

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

EL11-006

Motion for Commission Resolution of Contractual Provisions and Power Purchase Agreement Approval

NorthWestern Corporation, d/b/a NorthWestern Energy (“*NorthWestern*”) moves the South Dakota Public Utilities Commission (“*Commission*”) for an order that the proposed Section 5.5.3, Section 6.5.1, and Section 8.2, quoted below, are reasonable and consistent with the Public Utility Regulatory Policies Act of 1978 (“*PURPA*”) and should be included in the Power Purchase and Sale Agreement (“*Agreement*”), and further approve the Agreement if the contract is executed by Oak Tree Energy LLC (“*Oak Tree*”) in a form consistent with the terms and conditions set forth in attached confidential *Exhibit A* and the Commission’s decision herein.

BACKGROUND

On May 17, 2013, the Commission issued an Amended Final Decision and Order; Notice of Entry (“*Order*”), and instructed NorthWestern and Oak Tree to reach a mutual understanding as to the terms and conditions of a power purchase agreement within 30 days. The parties were also ordered to file the Agreement with the Commission. The parties continued previously initiated contract negotiations. On June 17, with Oak Tree’s consent, NorthWestern submitted a letter to the Commission requesting a 10-day extension to continue efforts to resolve key commercial terms and conditions. The parties were unable to mutually agree to several important contractual provisions during the extension. On June 27, with Oak Tree’s acknowledgement, NorthWestern notified the Commission of its intent to request review of the outstanding items.

As of June 27, the parties had not reached consensus on the allocation of expenses for ancillary services, NorthWestern's discretionary right to curtail energy, and the appropriate security during the term of the Agreement. Subsequent negotiations produced a resolution as to appropriate security.

The parties require the Commission's assistance to resolve the remaining commercial conditions. Upon final resolution of the remaining conditions, NorthWestern respectfully requests the Commission's determination that the Agreement complies with the Order and with PURPA, and that costs NorthWestern will incur under the Agreement are prudent, efficient, and economical and are reasonable and necessary pursuant to SDCL § 49-34A-8.4.

NorthWestern requests expedited review of this Motion for Commission Resolution of Contractual Provisions and Power Purchase Agreement Approval ("*Motion*") to provide Oak Tree with the opportunity to continue development of the project in a timely manner.

ARGUMENT

1. Wind Integration and Ancillary Services.

NorthWestern and Oak Tree are unable to agree to terms and conditions allocating financial responsibility for the cost, expense, and potential penalties directly associated with the integration of the energy into NorthWestern's system.¹ Section 5.5.3, as proposed by NorthWestern, provides:

Wind Integration and Ancillary Services. Seller acknowledges NorthWestern's utilization of WAPA services for balancing and related ancillary services. In the event NorthWestern: (i) is required to pay WAPA or a New Joint Transmission Authority pursuant to applicable tariff for any fees, costs, charges, expenses and penalties for Ancillary Services (as defined herein) associated with the generation, delivery and integration of Energy

¹ In this Motion, NorthWestern will refer to services necessary to integrate and balance energy resources as "ancillary services."

(“Ancillary Service Charges”); and (ii) Ancillary Service Charges can be allocated or otherwise directly attributed to the generation, delivery and integration of the Energy, Seller shall reimburse NorthWestern within 30 days of receipt of an invoice. As used in this Agreement, “Ancillary Services” means any ancillary services that are made available to NorthWestern by WAPA or a New Joint Transmission Authority pursuant to applicable tariff, and such services contemplated herein include, without limitation, generator imbalance, reserve and regulation/frequency response services required to maintain the stability of the power system. NorthWestern shall be responsible for Ancillary Service Charges assessed by WAPA or a New Joint Transmission Authority for Ancillary Services if such Ancillary Service Charges cannot be allocated or otherwise directly attributed to the generation, delivery and integration of Energy pursuant to this Agreement.

NorthWestern agrees to use commercially reasonable efforts to minimize the Ancillary Service Charges incurred for Ancillary Services charged to Seller under this Section 5.5.3; provided that such efforts shall not require the expenditure of any financial resources by NorthWestern. In no event shall NorthWestern be entitled to charge Seller an amount in excess of the actual Ancillary Service Charges incurred by NorthWestern for such Ancillary Services. If following the date of this Agreement NorthWestern is authorized under any tariff filed with the Commission to cost recovery for Ancillary Service Charges NorthWestern is entitled to charge to Seller under this Section 5.5.3, then thereafter NorthWestern shall not charge Seller for such Ancillary Services.

Pursuant to PURPA, NorthWestern is obligated to purchase energy from a qualifying facility (“QF”) at NorthWestern’s avoided cost. *See* 16 U.S.C. § 824a-3. The Commission established a levelized-energy price in the Order. However, in this docket neither party nor the Commission considered the details of Oak Tree’s interconnection to NorthWestern and WAPA along with potential financial responsibility.

Oak Tree’s generating facility creates the distinct possibility of additional cost, expense, and potential penalties for variable energy ancillary services. The generation and delivery of energy is the cause of the potential liability, and NorthWestern believes the monetary risk associated with ancillary services should remain, without limitation, upon Oak Tree as the responsible party. The burden should not rest with NorthWestern and its customers. PURPA does not require

NorthWestern's customers to be responsible for additional costs to subsidize a QF. See 16 U.S.C. § 824a-3(b) (rates for purchase shall be just and reasonable to the electric consumers of the electric utility).

NorthWestern's generation and transmission facilities in South Dakota are not designed to handle all of its load requirements. See Exhibit B - Affidavit of Bleau J. LaFave, ¶ 6. Because NorthWestern is situated within the Western Area Power Administration ("WAPA") balancing authority area, the utility relies entirely upon WAPA for the management of the system. *Id.* Although WAPA publishes tariff rates for ancillary services applicable to NorthWestern and generators, see <http://www.oasis.oati.com/WAPA/WAPAdocs/IS-Rate-Calculation-2013-0101.pdf>, historically WAPA has not assessed any cost, expense, or penalties for ancillary services necessary to integrate and manage variable energy resources. LaFave Aff. ¶ 6. Recently, however, WAPA indicated an intent to begin charging for certain services applicable to intermittent resources upon the completion of billing procedures. See comments to WAPA memo, <http://www.oasis.oati.com/WAPA/WAPAdocs/is-transmission-rates-2013-0101.pdf>.

NorthWestern believes the increase in variable energy resources requiring integration into transmission systems designed for baseload generation creates potential monetary exposure for the associated cost and expense of ancillary services. Attached to this Motion as Exhibit C is the Affidavit of Philip Q. Hanser of The Brattle Group. For the purpose of assisting NorthWestern and the Commission, The Brattle Group prepared a report entitled "Wind Integration Services, Summary of Industry Practices in North America" ("*Brattle Report*"), attached as Exhibit C - 1. The Brattle Report is informative and summarizes current industry developments concerning the treatment of variable energy resource ancillary services. Currently, many organized markets are not levying on generators specific charges for wind integration and balancing charges. Brattle Report at

11. However, the industry's treatment of the issue is continuing to evolve. *Id.* at 25–26. Notably, several jurisdictions are assessing costs on generators, specifically in areas experiencing high wind penetration levels and jurisdictions with a limited ability to provide cost-effective integration services. *Id.* at 26–27.

NorthWestern's wind penetration factor in South Dakota after Oak Tree's facility is commercially operable will be 9.82%. LaFave Aff. ¶ 4. NorthWestern recently executed a separate QF power purchase agreement for an additional 41 MW of wind generation. *Id.* Assuming both facilities are constructed, NorthWestern's penetration factor will be at a level significantly higher than many organized markets (*see* Brattle Report at 23 for listing) and comparable to the Bonneville Power Administration, a balancing area assessing fees for ancillary services. *See id.* at 27–34 (noting BPA's 19% penetration level and case study discussion). WAPA's future capacity to integrate wind generation in an area of the country experiencing significant growth in renewable energy resources is unknown. Regardless, NorthWestern's concern of significantly higher future cost, expense, and penalty exposure is justified. The parties are entering into a 20-year contractual arrangement, and NorthWestern's request to address this issue within the Agreement is reasonable.

The Brattle Report also identifies Westar as another balancing area charging temporary wind integration services pursuant to Federal Energy Regulatory Commission (“FERC”) approval. Brattle Report at 26. Notably, Westar is temporarily assessing charges until the full Southwest Power Pool (“SPP”) market is implemented. *Id.* WAPA has publicly declared an intent to join SPP or MISO. If WAPA joins SPP, Oak Tree's facility may be subject to charges for ancillary services soon after reaching commercial operation.

Considering the present uncertainty within the industry, NorthWestern attempted to seek an equitable solution to address the concern and proposed the language in Section 5.5.3 set forth above during contractual negotiations. NorthWestern's proposed language strikes an appropriate balance. If WAPA begins assessing fees or penalties per an established tariff for variable energy resource ancillary services and such monetary liability results directly from Oak Tree's generation and delivery of energy, Oak Tree should be the party responsible for payment. If the fees or penalties cannot be allocated or attributed to a specific variable energy resource generator providing power to NorthWestern, then the monetary consequences remain the responsibility of the utility and its customers.

Without NorthWestern's proposed Section 5.5.3, NorthWestern's customers will bear all risk of increased costs. If NorthWestern's future resource plans suggested a need for additional intermittent generation resources, NorthWestern would be asking its customers to share the risk associated with ancillary services. However, NorthWestern's resource plans do not currently include additional generation (LaFave Aff. ¶ 3), and utility customers should not be saddled with the future costs and expense to the benefit of the generator.²

2. Curtailement.

The parties are also unable to resolve differences relating to NorthWestern's curtailment rights. NorthWestern's proposed Section 6.5.1 provides:

Curtailement Right. NorthWestern may curtail the delivery of Energy from the Facility pursuant to this Agreement to the extent required by (i) an Emergency; (ii) Force Majeure; (iii) WAPA, a New Joint Transmission Authority or any Governmental Agency with jurisdiction; (iv) as required or allowed by the provisions of the Generator Interconnection Agreement or WAPA Interconnection Agreement; and (v) as otherwise necessary for the

² Oak Tree suggests a willingness to pay a limited amount for generator imbalance. Generator imbalance is just one ancillary service, and charges are regulated by FERC. As NorthWestern cannot legally charge something other than the tariffed rate, a cap would be illegal.

purpose of managing its generation portfolio and avoiding or mitigating adverse effects to NorthWestern or its customers. Additionally, the Parties acknowledge that there may be circumstances in which a Governmental Agency, NorthWestern, the Transmission Provider, WAPA, or a New Joint Transmission Authority will curtail deliveries of Energy from the Facility in accordance with applicable Law or tariffs or in an Emergency.

The issue of curtailment is often a point of contention as parties negotiate power purchase arrangements, and wind generation facility owners seek to protect revenue during periods when a utility curtails energy production. However, the curtailment provisions qualifying a generator's right to payment usually forms the basis for the dispute. For instance, the parties may agree that an uncompensated period of curtailment for transmission line maintenance is reasonable, but dispute the appropriate duration before a payment obligation arises. Here, NorthWestern agreed to compensate Oak Tree for a wide variety of curtailments and limited non-payment for necessary transmission maintenance, and further acquiesced to the request for additional payment for lost federal production tax credits. *See* Agreement at 6.5.2, 6.5.4 & Exhibit E.

Oak Tree is not satisfied with compensation and demands contractual language prohibiting NorthWestern from curtailing energy from the facility for discretionary reasons. NorthWestern has absolutely no incentive to order a curtailment and pay for both energy it does not receive and Oak Tree's tax benefits. However, while the likelihood of a curtailment of energy for a reason other than force majeure, an emergency, or transmission line outage is very low, a utility in the position of NorthWestern must retain the discretionary ability to manage its system and load without risk of default under its power purchase arrangements. NorthWestern is already in a position with an energy surplus (*see* LaFave Aff. ¶ 3), anticipates a high penetration level of wind (*id.* ¶ 4) with unknown consequences to the management of its system, can only back down its coal-fired facilities to a specified level of generation, and is occasionally forced to sell power on

the market at a loss (*id.* ¶ 5). NorthWestern also faces the distinct possibility of an increase in wind generation under PURPA contracts. Without a clear understanding of future system limitations and requirements, NorthWestern must not be restrained unreasonably in its ability to curtail the production of energy.

Oak Tree claims it will experience difficulty securing tax investors if NorthWestern possesses an unlimited right to curtail. However, Oak Tree and its investors are protected in the unlikely event of a discretionary curtailment, the risk of any extended curtailment is low, and this argument is without significant merit. Additionally, Oak Tree relies on a recent FERC case from Idaho, 140 FERC ¶ 61,219, Docket No. EL12-74-000 (“*Idaho Wind*”), for the proposition that utilities are prohibited from curtailing for economic reasons. *Idaho Wind* is clearly distinguishable. FERC prohibited the Idaho Public Utilities Commission from authorizing economic or operational curtailments under previously executed power purchase agreements subject to PURPA. *Id.* at P 40. However, the QFs were subjected to curtailment without compensation under previously executed power purchase agreements. Section 6.5.1 does not authorize uncompensated economic or operational curtailments. Nor is NorthWestern suggesting any revision to an existing contract. *Idaho Wind* is not applicable in this situation. FERC emphasized that the *Idaho Wind* decision was intended to preserve the economic expectations of the parties. NorthWestern’s proposed Section 6.5.1, with other articles, preserves the economic expectations of Oak Tree with “compensated curtailments.”

NorthWestern’s template power purchase contract explicitly provided the right to curtail at any time and at the discretion of the utility. Although NorthWestern maintains discretionary curtailment is justified so long as compensation is paid, in an effort to reach an amicable resolution NorthWestern agreed to eliminate the pure discretionary right and conceptually agreed

to a specific list of approved curtailment reasons, provided the language reasonably afforded protection to the utility and its customers. The right to curtail set forth in (v) of the proposed language set forth above is admittedly broad. However, for reasons previously stated, NorthWestern must have the ability to manage its generation portfolio in an evolving marketplace and respectfully requests the Commission accept and approve the proposed language above.

Directly related to the curtailment right issue is Oak Tree's demand for a termination remedy, without cure, in the event NorthWestern fails to accept energy. Oak Tree proposes a default provision in Section 8.2.3, whereby a material breach would occur if:

NorthWestern fails to accept delivery of Energy at the Point of Interconnection for any reason other than a curtailment permitted by Section 6.5.1 of this Agreement.

The language of Agreement Section 6.5.1 set forth above, even without the inclusion of NorthWestern's proposed curtailment rights in (v), is subject to interpretation. For instance, the parties may disagree as to whether a curtailment ordered by NorthWestern constitutes an Emergency or an event of Force Majeure as such terms are defined in the Agreement. If NorthWestern is wrong and its rationale for curtailment is not justified, NorthWestern would be in violation of the Agreement, but must have the opportunity to remedy the error. In language proposed as Section 8.2.3, however, Oak Tree maintains that any error on NorthWestern's part in ordering a curtailment constitutes an Event of Default allowing Oak Tree to terminate the Agreement. So long as Oak Tree receives compensation for the curtailment, a termination right is not warranted. At the very minimum, NorthWestern must have the opportunity to cure the breach of the Agreement. Oak Tree is adequately protected in this instance by the default provision in Section 8.2.4, and NorthWestern respectfully requests the Commission strike the curtailment default provision in Section 8.2.3.

CONCLUSION

For the reasons set forth herein, NorthWestern respectfully requests the Commission approve NorthWestern's proposed Agreement Sections 5.5.3 and 6.5.1, and strike Section 8.2.3. NorthWestern also respectfully requests the Commission find the Agreement complies with the Order and PURPA and find the costs NorthWestern will incur under the Agreement are prudent, efficient, and economical and are reasonable and necessary pursuant to SDCL § 49-34A-8.4.

Dated at Sioux Falls, South Dakota, this 16th day of July, 2013.

Respectfully submitted,

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