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 Response to Oak Tree Energy, LLC's Pre-Hearing Motions Regarding Right to Full Avoided Cost and Creation of Legally Enforceable Obligation**

Introduction

NorthWestern Energy submits this response opposing Oak Tree Energy, LLC's Omnibus Pre-Hearing Motions.

In a document rife with legal misrepresentations, unsupported assertions, and logical fallacies, Oak Tree has requested that the Public Utilities Commission issue an order finding that Oak Tree's long-term avoided cost forecast is the basis for rates for the Oak Tree wind project and that Oak Tree has incurred a legally enforceable obligation (LEO) and asserted that these issues do not need further evidentiary exploration at the hearing in this matter. For the reasons set forth below, the Commission should deny Oak Tree's motions.

NorthWestern Energy's Avoided Cost

Length of Contract

In support of its argument that it is entitled to a rate based on Mr. Lauckhart's market forecast, Oak Tree first argues that it has a right to determine the length of any contract between it and NorthWestern.[1] Oak Tree cites two cases, *New York State Elec. & Gas Corp. v. Saranac Power*

[1] Omnibus Prehr'g Mot. at 3.

Partners, L.P.[2] and *Phoenix Power Partners, L.P. v. Colorado Public Utilities Comm'n*[3], to support its assertion. Neither case stands for the proposition for which Oak Tree cites it. Oak Tree merely quotes dicta from each case without providing the factual background or the holdings of either. Examination of the actual decisions clearly shows that they do not support Oak Tree's conclusions.

Saranac involved an attempt by a utility to lower the price agreed to in a contract when it became clear that the initial estimate of its avoided cost was too high. As the court stated:

> Plaintiff, New York State Energy & Gas Corporation ("NYSEG"), a traditional electrical utility, brings the present action principally to obtain relief from long-term contracts with two QFs, defendants Saranac Power Partners, L.P. ("Saranac"), and Lockport Energy Associates, L.P. ("Lockport"). In each case, NYSEG's contract requires it to pay for energy purchased from these two companies at a fixed rate equal to its estimated long-run avoided costs ("LRACs") as calculated—or miscalculated—in 1988 by NYSEG and other public utilities in conjunction with PSC. Unfortunately for NYSEG, its LRACs as estimated at the time it entered into required contracts with Saranac and Lockport are considerably higher than its current LRAC projections. According to two independent analysts retained by NYSEG, payments under both the Saranac and Lockport agreements will significantly exceed NYSEG's avoided costs over the terms of the agreements. Based on these predictions, NYSEG asserts that the fixed rates of its power purchase agreements ("PPAs") with Saranac and Lockport are unauthorized under PURPA which limits rates for QF purchases to a utility's "incremental" or avoided costs.[4]

The New York Public Service Commission (PSC) had established guidelines for the calculation of long-run avoided costs; ordered major utilities within the state to file long-run avoided costs for 1998 through 2008 by July 1, 1987; adopted the estimates filed by the utility; and ordered the

[2] 117 F. Supp. 2d 211 (N.D.N.Y. 2000).
[3] 959 P.2d 359 (Colo. 1998).
[4] *Saranac*, 117 F. Supp. 2d at 217–18 (footnotes omitted) (*aff'd sub nom New York State Elec & Gas Corp. v. Saranac Power Partners, L.P.*, 267 F.2d 128 (2d Cir. 2001).

utility to enter into 15-year contracts with the qualifying facilities (QFs).[5] In 1992, the New York PSC lowered the utility's estimated long-run avoided costs by about 40 percent but did not alter the existing contracts.[6]

The utility petitioned the Federal Energy Regulatory Commission (FERC) to issue declaratory rulings and to reform the contracts. FERC denied the petition in its entirety.[7] The utility then petitioned the United States Court of Appeals, District of Columbia Circuit for review of FERC's denial of its petition, and the court dismissed the utility's petition.[8] The utility then proceeded to file a complaint against FERC, the New York PSC, various officials, and the QFs. The defendants filed motions to dismiss the complaint, and the court granted those motions.[9]

Saranac did not involve any right of a QF to determine the length of a specified term. It merely affirmed that an agreed-upon contract based on estimated avoided costs at the time it was entered into could not be subsequently changed when the estimates proved to be too high.

Phoenix Power also did not involve the right of a QF to determine the length of a specified term. In that case, the utility and the QF were negotiating for a contract when the state regulatory commission imposed a moratorium on QF contracts. The *Phoenix Power* contract was excluded from the moratorium by a grandfather clause. In 1988, the utility and the QF entered into a 15-year contract. Over the next five years there were several amendments to the contract. In 1993, the utility submitted the contract to the regulatory commission for approval. The commission found that the contract amendments amounted to a novation and a new contract, that the new contract was not grandfathered, and that the new contract was subject to new rules requiring

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[5] *Saranac*, 117 F. Supp. 2d at 219.
[6] *Id.* at 220.
[7] *Id.* at 220–21.
[8] *Id.* at 223.
[9] *Id.* at 256.

bidding for QF contracts.[10] The Colorado Supreme Court affirmed the district court's decision upholding the regulatory commission's decisions.[11]

Contrary to Oak Tree's assertion, the cases it cited do not support its contention that a QF has a right to specify the length of period over which an avoided cost must be computed.

Avoided Cost

Oak Tree next asserts that it is entitled to a rate based equal to NorthWestern's full avoided cost.[12] NorthWestern does not dispute this assertion. However, Oak Tree links this assertion with an argument that a "QF can generate the avoided cost forecast over the specified term itself."[13] Oak Tree further argues that it "generated a very detailed avoided cost forecast using an established avoided cost forecast methodology, using detailed data from national expert Black & Veatch."[14] Neither of Oak Tree's arguments is well taken.

First, Oak Tree does not cite any legal authority for its proposition that a QF may generate an avoided cost forecast for a utility. NorthWestern believes that Oak Tree did not cite any authority because there is none. Estimates of avoided cost are utility specific. This is understandable when one considers the complexities of determining an avoided cost. A utility's avoided cost will depend on the resources it has, the variable cost of producing energy with those resources, the load it serves, its need to acquire additional resources, and the cost of additional energy and capacity.

Second, Oak Tree's argument that it determined NorthWestern's avoided cost using "detailed data from national expert Black & Veatch" is absurd on its face. People, not companies,

[10] *Phoenix Power*, 959 P.2d at 361–63.
[11] *Id.* at 367.
[12] Omnibus Prehr'g Mot. at 3–4.
[13] *Id.* at 4.
[14] *Id.* at 5.

are experts. An expert is one who is qualified by knowledge or experience. Companies do not have knowledge or experience; people do.

Third, this Commission, not Oak Tree, has the authority to determine how avoided costs for South Dakota utilities should be determined. To date, the Commission has not established a methodology.

Oak Tree also argues that there is no contested issue regarding NorthWestern's avoided cost because "only Oak Tree has produced a 20-year avoided cost forecast in this proceeding."[15] In making this assertion, Oak Tree ignores the statute and the evidence in this proceeding and engages in semantics. NorthWestern contests the issue regarding its estimated avoided cost.

Federal law requires that rates paid to QFs not exceed a utility's incremental cost of alternative energy.[16] NorthWestern has provided its estimate of its 20-year incremental cost in the testimony of Bleau LaFave.[17] NorthWestern also asserts that avoided cost for a QF is resource specific and should consider the factors set forth in 18 C.F.R. § 292.304(e)(2). Although NorthWestern does not call its estimate of long-run incremental costs an avoided cost estimate, it clearly sets forth the upper limit of the costs it could avoid by purchasing the output of the Oak Tree project, if it is ever built. Oak Tree's motions ignore this clear evidence contradicting Mr. Lauckhart's estimate. The motions also ignore the testimony of the Commission's staff witness, Mr. Rounds, supporting NorthWestern's calculations. If the Commission were to adopt Mr. Lauckhart's calculations, NorthWestern would be required to pay rates that exceed its incremental costs.[18]

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[15] Omnibus Prehr'g Mot. at 7.
[16] 16 U.S.C. § 824a-3(b).
[17] LaFave Direct Test. 18:4–9 & Ex. BJL-1.
[18] *Id.* at 18:20–22 & Ex. BJL-3.

Oak Tree also asserts that NorthWestern failed to negotiate in good faith and that it should not be permitted to capitalize on this refusal.[19] NorthWestern vigorously disputes that it failed to negotiate in good faith and has provided testimony that Oak Tree did not even attempt to negotiate with respect to rates and terms for a power purchase agreement.[20] Contrary to Oak Tree's implication, NorthWestern is not attempting "to evade its PURPA obligations." NorthWestern is trying to fulfill all of its obligations under PURPA, including its obligations to its South Dakota consumers.

For the foregoing reasons, the Commission should deny Oak Trees request that the avoided cost determination in this proceeding be based on Mr. Lauckhart's forecast.

Legally Enforceable Obligation

Oak Tree requests that the Commission find that it has incurred an LEO to deliver its output to NorthWestern. Oak Tree represents that FERC's recent decisions in *Cedar Creek Wind, LLC*[21] and *JD Wind 1, LLC*[22] stand for the proposition that by committing to sell the output from an unbuilt plant, Oak Tree has incurred an LEO. Oak Tree admits that "[t]he existence and timing of the creation of an LEO is an issue of first impression" before this Commission.[23] However, it also asserts that the Commission may not impose requirements not found in the federal regulations.[24] As it did with the *Saranac* and *Phoenix Power* decisions, Oak Tree puts a gloss on the decisions that is not supported on close analysis. Neither *Cedar Creek* nor *JD Wind* overruled FERC's statement that "[i]t is up to the States, not [FERC], to determine the specific parameters of

[19] Omnibus Prehr'g Mot. at 8.
[20] LaFave Direct Test. 6:10–8:28.
[21] 137 FERC ¶ 61,006 (Oct. 4, 2011).
[22] 129 FERC ¶ 61,148 (Nov. 19, 2009).
[23] Omnibus Prehr'g Mot. at 8.
[24] *Id.* at 14.

individual QF power purchase agreements, including the date at which a legally enforceable obligation is incurred under State law."[25]

In Texas, "the '90-day rule,' provides that a utility may be compelled purchase power from a QF pursuant to a LEO only if the QF can provide that power within 90 days."[26] A Texas administrative law judge determined that a built wind project able to deliver electricity within 90 days could not create an LEO because the output was not firm.[27] FERC found that limiting an LEO to QFs that provided firm power was inconsistent with federal regulations.[28] FERC did not invalidate the 90-day rule.

The *Cedar Creek* decision involved an Idaho Public Utility Commission (PUC) decision determining that a QF had not created an LEO because a the utility had not signed a power purchase agreement. Prior to December 14, 2010, wind QFs in Idaho up to 10 MW were allowed to sell power at a published standard offer rate. After December 14, 2010, the standard offer rate was limited to wind QFs not larger than 100 kW. The QF and the utility had agreed to all contract terms, and the QF submitted a signed contract to the utility prior to December 14, 2010. The utility did not sign the contract before December 14, 2010. The power purchase agreements were submitted to the Idaho PUC for approval. The Idaho PUC rejected the contracts and adopted a bright-line rule that an LEO could be created only if a power purchase agreement had been signed by both parties.

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[25] *Metropolitan Edison Co.*, 72 FERC ¶ 61,015, ¶ 61,050 (July 6, 1995) (quoting *West Penn Power Co.*, 71 FERC ¶ 61,153 (May 8, 1995)).
[26] *Power Res. Group, Inc. v. Pub. Util. Comm'n of Texas*, 422 F.3d 231, 233 (5th Cir. 2005) (citing PUC Subst. R. 25.242(f)(1)(B)).
[27] *JD Wind 1*, 129 FERC at ¶ 61,630.
[28] *Id.* at ¶ 61,634.

FERC ruled that the Idaho PUC's bright line rule violated the federal PURPA regulations. "We accordingly find that the Idaho PUC's requirement that an executed contract was necessary to create a legally enforceable obligation in these circumstances is inconsistent with PURPA and the Commission's regulations implementing PURPA."[29] However, FERC did not determine that the QF had created an LEO. "Whether the conduct of Cedar Creek and Rocky Mountain Power constituted a legally enforceable obligation subject to the Commission's PURPA regulations is not before us."[30]

Oak Tree also argues that NorthWestern refused to negotiate in good faith and asserts that this is established by Michael Makens's Prefiled Rebuttal Testimony.[31] On this issue, there is conflicting testimony—that of Bleau LaFave and that of Michael Makens. Mr. LaFave describes the communications with Oak Tree[32] and shows that neither Mr. Makens nor any other representative of Oak Tree ever accepted Mr. LaFave's repeated invitations to call and negotiate.[33] The Commission, not Oak Tree, is responsible for judging the credibility of witnesses.

Only after the Commission determines what is necessary to establish an LEO in South Dakota can it be determined whether Oak Tree created an LEO. This is a matter that will depend on South Dakota law and the actual facts of this case. Only after the hearing and the Commission's evaluation of the conflicting evidence can this determination be made. Oak Tree has never committed to delivering anything to NorthWestern; it has only committed to providing

[29] *Cedar Creek*, 137 FERC ¶ 61,006 at P 37.
[30] *Id.* at P 38.
[31] Omnibus Prehr'g Mot. at 10–11.
[32] LaFave Direct Test. 6:10–8:28.
[33] NorthWestern admits that Oak Tree engaged in negotiations with respect to transmission interconnection. Mr. Makens may be confusing his contacts regarding interconnection with the lack of negotiations regarding a power purchase agreement.

power at a price far above NorthWestern's incremental cost if Oak Tree actually builds the plant. Oak Tree has never committed to building the plant.

For these reasons the Commission should deny Oak Tree's request that it find Oak Tree incurred an LEO on February 25, 2011.

Dated at Sioux Falls, South Dakota, this 7th day of March, 2012.

Respectfully submitted,

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