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	EL 11-006 **NorthWestern Energy's Answer in Opposition to Oak Tree Energy, LLC's Motion for Partial Reconsideration of Interim Order**

Introduction

COMES NOW NorthWestern Corporation, d/b/a NorthWestern Energy ("NorthWestern" or "NWE") and, pursuant to 20:10:01:30.02, answers Oak Tree Energy, LLC's Motion for Partial Reconsideration of Interim Order ("Reconsideration Motion"). On May 29, 2012, Oak Tree Energy, LLC ("Oak Tree") filed the Reconsideration Motion with the Public Utilities Commission ("Commission"). Oak Tree sought reconsideration of the following findings and conclusion made by the Commission in its Interim Order; Order for and Notice of Further Hearing dated the 15th of May, 2012, in this docket ("Interim Order"):

> 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.
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> . . .
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> 3. That the carbon emission cost values of $5/ton starting in 2015 and 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.

Oak Tree also sought reconsideration of the Commission's order that the parties file pre-filed testimony to enable the Commission to determine:

> 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.

As explained below, NorthWestern opposes Oak Tree's Reconsideration Motion and the relief requested therein.

Argument

A. The hybrid method neither understates NorthWestern's avoided cost nor discriminates against Oak Tree.

Oak Tree argues that it is entitled to be paid NorthWestern's full avoided cost.[1] NorthWestern agrees. However, a further requirement is that Oak Tree be paid **no more** than NorthWestern's actual avoided cost. Federal statute and regulations prohibit requiring a utility to pay more to a qualifying facility ("QF") than the utility's avoided cost.[2] The failure of the Commission to ensure that the rate NorthWestern pays to Oak Tree does not exceed NorthWestern's avoided cost is a failure to comply with the Federal Energy Regulatory Commission's ("FERC") regulations.[3] The hybrid method proposed by the Commission appropriately balances these principles.

Oak Tree incorrectly asserts that the hybrid method violates these legal principles because it assigns "a market price value to Oak Tree in hours where market is less than the cost of NWE

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[1] *Reconsideration Motion* at 4–5.
[2] *See* 16 U.S.C. § 824a-3(b) (2006 & Supplement V) and 18 C.F.R. § 292.101(b)(6) (2012) (defining "avoided costs" as incremental costs).
[3] *See Connecticut Valley Elec. Co. v. FERC*, 280 F.3d 1037, 1034 (D.C. Cir. 2000); *New York State Elec. & Gas Corp. v. FERC*, 117 F.3d 1473, 1476 (D.C. Cir. 1997).

meeting its loads with its own resources"[4] and by "inconsistently failing to utilize the market price in [low load] hours, even though NWE can and does sell generation in hours where market exceeds the incremental cost of NWE's coal fired resources."[5]

Oak Tree argues that the Commission must set avoided cost either using an estimated market price for all hours or using only the incremental cost of NorthWestern's owned resources for all hours.[6] Oak Tree disingenuously obfuscates the concept of avoided cost and ignores the clear evidence in the record as to how NorthWestern serves its customers' loads.

1. The hybrid method accurately captures the costs that NorthWestern could avoid by purchasing power from Oak Tree.

At its core, avoided cost is nothing more than an inquiry into the expense that NorthWestern will not incur if it purchases power from Oak Tree. The uncontroverted testimony of Richard Green is that NorthWestern supplies its customers' loads with self-generated power up to the capacity of its baseload coal units and with market purchases for any excess.[7] During low load hours, the only cost that NorthWestern could not incur is the variable cost of its baseload coal generation. NorthWestern's ability to make off-system sales when its load is less than the output of its baseload coal units is not relevant to avoided cost. Off-system sales create revenue, not cost. Neither federal statute nor administrative regulations include off-system sales revenue in the definition of avoided cost. Other states have concluded that off-system sales should not be included in the calculation of avoided cost.[8]

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[4] *Reconsideration Motion* at 5.
[5] *Id.*
[6] *Reconsideration Motion* at 7.
[7] *Prefiled Direct and Rebuttal Testimony of Richard J. Green* (NWE Ex. 3), 3:3–8:18.
[8] *See, e.g., In re Entergy Arkansas Inc.*, Docket No. 04-113-U, Order 18, 2008 WL 495538, at *10 (Ark. P.S.C. Jan. 15, 2008); *In re Virginia Elec. & Power Co.*, Case No. PUE980463, 2000 WL 1510083, at *4 (Va. S.C.C. July 28, 2000).

During hours in which NorthWestern's customers' needs exceed the output of its baseload coal units—i.e., when those needs cannot be met with baseload units—the only cost that NorthWestern could not incur is the market price of the energy that it purchases. NorthWestern does not avoid the cost of operating its natural gas peaking units, as Oak Tree attempts to assert.[9] Generally, NorthWestern's peaking plants provide capacity to NorthWestern and limited energy at the Western Area Power Administration's ("WAPA") direction. The plants are connected to load for very few hours in any given year.[10] Except for certain emergencies, NorthWestern does not control the plants' operation. WAPA dispatches the plants in economic order. When WAPA dispatches the plants, their operation is justified by market or operational conditions. NorthWestern's purchase of power from Oak Tree will not change the operation of these plants.

2. The hybrid method does not discriminate against Oak Tree.

Oak Tree fallaciously argues that because the hybrid method does not provide that it receive the same market price that NorthWestern might receive when it makes off-system sales, the method discriminates against Oak Tree.[11] This argument demonstrates that Oak Tree misunderstands the PURPA avoided-cost concept. First, the Commission should note that Oak Tree does not want to be paid market price for its output; it wants to be paid a fixed price based on its inflated estimate of future market price and to transfer all market price risk to NorthWestern's consumers.[12] Second, PURPA requires that NorthWestern pay Oak Tree the equivalent of its cost for alternative power, not the equivalent of its revenue. Neither the price

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[9] *Reconsideration Motion* at 5–6.

[10] In 2010, the plants were connected to load for between 8 and 122 hours, each. *See* FERC Form 1 (2010). In 2011, the plants were connected to load for between 20 and 145 hours, each. *See* FERC Form 1 (2011).

[11] *Reconsideration Motion* at 8–9.

[12] NorthWestern is willing to purchase Oak Tree's output at actual market prices in all hours. NorthWestern will purchase and immediately resell Oak Tree's output into the market through WAPA. NorthWestern would pay Oak Tree the exact amount that it receives.

received by NorthWestern nor the avoided cost of some hypothetical, unknown electric grid resource is relevant to NorthWestern's avoided cost or to the prohibition against discrimination.

The hybrid method most accurately reflects NorthWestern's avoided cost. The hybrid method does not discriminate against Oak Tree. The Commission should deny Oak Tree's motion for reconsideration of the hybrid method of calculating avoided cost.

B. Current market conditions and projections properly reflect the information that was known or should have been known to calculate NorthWestern's avoided cost.

Oak Tree seeks reconsideration of the Commission's order to provide pre-filed testimony to enable the Commission to determine "[t]he proper electric market rates that the parties may deem warranted to reflect current market conditions and projections."[13] Oak Tree asserts that "requiring Oak Tree to calculate an avoided cost utilizing inputs based on any date other that [*sic*] February 25, 2011 would violate PURPA."[14] Oak Tree's argument should fail for two reasons.

First, Oak Tree's argument is dependent on the creation of a legally enforceable obligation ("LEO") on February 25, 2011. NorthWestern has applied for reconsideration of this finding and incorporates its analysis of the LEO issue by this reference.[15] If the Commission grants NorthWestern's *Application*, then this argument is moot. If the consequence of the Commission's finding that an LEO was created on February 25, 2011, is to impose excessive costs on NorthWestern's consumers, then the Commission should reconsider its finding.[16]

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[13] *Reconsideration Motion* at 4, 10–12.
[14] *Reconsideration Motion* at 12.
[15] *See NorthWestern Energy's Application for Reconsideration of Findings and Conclusions in Interim Order Issued on May 15, 2012* ("*Application*") filed on June 14, 2012.
[16] ARSD 20:10:01:30.01 provides that reconsideration may be based upon consequences resulting from compliance with a Commission decision or order.

Second, Mr. Lauckhart was either unaware of or deliberately failed to consider certain known information. Specifically, Mr. Lauckhart did not consider the game-changing impact of increased natural gas reserves that EIA published on November 30, 2010.[17]

Mr. Lauckhart did not consider the impacts of higher valued natural gas liquids and natural gas recovered from oil wells in supporting natural gas production even with low prices. Mr. Lauckhart relied on the Black & Veatch Fall 2010 Energy Market Perspective, Lauckhart Exhibit 5. Lauckhart Exhibit 5 does not mention natural gas liquids. The Spring 2011 Black & Veatch Energy Market Perspective includes the following:

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Mr. Lauckhart indicated that the Spring Energy Market Perspective was issued in February.[19]

Mr. Lauckhart failed to consider that the Waxman-Markey bill was dead.[20] Mr. Lauckhart did not consider the impact of the 2010 election, specifically the change of control of the United States House of Representatives. Mr. Lauckhart continued to estimate market prices with carbon costs being imposed in 2016 and with that carbon tax starting at $Redacted/ton and increasing to $Redacted/ton in 2031.[21] However, Black and Veatch had recognized, " Redacted RedactedRedactedRedactedRedactedRedactedRedactedRedactedRedacted

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[17] *Hr'g Transcript*, Vol. I, 87:24–88:9; *U.S. Crude Oil, Natural Gas, & Natural Gas Liquids Proved Reserves, 2009*, Energy Information Administration (Nov. 30, 2010).

[18] *Black & Veatch Energy Market Perspective, Spring 2011 – National Overview* ("*B&V Spring 2011*"), slide 121.

[19] *Hr'g Transcript*, Vol. I, 88:14.

[20] The 111th Congress adjourned on December 22, 2010.

[21] *See Lauckhart Ex. 3*, Tab "Rich_SanityCheck Worksheet," column N, lines 10–25.

RedactedRedactedRedactedRedacted."[22] Furthermore, Black and Veatch had changed its projections regarding the beginning date of carbon cost from 2016 to 2020 and lowered the amount of any carbon cost to $Redacted Redacted in 2020 and $Redacted Redacted in 2035.[23]

All of the above-mentioned items were known on February 25, 2011, to market participants. However, the only estimate of avoided cost in the record that includes consideration of all information that was known, or should have been known, on February 25, 2011, is the estimate provided by Steven Lewis of Lands Energy. Mr. Lewis's estimate was based on the forward electricity and natural gas markets. Markets reflect all known information. Therefore, only Mr. Lewis's estimate reflected all of the known information that Mr. Lauckhart did not consider.

The Commission should deny Oak Tree's motion for reconsideration regarding the use of current market conditions and projections.

C. To the extent that the Commission requires the inclusion of carbon costs in the calculation of NorthWestern's avoided cost, the conservative estimates of Mr. Lewis are appropriate.

Oak Tree seeks reconsideration of the Commission's finding, "That the carbon emission cost values of $5/ton starting in 2015 and 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."[24] NorthWestern has applied for reconsideration of the inclusion of any speculative potential carbon costs in the calculation of avoided cost and incorporates the analysis

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[22] *B&V Spring 2011*, slide 67.
[23] *Id.*, slide 105.
[24] *Reconsideration Motion* at 1–2, 13–19.

of carbon cost in its *Application* by this reference.[25] If the Commission grants NorthWestern's *Application*, this issue is moot.

Oak Tree first compares Lands Energy's estimate of carbon costs with those used by NorthWestern in its 2011 Montana Electricity Supply Resource Procurement Plan and asserts that the difference is an "example of discriminatory treatment by NWE."[26] In making this comparison, Oak Tree (1) ignores the difference between considering risk for resource planning and calculating avoided cost, (2) ignores the decrease in the probability of carbon costs as a result of the 2010 election discussed above, and (3) when it is convenient for Oak Tree, abandons its contention that the Commission can only consider events occurring prior to February 25, 2011.

NorthWestern's 2011 Montana Electricity Supply Resource Procurement Plan, which was filed nearly 10 months after February 25, 2011, is a planning document, not a calculation of avoided cost. As such, NorthWestern prepared it in accordance with directives from the Montana Public Service Commission (MT PSC) that are not appropriate to calculating South Dakota avoided cost. Specifically, in 2004, the MT PSC directed, "In its next planning cycle NWE should explicitly incorporate environmental costs into its portfolio analysis."[27] In 2006, the MT PSC stated, "The 2005 DSP did not sufficiently assess the risk from possible regulation of CO_2 emissions, and the method NWE used was not transparent and caused confusion. . . . NWE should consult with its advisory committee on ways to improve the evaluation of risk from possible regulations of CO_2 emissions."[28] Similarly, the MT PSC commented negatively in 2008, "NWE's

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[25] *Application*.
[26] *Reconsideration Motion* at 14–15.
[27] *In the Matter of the Submission of NorthWestern Energy's Default Electricity Supply Resource Procurement Plan*, Docket No. N2004.1.15, p. 15 (MT PSC Aug. 17, 2004).
[28] *In the Matter of NorthWestern Energy's December 2005 Electric Default Supply Procurement Plan*, Docket No. N2005.12.172, ¶ 114 (MT PSC July 31, 2006).

2007 plan significantly improved the evaluation of portfolio risks related to future CO_2 costs. The PSC's primary concern is whether NWE adequately captures the magnitude of possible cost impacts."[29] In its 2009 plan, NorthWestern incorporated the average carbon tax from the Northwest Power and Conservation Council's ("NWPCC") 6th Plan. The MT PSC did not have a negative comment.[30] Faced with this history, NorthWestern logically included the NWPCC estimate in its 2011 plan that was filed just three weeks after the MT PSC's comments on the 2009 plan.

After comparing—and confusing—a planning document with an avoided cost determination, Oak Tree asserts, "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."[31] This bald, unsupported assertion is erroneous. As explained above, Waxman-Markey is dead. There is no reasonable probability that a similar statute will be passed in the foreseeable future. Relying on Oak Tree's assumption suggesting otherwise is imprudent.

Lastly, Oak Tree asserts that the Commission should rely on the EIA 2011 forecast, the 2010 Black & Veatch forecast, and the 2009 NWPCC forecast.[32] Oak Tree refers to the EIA forecast as Exhibit 1.[33] Exhibit 1 is not an EIA forecast; Exhibit 1 is a one-page demonstrative exhibit purporting to show two days of load and generation capacity and associated incremental cost and market prices. NorthWestern does not know to what EIA forecast Oak Tree is referring

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[29] *In the Matter of NorthWestern Energy's December 2007 Electric Default Supply Procurement Plan*, Docket No. N2007.11.138l, ¶ 96 (MT PSC Dec. 12, 2008).

[30] *See In the Matter of NorthWestern Energy's December 2009 Electric Default Supply Procurement Plan*, Docket No. N2010.6.57 (MT PSC Nov. 22, 2011).

[31] *Reconsideration Motion* at 16.

[32] *Reconsideration Motion* at 17.

[33] *Id.*

and, therefore, cannot analyze or discuss it. However, it would be inappropriate for the Commission to rely on something that is not in the record and is misidentified. As discussed above, in February 2011 Black & Veatch had abandoned its 2010 forecast because of changed circumstances; thus, reliance on the 2010 Black & Veatch forecast is inappropriate. Similarly, any 2009 NWPCC forecast is invalid for calculating NorthWestern's South Dakota avoided cost.

Contrary to Oak Tree's assertion, the Commission should not rely on this information. The Commission should deny Oak Tree's motion for reconsideration regarding the Commission's finding with respect to Lands Energy's estimate of carbon emissions cost values.

Conclusion

The hybrid method appropriately estimates NorthWestern's avoided cost and does not discriminate against Oak Tree. Consideration of current market conditions and projections is proper in this case. Lands Energy's estimate of carbon emission costs is the best estimate in this proceeding. For these reasons, NorthWestern respectfully requests that the Commission deny Oak Tree's Reconsideration Motion in its entirety.

Dated at Sioux Falls, South Dakota, this 18th day of June, 2012.

Respectfully submitted,

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