracts, a role limited to resolving any contract disputes which arise between the parties.

¹ Attached as Appendix A

The Commission's decision in setting the avoided cost rate as well as resolving the contract disputes in Docket EL11-006 was made due to the existence of such contract disputes. However, in this case no contract dispute exists. The parties have willingly executed the PPA. NWE is simply seeking approval of the PPA, it seems, for assurance of rate recovery at a later time. Thus, Staff submits that this PPA inherently complies with PURPA because it is the result of a negotiation between the utility and the QF.

RATE RECOVERY

It appears that NWE is primarily seeking Commission approval of the PPA in order to ensure rate recovery at a later time. Staff first points to the Commission's decision in EL11-007, in which Black Hills Power (BHP) requested similar treatment of a potential wind investment. The Commission granted Staff's Motion to Dismiss the Petition for Declaratory Ruling finding "[u]nder South Dakota law, the Commission's decisions on reasonableness, prudence, and cost-effectiveness are made in connection with a rate filing as provided in SDCL 49-34A-8 and 49-34A-8.4." See, Docket EL11-007, *Order Granting Motion to Dismiss; Notice of Entry*, dated June 8, 2011.

In comparing EL11-007 to this case, the major differences are that (1) BHP was requesting pre-approval of an investment rather than a PPA, (2) BHP was making their request in part to satisfy the state's Renewable, Recycled and Conserved Energy Objective and its required cost-effectiveness test, and (3) in EL11-007 there was no consideration of PURPA. However, Staff would note that both dockets are similar in requesting approval of costs that the utility would incur prior to making a rate filing, and the Commission simply does not have the authority to pre-approve such costs.*Id.*

Of course, the Commission will have a chance to review the prudence of this PPA when the costs are incurred and placed into NWE's fuel adjustment clause, but Staff does not believe NWE's concerns regarding that process are warranted. NWE has already executed a PPA for the Titan wind project which was not required by PURPA, and the Commission did not object to those costs. Additionally, Staff has been working with Mr. LeFave over the last several months on the avoided cost model he used to determine a price for this contract, making suggestions for edits and reviewing outcomes, and we think the resulting price is a reasonable estimate. The model itself is a marked improvement from the models used in the Oak Tree case, and Staff feels it creates a credible projection of NWE's avoided costs at this time.

In fact, Staff would argue that NWE's extreme caution in this matter could cost ratepayers in the future and put its future investments under heightened scrutiny. If the federal PTC for wind expires at the end of this year and the project is unable to begin construction prior to that time because of the clause in the PPA requiring Commission approval of the Agreement, NWE will not likely have another opportunity to add wind

generation to its portfolio at this low of a price going forward. Mr. LeFave's avoided cost model was built under the assumption ratepayers would be indifferent to a purchase at the resulting rate. Thus, not accepting an offer at or below that resulting rate when we are fairly certain such offers will not be around for long would need to be justified when attempting to recover higher costs down the road.

NWE is required by PURPA to accept delivery of the power at its avoided cost, and the model NWE used to determine the avoided cost rate is reasonable. Therefore, Staff believes the costs incurred as a result of this PPA are "prudent, efficient, and economical and are reasonable and necessary."

However, Staff would prefer the Commission not set a precedent of approving the costs that the utility would incur prior to making a rate filing as the Commission lacks the authority to pre-approve such costs. Staff believes the utilities are required to make resource planning decisions carefully and archive their options and reasoning diligently because they know their decisions will be subject to subsequent review by the Commission in a rate case filing. SDCL 49-34A-6, 49-34A-8 and 49-34A-8.4. Consequently Staff would prefer the Commission make note in its declaratory ruling order that future petitions for such approvals will be dismissed immediately.

STAFF RECOMMENDATION

For the reasons stated above, Staff recommends the Commission approve the PPA and grant the declaratory ruling stating that the price, terms and conditions of the PPA comply with PURPA, noting that future PPAs should not include nor require Commission approval. Staff further recommends that the Commission not find that NWE's resulting costs are "prudent, efficient, and economical and are reasonable and necessary" prior to their submittal in a rate filing.