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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 RESPONSE TO NORTHWESTERN ENERGY'S PREHEARING MOTIONS**

OAK TREE ENERGY, LLC'S RESPONSE TO NORTHWESTERN ENERGY'S PREHEARING MOTIONS

I. INTRODUCTION

Oak Tree Energy, LLC (Oak Tree), acting by and through counsel and pursuant to the South Dakota Public Utility Commission's (PUC) Second Amended Scheduling order, hereby submits its response to NorthWestern Energy's (NWE) prehearing motions. At the outset, Oak Tree notes that NWE's motions are without merit in that they purport to prevent Oak Tree's policy and fact witnesses from presenting Oak Tree's case at the hearing on this matter. Undoubtedly NWE does not much care for what Oak Tree's witnesses have to say, but there is no legal basis for excluding this testimony.

With respect to NWE's motion to exclude portions of testimony by Oak Tree expert Richard Lauckhart, Oak Tree notes that Mr. Lauckhart is merely pointing out the inconsistencies in what NWE has said about avoided cost for wind projects, the manner in which NWE calculates natural gas prices when it wishes to be paid a higher price for its own projects, and such issues as the value of wind toward hedging against future risks. None of these issues have the slightest thing to do with the distinction between NWE's Montana system and its South Dakota system as argued by NWE. Mr. Lauckhart's testimony merely points out the blatant inconsistencies offered from the mouths of NWE witnesses (often the same) in the two jurisdictions, where the only distinction appears to be that NWE will own the project in Montana and in South Dakota it will not. The testimony to be introduced is relevant to the proper calculation of avoided costs in this proceeding, and to the credibility of NWE's witnesses.

With respect to the testimony offered by Oak Tree witness Michael Makens regarding legal expenses, NWE misapprehends Mr. Makens' testimony. The point of the testimony, contrary to NWE's interpretation, is that whatever NWE's legal costs are, it is allowed to seek cost recovery for those expenses from its ratepayers. Mr. Makens is not saying NWE has no expenses or that he has any personal knowledge with respect to those expenses. He is merely testifying that Oak Tree has no ratepayers to reimburse it for the expense of lengthy PUC proceedings and thus had every incentive to negotiate with NWE.

Through NWE witness Bleau LaFave, NWE at least implied that negotiations did not go forward because of Oak Tree. In doing so, NWE apparently hopes to convince the PUC that Oak Tree has no legally enforceable obligation (LEO). Oak Tree then responded with Mr. Makens' testimony because of the absurd, self-serving testimony of Mr. LaFave. With respect to the scope and history of negotiations, and NWE's inability or unwillingness to negotiate, NWE argues that Mr. Makens testimony is irrelevant. The testimony of Mr. Makens establishes that NWE absolutely refused to negotiate in order to prevent Oak Tree from getting a contract to sell output from its wind project. Finally, contrary to NWE's contention, the issue of "bad faith" refusal to negotiate is very much relevant to the question of when and whether an LEO was created by Oak Tree. Under FERC's regulations, the failure to negotiate or sign an agreement creates an LEO. *See Cedar Creek Wind LLC*, 129 FERC ¶ 161, 148 (Nov. 19, 2009) ¶ 32, pp. 13-14 ("[I]f the electric utility refuses to sign a

contract, the QF may seek state regulatory authority assistance to enforce the PURPA-imposed obligation on the electric utility to purchase from the QF, and a non-contractual, but still legally enforceable, obligation will be created pursuant to the state's implementation of PURPA.") NWE is arguing, through Mr. LaFave's prefiled testimony, that it did not refuse to negotiate or to sign a contract, all in an attempt to claim Oak Tree has no LEO. Then, when Mr. Makens submits rebuttal testimony pointing out the facts regarding negotiations, NWE does not wish to permit rebuttal. Mr. Makens's testimony is relevant and indeed necessary to rebut NWE's assertions that Oak Tree did not attempt to negotiate, and to establish Oak Tree's LEO and the date on which that LEO was created (February 25, 2011).

With respect to the testimony of Oak Tree witness Thomas Anson, NWE offers a number of arguments, none of them legally meritorious. First, NWE argues that Mr. Anson's testimony should have been in prefiled direct testimony. As will be shown, Mr. Lauckhart's testimony on the LEO issue was very limited and said nothing about South Dakota law or any law of any jurisdiction. In an apparent response, NWE offered the direct and prefiled rebuttal testimony of Mr. LaFave, wherein he opines at length regarding the requirements of PURPA and the requirements to create an LEO. Much of Mr. LaFave's testimony is in the form of legal opinion. In response, Mr. Anson, an attorney with years of experience in trying PURPA cases before FERC and elsewhere, submitted rebuttal testimony explaining the facts surrounding current FERC policy regarding the formation of an LEO. In particular, Mr. Anson rebutted Mr. LaFave's assertions regarding FERC LEO policy which does not require all the details about price and project specifics be hammered out before an LEO can be created. Mr. Anson's testimony effectively rebuts Mr. LaFave's unfounded assertions.

Second, Oak Tree had no idea that NWE was going to claim in rebuttal testimony that Oak Tree had not established an LEO prior to reviewing Mr. LaFave's testimony on January 13, 2012. For NWE to claim that Oak Tree should have known that NWE would take such untenable positions contrary to FERC policy (Oak Tree assumes parties act rationally) strains credulity. Oak Tree agrees with NWE that the LEO issue is crucial to the case, which is why Oak Tree chose to rebut Mr. LaFave. It is unsurprising that NWE would not like Mr. Anson's testimony, but NWE cannot control Oak Tree's case. Mr. Anson's testimony is properly rebuttal and it refutes Mr. LaFave effectively.

Surprisingly, after resisting discovery on its own rebuttal experts on the grounds the

discovery deadline had passed and that it was inappropriate to permit additional discovery, NWE argues it would be "unfair" to permit Mr. Anson to testify as a rebuttal expert. If Mr. Anson's testimony is relevant rebuttal testimony (and it is), then "unfairness" is not an issue. Oak Tree, not NWE, gets to control its case and decide who its witnesses are as long as there is a legal basis for that testimony.

NWE also asserts that Mr. Anson may not offer legal conclusions. Mr. Anson is testifying as a policy witness on the fact of current FERC policy on the formation of LEOs. Mr. Anson has not offered legal conclusions which violate the rules of expert testimony, nor has he invaded the province of a court to determine legal questions. Mr. Anson is offering factual testimony regarding FERC's policy with respect to LEOs. He has not testified on the ultimate issue in the case, nor has he opined about the state of the law in South Dakota or anywhere else.

Finally, NWE states it agrees with PUC staff that any LEO policy determination by the PUC should await a rulemaking with input from all stakeholders. Oak Tree has no objection to such a rulemaking, but the PUC has a complaint before it and must enforce FERC policy. FERC policy is that if a utility refuses to negotiate with a QF, a LEO is formed. If NWE wishes to waive its argument that Oak Tree has no LEO, then Oak Tree will heartily endorse NWE's position. Until such time, however, Oak Tree needs to put on its case and NWE cannot (again) attempt to have it both ways and simultaneously offer legal opinion from Mr. LaFave and also prevent Oak Tree from rebutting that testimony through Mr. Anson's testimony.

II. ARGUMENT

A. Mr. Lauckhart's Testimony is Relevant to A Proper Calculation of Avoided Costs and Exposes NWE Hypocrisy

1. Standards

The South Dakota Supreme Court has stated that evidence having any tendency to make the existence of any fact that is of consequence to the determination of the action more probable or less probable than it would be without the evidence is relevant under SDCL 19-12-1. *State v. McDonald,* 421 N.W.2d 492, 494 (S.D. 1993). In *Supreme Pork, Inc. v. Master Blaster, Inc.,* 2009 S.D. 20, 764 N.W.2d 474, the South Dakota Supreme Court

emphasized the test for relevance stated in SDCL § 19-12-1 (Rule 401):

> Rule 401 uses a lenient standard for relevance. Any proffered item that would appear to alter the probabilities of a consequential fact is relevant, although it may be excluded because of other factors. To merely alter the probability of the existence of a fact, or 'make it more probable or less probable,' as the Advisory Committee notes, is not a stringent standard. Evidence, to be relevant to an inquiry, *need not conclusively prove the ultimate fact in issue,* but only have a tendency to make the existence of any fact that is of consequence to the determination of the action more probable or less probable than it would be without the evidence.
>
> > To be admissible, evidence need only to alter the probabilities of a proposition; it need not sway the balance to any particular degree. This standard of relevance, adopted by most commentators, revisers and many courts is usually termed 'logical' relevance as opposed to the theory of 'legal' relevance championed by Wigmore, and adopted by some courts prior to the enactment of Rule 401 ...
> >
> > The standard of logical relevance is more lenient, and permits evidence to be admitted even if it only slightly affects the trier's assessment of the probability of the matter to be proved. Even though each piece of evidence considered separately is less than conclusive, if when considered collectively with other evidence it tends to establish a *consequential fact,* such evidence is relevant. For purposes of Rule 401, that is enough.
>
> Jack B. Weinstein & Margaret A. Berger, *Weinstein's Federal Evidence,* § 401.04[2][c] (*Joseph M. McLaughlin, ed., Matthew Bender* 2d ed.2008)

(Emphasis added).

Here, the issue is whether Mr. Lauckhart's testimony that NWE seeks to exclude from the PUC's consideration is relevant to the issues in this proceeding. As the PUC knows, one of the primary issues for the PUC's consideration in this proceeding is:

> (1) Whether, and in what amounts, NWE should be required, pursuant to 16 U.S.C. § 824a-3 and 18 C.F.R. §§ 292.303 and 292.304, to pay Oak Tree over the life of the Project for electricity made available to NWE from the project[.] The determination of this issue will require consideration of the avoided cost issues presented by 18 C.F.R. § 292.304, including, but not limited to, both

avoided energy costs and avoided capacity costs.

As will be more than amply demonstrated below, Mr. Lauckhart's testimony, including the portions that NWE seeks to strike, is directly relevant to a proper calculation of avoided costs. In particular, Mr. Lauckhart points out that NWE is self-serving and hypocritical when it does not want to purchase Oak Tree's energy and capacity, as opposed to when NWE wishes to own and put a wind generation facility in its rate base. Recall that the test is whether the proposed testimony is relevant to the issue of avoided cost. There is no question that it is, but NWE seems to be arguing that it disagrees with Mr. Lauckhart's testimony. This is not a basis for excluding testimony, but rather is an issue for the PUC to decide at hearing. NWE also argues that Montana's LEO law is not relevant to South Dakota. However, Mr. Lauckhart did not offer an opinion regarding Montana's LEO law in his testimony. Instead, Oak Tree has consistently argued that FERC's policy regarding LEOs is the relevant consideration in this proceeding.

2. NWE's Argument on Relevance is Riddled with Inaccuracies

NWE first argues that "Oak Tree persists in suggesting that NorthWestern's South Dakota customers should pay for the policy mistakes made in Montana." *Brief Supporting NWE's Pre-Hearing Motions*, p. 2. NWE does not identify what these "policy mistakes" are in its brief. However, the testimony that Mr. Lauckhart provided largely compared what NWE said in two proceedings: this one, where NWE does not wish to do business with Oak Tree, and the D2011.5.41 proceeding where NWE sought and obtained pre-approval for Spion Kop from the Montana Public Service Commission (MPSC). Why NWE would claim the decision to build its own wind generation facility in Montana is a policy mistake is unclear to Oak Tree, but what is clear is that NWE took two radically different positions in Montana and South Dakota, and the only real difference between NWE's two positions is whether it was NWE's project or Oak Tree's project. Mr. Lauckhart's testimony is relevant to a determination of the proper avoided cost methodology in South Dakota, and for the Commission to judge NWE's credibility (or lack thereof).

NWE offers the following bewildering array of assertions (all inaccurate or irrelevant) as reasons why Mr. Lauckhart's testimony should not be heard by the PUC:

> NorthWestern's Montana and South Dakota systems are separate. One is in the Western Interconnect; the other is in the Eastern Interconnect. One has no

access to an organized market; the other is near to the Midwest Independent System Operator market. In one, there is no defined capacity market; in the other, NorthWestern purchases capacity separate from energy. One is a balancing authority; the other is within the balancing authority area of the Western Area Power Administration. In one, NorthWestern generates a small portion of its necessary electric load and purchases the rest; in the other, NorthWestern operates baseload generators to produce the majority of the electricity needed to serve load and only purchases a small portion of the time. In Montana, NorthWestern is moving from being a utility with no generation to being a vertically integrated utility. In South Dakota, NorthWestern is a vertically integrated utility. Finally, in Montana, NorthWestern faces significant monetary penalties if it does not meet mandatory renewable portfolio standards; in South Dakota, NorthWestern aspires to satisfy a voluntary renewable resource objective but does not face any penalty for noncompliance. All of these differences indicate that cases before the Montana PSC have no bearing on issues in this docket.

Obviously, Oak Tree strongly disagrees with the facts and reasoning presented by NWE on these matters as follows:

- NWE claims that its Montana and South Dakota systems are separate. While the service territories of these two systems do not touch, the systems are connected electrically through transmission lines owned by others. But these lines are subject to open access rules established by FERC. *It is the existence of the transmission grid (along with other matters discussed below) that makes an avoided cost in Montana relevant to the avoided cost in South Dakota.*
- NWE points out that its Montana system is in the Western Interconnection and its South Dakota system is in the Eastern Interconnection. However, NWE utterly fails to acknowledge that there are *transmission ties,* subject to open access, between these two interconnections that allow power to be moved between them. Those transmission ties are necessarily AC-DC-AC ties due to the fact that they move power between two interconnects. These ties allow the two systems to be connected electrically and allow power to be scheduled from one interconnect to the other. The existence of these AC-DC-AC ties (along with other matters discussed below) makes an avoided cost in Montana relevant to the avoided cost in South Dakota.
- NWE claims its Montana system has no access to an organized market while its South Dakota system is near to the Midwest Independent System Operator market. This statement is irrelevant for a number of reasons. First, NWE in South Dakota is not a part of the MISO organized market. Second, being in the WECC Interconnect, NWE's Montana system can interact with the CAISO organized market. So there is no meaningful distinction between NWE's utilities in Montana and South Dakota. Third, and most importantly, *whether in an organized market or a bilateral market does not change the*

fundamentals of matching loads to resources and finding the resource that is "on the margin" in any hour. The marginal resource typically sets the market clearing price for power on that hour. *Hourly energy prices are based on supply and demand fundamentals whether in an organized marker or in a bilateral market.*

- NWE claims that "[i]n one [state], there is no defined capacity market; in the other, NorthWestern purchases capacity separate from energy." It is unclear what NWE is saying with this sentence. What is clear beyond peradventure is that whether a utility is located in Montana or South Dakota, *capacity and energy are needed to reliably serve load.* Although NWE has not defined what it means by "defined capacity market," if one utilizes a normal definition of "defined capacity market" there is no such market in either Montana or South Dakota. But, in both states it is necessary to have sufficient capacity to cover the peak load.
- NWE states that its Montana system is a balancing authority while its South Dakota system is within the balancing authority area of the Western Area Power Administration. While the statement is true, this distinction has nothing to do with avoided cost. Nor is it a reason to reject Mr. Lauckhart's testimony that relies in part on NWE's testimony in MPSC proceedings regarding avoided costs and wind project value. Perhaps one could argue that the differences between Montana and South Dakota balancing authorities are a reason to treat *wind integration costs* differently in Montana than in South Dakota. However, Mr. Lauckhart's testimony already takes that difference into account when he compares avoided costs in Montana with avoided costs in South Dakota.
- NWE claims that in Montana, NWE generates a small portion of its necessary electric load and purchases the rest while in South Dakota, NWE operates baseload generators to produce the majority of the electricity needed to serve load and only purchases a small portion of the time. This statement is not borne out by the record in this proceeding to date and, more importantly, it is irrelevant to avoided cost determinations. In both Montana and South Dakota NWE purchases a lot of spot market power to serve its load. The question is simply what is the *price of spot market power in the two regions and how would that be calculated.* As indicated above, the theory of supply and demand for power (and the fundamental approach to determining market clearing prices) *is the same between regions.* Using different theories on estimating market clearing prices between the two regions is inappropriate and has no basis in theory or fact.
- NWE claims that in Montana NWE is moving from being a utility with no generation to being a vertically integrated utility while in South Dakota, NWE is already a vertically integrated utility. Again, Oak Tree does not understand the rationale for why NWE believes that this difference is a reason to reject theories on avoided costs and wind value in Montana when considering these matters in South Dakota. In any event, the statement is false in that the theories involved in calculating avoided cost for a utility would be the same whether the utility was an integrated electric utility or was simply

transitioning to becoming an integrated electric utility.

- NWE claims that in Montana NWE faces significant monetary penalties if it does not meet mandatory renewable portfolio (RPS) standards while in South Dakota NWE merely aspires to satisfy a voluntary renewable resource objective but does not face any penalty for noncompliance. This statement is misleading at best. A close reading of the Montana RPS requirements indicates that NWE will not be assessed monetary penalties if it does not meet the RPS goals if the renewable alternatives are more expensive than other power supplies such as market purchases. Therefore, in both South Dakota and Montana, NWE will not face monetary penalties if renewable resources are more expensive than other sources of power and, as a result, NWE chooses not to meet the RPS. That is why NWE needed to demonstrate to the Montana Public Service Commission that the cost of its Spion Kop wind project was less than the cost of market purchases.

Oak Tree also believes there are a number of reasons that MPSC proceedings on avoided costs and wind value are critically relevant to the Oak Tree proceeding in South Dakota. These reasons include:

- In the power industry, both in the Western Interconnect and the Eastern Interconnect, natural gas fired generation is "on the margin" a very large portion of the time. *So natural gas prices are prime drivers of market power prices in both interconnects.* The natural gas delivery system is not separate between the Western Interconnect and the Eastern Interconnect. The gas delivery system interconnects all of North America. Gas can be moved across North America which results in high correlations of gas prices for gas plants in the Western Interconnect and the Eastern Interconnect. *Therefore market prices in the Western Interconnect region are highly correlated with market prices in the Eastern Interconnect.*
- *Theories of avoided cost do not change between Montana and South Dakota.* Fundamentals theories of supply and demand are the same in Montana and South Dakota. Power can move between Montana and South Dakota. The cost of many new resources are the same whether in Montana or in South Dakota. Although there are some input assumption details that need to be taken into account, Mr. Lauckhart has taken those differences into account in his calculations. However, and most importantly, avoided cost theories, the value of wind, and any fundamental analysis of the market are the same whether in Montana or South Dakota. It is appropriate for Oak Tree to point out how NWE modified its avoided cost theories, value of wind theories, and fundamental analysis theories between its testimony in Montana and its testimony in the South Dakota Commission.

In summary, NWE is profoundly inaccurate in its presentation of the facts contained throughout its prehearing motions brief. Montana and South Dakota are connected through

a transmission grid and through interties, meaning the price of electricity in one market is related to the price of electricity in the other. Montana and South Dakota both equally have access to organized markets in the sense both have access to Regional Transmission Organizations if they choose to do so. However, the fundamentals of determining marginal resource operation do not change based on access to "organized markets." The fundamental principle of supply and demand does not change depending on whether a utility is in an organized market. The term "defined capacity market" is simply a red herring; in both Montana and South Dakota, NWE's utilities have to plan to have sufficient capacity to meet peak load.

Furthermore, NWE's argument about balancing authorities has nothing to do with a proper calculation of avoided cost in South Dakota. It might have something to do with wind integration, but Mr. Lauckhart's testimony has taken those differences into account. The differences in the two utilities with respect to having sufficient capacity to meet loads is also irrelevant to a determination of avoided cost in that the fundamentals of supply and demand do not magically change between Montana and South Dakota. In addition, the fact that one utility is in the process of moving towards vertical integration and another is already fully integrated is simply irrelevant to a calculation of avoided cost. The methodology is the same. Finally, NWE misrepresents the status of the law in Montana. It will not be fined if the renewable resources it is forced to purchase are more expensive than alternative resources in the same state.

3. NWE Has No Basis for Striking Mr. Lauckhart's Testimony on Relevance Grounds

(a) *Mr. Lauckhart's Testimony on page 2, line 13, through p. 3, Line 6.*

Having established that what NWE has stated about the difference between the two systems is largely false, irrelevant or misleading, the question remains, what does NWE find so troubling about Mr. Lauckhart's testimony? What is important to remember is that Mr. Lauckhart used the testimony of NWE's own witnesses before the MPSC to create his prefiled rebuttal testimony. What Mr. Lauckhart said was:

> Further, I have observed that when NorthWestern wants the Montana Public Service Commission (MPSC) to approve a wind project that NorthWestern will own in Montana, NorthWestern is very positive about wind. However,

> when NorthWestern does not want to be required to purchase the output of a wind project in South Dakota from an independent party seeking to sell its output pursuant to the Public Utility Regulatory Policies Act of 1978 (PURPA), NorthWestern is very negative about the prospects of acquiring wind generation to serve its customers. The contrast in NorthWestern's views on wind in the two proceedings is very enlightening. In summary, my testimony will demonstrate that the Oak Tree wind project in South Dakota would be every bit as good for South Dakota ratepayers, if not better than, the Spion Kop wind project that NorthWestern proposes to own will be to Montana ratepayers.
>
> While NorthWestern testifies in this proceeding in South Dakota that the avoided cost of a wind plant would appear to be about $35.85/MWh, NorthWestern has simultaneously testified before the Montana PSC that the value of a wind plant in Montana is $75.52/MWh. There is no legitimate reason for such a large difference in the value of wind between South Dakota and Montana. It is further noteworthy that the MPSC ruled in October 2011 that an appropriate avoided cost to pay a wind plant would be $57.87/MWh when the wind plant gets to keep the Renewable Energy Credit (REC). *See Docket No. EL11-006 Rebuttal Testimony of J. Richard Lauckhart Page 3 of 25* Final Order 7108e, Docket D2010.7.77, at p. 26 (October 19, 2011) (attached hereto as "Exhibit 1"). The MPSC determined avoided cost rate for wind would be consistent with the price that Oak Tree has provided in its February 25, 2011 LEO/PPA. The MPSC's rate determination is particularly noteworthy because the MPSC was using new gas prices that were only known after February 25, 2011, thus incorporating new information regarding natural gas prices, which have fallen in the past year.

Prefiled rebuttal testimony of J. Richard Lauckhart, at p. 2, lines 13, through p. 3, line 6.

Mr. Lauckhart's testimony was merely pointing out there is no rational justification for the differences between NWE's testimony in the two proceedings other than that NWE wanted to own Spion Kop and it did not want to buy output from Oak Tree. Also, Mr. Lauckhart pointed out that the main cost drivers in the avoided cost forecast in both proceedings has been NWE's testimony regarding the future price of natural gas. Before the MPSC, NWE utilized a different gas price methodology and a different witness, Mr. Guldseth, than NWE has utilized in this proceeding. Mr. Lauckhart's opinion is that this difference is entirely due to the fact NWE wanted a different result in Montana than in South Dakota.

Oak Tree understands that NWE disagrees with Mr. Lauckhart, but the purpose of evidentiary hearings is to resolve just such disagreements. The PUC should not be deprived

of weighing Oak Tree's testimony on this important fact issue. If Oak Tree is right and NWE manipulated its forecast to achieve a particular result, it would mean that NWE's witnesses are unreliable and its forecast therefore unreliable. This is directly relevant and even compelling evidence.

(b) *Mr. Lauckhart's Testimony on Page 6, Line 4, Through P. 11, Line 14.*

NWE objects to Mr. Lauckhart's testimony commencing on page 6, line 4, and continuing through page 11, line 14. What did Mr. Lauckhart say that NWE found so irrelevant?

First, Mr. Lauckhart points out in this testimony that the price risk to NWE ratepayers in South Dakota is lower than the price risk to a project that NWE owns. Mr. Lauckhart's testimony is undoubtedly correct: regardless of where a wind generation facility is located, if a utility owns it and it is put into rate base and the project underperforms, the utility can and often does seek additional revenue through a rate filing to ensure the project can continue to meet its debt service and other obligations. A wind generator that sells pursuant to a contract must limit itself to the revenue generated pursuant to the contract and has no recourse to ratepayers if there is underperformance. Mr. Lauckhart testified that the MPSC recognized this fundamental utility ratemaking issue which is true regardless of the state where the project is located.

Second, Mr. Lauckhart points out that the Montana RPS requirements are essentially the same as those in South Dakota. In both states, the utility cannot be forced to acquire renewable resources that are more expensive than the alternatives. Then Mr. Lauckhart testified that NWE made that demonstration in the Spion Kop proceeding relying on the testimony of NWE witnesses Mr. Hines and Mr. Guldseth that the Spion Kop project at $68.77 per megawatt hour (MWH) for 20 years was less than the "market sensitivity scenario" (electric price forecast) plus renewable energy credit price of $75.72 over the same period. As noted above, the methodology of preparing an electric price forecast (or an avoided cost forecast) does not vary by state. An electric price forecast in Montana may produce a different result from one prepared for South Dakota, but Mr. Lauckhart has assiduously accounted for each of these changes.

Third, Mr. Lauckhart testifies regarding Mr. LaFave's cost of market power calculations in this proceeding which is less than half of the market power cost that NWE

testified to in the Spion Kop proceeding. Taking into account all the factors identified by NWE in its motion to exclude his testimony, Mr. Lauckhart nonetheless concludes there is no reasonable explanation for this extremely large difference in electric price forecasts. He further concludes that in both Montana and South Dakota, natural gas fired generation is on the margin. Mr. Lauckhart also states that in both Montana and South Dakota natural gas prices are reasonably located at the AECO virtual trading hub. However, Mr. Lauckhart concludes that Mr. Lewis's electric price forecast is unreasonably low because he has not prepared a reasonable estimate of natural gas prices. This lack of a reasonable estimate does not depend in any way on whether the forecast is for Montana or South Dakota.

Fourth, Mr. Lauckhart questions in some detail the methods and analyses performed by Mr. Lewis and concludes that, based on what NWE said in Montana, NWE is attempting to manipulate its electric price forecast in this proceeding. For example, Mr. Lewis utilized a method that the Montana PSC did not approve in Docket D2010.7.77. Mr. Lauckhart noted that NWE itself did not use this methodology or Mr. Lewis as its witness when it wanted to justify a higher 20-year term electric price forecast for its own project, Spion Kop. As stated previously, the differences between Montana and South Dakota, whether it be physical constraints, market structure, or methodologies, do not account for NWE's use of a different, and self-serving price forecast by Mr. Lewis in this proceeding.

There is another reason that Mr. Lauckhart's criticism of Mr. Lewis, Mr. LaFave, and the other NWE witnesses' utilization of a flawed, self-serving methodology in this proceeding is relevant to the PUC's inquiry. "[W]hile inquiry into an expert's alleged mistakes or connection to unrelated adverse claims do not impact on his credibility or character for truthfulness, *evidence contrary to the representation of the witness's expertise in the field for which he offers his opinion at bar is relevant to his competency, does impact credibility and therefore is appropriate inquiry.*" *Mousse au v. Schwartz*, 756 N.W.2d 345, 361 (S.D. 2008)(emphasis added). In this case, Mr. LaFave's and Mr. Lewis's self-serving testimony is not credible and therefore subject to challenge on that basis. If taking one position in a different state's proceeding, and then taking another diametrically opposite position in this proceeding is not cause to question a witnesses' credibility, what would be a proper basis for questioning these witnesses' statements before the PUC?

(c) *Mr. Lauckhart's Testimony on P. 23, lines 21-24.*[1]

NWE apparently feels this passage is irrelevant, but does not explain how the following passage is not relevant to a proper calculation of avoided costs for a wind generator in South Dakota:

> *Q. Is there somewhere else the SDPUC could look to see what an appropriate avoided cost* 18 *for a wind plant might be as of the year 2011?*
>
> A. Yes. The Montana PSC conducted several hearings on this matter and concluded that the avoided cost for a wind plant as of August 2011 would be $57.87/MWh if the wind plant retained the REC. While I believe that this price would have been higher if it would have been done before Feb 25, 2011, I think that would be a fair outcome in this case. Then the SDPUC could use Northwestern's estimate of $7.48/MWh as the levelized value of the REC. Those two numbers would create an avoided cost consistent with the price provided in the Oak Tree February 25, 2011 LEO/PPA.

There is no question Mr. Lauckhart's testimony regarding the proper method and sources of information by which the PUC might calculate avoided costs in this proceeding is directly relevant. There is no basis on the grounds of relevance for excluding Mr. Lauckhart's testimony.

(d) *Mr. Lauckhart's testimony on page 25, lines 9-14.*[2]

The subject matter of this portion of Mr. Lauckhart's testimony deals with NWE's decision to treat its own project far differently in calculating avoided costs with respect to the issue of C02 emissions:

> *Q. Do you have comments on the testimony regarding CO2 emissions pricing?*
>
> A. Yes. I agree with Mr. Rounds that forecasting the price of CO2 is very difficult. However, as NorthWestern has pointed out in its testimony in Montana in the Spion Kop proceeding, it would be prudent for a regulator to factor in a risk of EPA regulating greenhouse gases when considering whether acquisition of wind resource is appropriate or not. NorthWestern did include that in its analysis of the cost effectiveness of the Spion Kop project in Montana. It inappropriately chose not to do so here.

Note that NWE has no explanation for why and how C02 emissions are a matter of

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[1] NWE cites page 25, lines 25-28, but Oak Tree believes this is the passage to which NWE takes umbrage.

[2] NWE cites page 27, lines 14-18, but there is no page 27 to Mr. Lauckhart's rebuttal. However, Oak Tree believes this is the proper passage.

state law or unique to Montana but not South Dakota. The answer is that they are plainly not dependent on the unique characteristics of a particular state, but rather decisions based on national policy, in particular, policy by the Federal Environmental Protection Agency. For NWE to argue that the issue of C02 emissions is somehow irrelevant to a determination of a proper avoided cost is specious. NWE made a deliberate policy choice to take the risk of greenhouse gas regulation in the future into account in Montana when valuing Spion Kop, but not in South Dakota when it wishes to drive down the price to be paid to Oak Tree.

(e) *The attachments to Mr. Lauckhart's testimony.*

Amazingly, NWE attempts to exclude the testimony from two MPSC dockets, D2011.5.41 (Spion Kop) and D2010.7.77 (avoided cost), as well as NWE's own testimony submitted in the Spion Kop proceeding by NWE witness Todd Guldseth. Mr. Guldseth's testimony constitutes an admission by NWE. There is no doubting its reliability or otherwise, presumably, NWE would not have submitted it to the MPSC. However, now that it is damaging to NWE, NWE wishes it to be excluded.

B. The Testimony of Michael Makens

NWE's motion requests that portions of Michael Makens's testimony be excluded as irrelevant or inadmissible. The testimony to which NWE refers, however, *is* relevant, *is* admissible, and *is* necessary for the PUC to rule in this matter.

1. The Testimony of Mr. Makens is in Response to NWE Testimony

In his prefiled direct and rebuttal testimony, NWE witness, Mr. Bleau LaFave, outlines his perception of the negotiation process between Oak Tree and NWE. *Testimony of Bleau LaFave*, p. 6, line 10 through p. 8, line 28. Mr. Makens, as a co-owner of Oak Tree, provided his testimony to address the implication made by NWE that Oak Tree did not provide NWE with an opportunity to negotiate in good faith, which is absurd.

NWE opens the door to testimony regarding the negotiation process. Mr. LaFave spends a good portion of his testimony summarizing the communications between Oak Tree and NWE as well as Mr. LaFave's opinion as to how this process relates to other negotiations. However, when Mr. Makens relays his view of the negotiation process, NWE would have the testimony excluded. NWE cannot exclude this testimony simply because it dislikes the content. Ultimately, the PUC will have to consider the credibility of each of these witnesses

and weigh the testimony accordingly.

Mr. Makens's perception as to the tenor of the negotiations is also relevant to this matter. NWE requests that references as to how Mr. Makens interpreted NWE's responses be excluded, however, these interpretations are directly relevant to these proceedings. One of the key issues is the creation of an LEO; and if an LEO exists, when it was created. Mr. Makens's testimony as to his interpretation of the negotiation process is directly relevant to the creation of the LEO and should be heard by the PUC.

Mr. Makens testimony as to the negotiation process is also relevant to the third issue before the PUC. The PUC will have to consider whether the requirements of PURPA are being met in this matter. To adequately consider this issue, the PUC must have access to both parties' perspectives regarding the negotiation process. Furthermore, if NWE failed to fulfill its obligations under PURPA or the SDPUC PURPA order, Oak Tree may be entitled to additional relief.

2. Imbalance in Bargaining Power is Relevant

Bargaining power can be defined as, "In negotiating, capacity of one party to dominate the other due to its influence, power, size, or status, or through a combination of different persuasion tactics."[3] Mr. Makens's testimony regarding the litigation process is indicative of the imbalance in bargaining power that exists between NWE and Oak Tree. Any reference that Mr. Makens makes regarding litigation in his testimony is not for the purpose of determining who has more money. Rather, Mr. Makens is simply stating that the resources available to NWE exceed the resources available to Oak Tree; therefore, negotiation would be preferred to litigation. In other words, contrary to Mr. LaFave's interpretation, Oak Tree has a strong incentive to negotiate because Oak Tree has no rate payers to which it can look for recovery of litigation costs.

Mr. Makens's testimony illustrates the attempt by NWE to dominate the process. FERC is keenly aware that an imbalance in bargaining power may exist as it relates to Qualifying Facilities (QF) like Oak Tree and public utilities like NWE. Under PURPA, FERC has attempted to level the playing field by not allowing a utility to simply refuse to negotiate with a QF. 18 C.F.R. § 292.304. Rather, the QF has the ability to create a LEO to

[3] BusinessDictionary.com, Bargaining Power, http://www.businessdictionary.com/definition/bargaining-power.html (last visited March 6, 2012).

sell its output to a public utility, which is what Oak Tree did and what Mr. Makens's testimony shows.

FERC decisions have also stated that refusal by a recalcitrant utility to execute a contract is a basis for creating a LEO. *Cedar Creek Wind LLC*, 129 FERC ¶ 161, 148 (Nov. 19, 2009) ¶ 32, pp. 13-14. Once it was evident to Oak Tree that NWE was not going to participate in negotiating a Purchase Power Agreement, regardless of their obligation under PURPA, Oak Tree had a right to an LEO. A fact integral to this proceeding is when a LEO was created. Mr. Makens's testimony is, therefore, relevant and admissible as it is necessary to determine when the LEO was created.

The requirements under PURPA are designed to ensure that an imbalance in bargaining power does not cause rate payers to be unduly harmed. If a public utility, such as NWE, is allowed to exert their market dominance by refusing to negotiate with QF's, NWE's rate payers will pay the price. Mr. Makens's testimony illustrates the potential for such a situation to exist. Consequently, the testimony provided by Mr. Makens is relevant to this proceeding and, therefore, admissible.

3. Realities of Litigation Are Relevant

NWE seeks to exclude all references to the costs of litigation and litigation as a 'last resort' because they are not relevant – to the contrary, the realities of litigation are relevant. First, NWE cites SDCL § 19-14-2 requiring Mr. Makens to have personal knowledge regarding the subject of his testimony. Mr. Makens has personal knowledge as to the costs of litigation as he is incurring the costs of this litigation. Furthermore, Mr. Makens is also aware of NWE's ability to pass any expenses that NWE incurs on to its ratepayers. Again, Mr. Makens makes no reference as to NWE's actual litigation costs, rather he references the ability of each party to recover costs, which may factor into the weight the PUC gives to each witnesses' testimony.

Second, NWE claims that the references to litigation are inadmissible because they are "more prejudicial than probative." *Brief in Support of NorthWestern Energy's Pre-Hearing Motions*, p. 4. At the outset, NWE misstates the standard in South Dakota under SDCL § 19-12-3. The rule states, in part, that "evidence may be excluded if its probative value is substantially outweighed by the danger of unfair prejudice." SDCL § 19-12-3 (emphasis added). Evidence is not prejudicial merely because its legitimate probative force damages the

defendant's case. *Novak v. McEldowney*, 2002 S.D. 162, 655 N.W.2d 909. Rather, the evidence must result in an unfair advantage caused by the ability to persuade by an illegitimate means. *Time Out, Inc. v. Karras,* 469 N.W.2d 380 (1991). This is not the case here.

Mr. Makens's testimony regarding litigation is relevant and should be considered by the PUC. It is not required that the evidence be able to convince the trier of fact by any significant degree. *Supreme Pork, Inc. v. Master Blaster, Inc.,* 2009 S.D. 20, 764 N.W.2d 474. It is only necessary that the information make a fact the least bit more or less probable. *State v. Bowker*, 2008 S.D. 61, 754 N.W.2d 56. Thus, Mr. Makens's views as to the process and costs of litigation *are* relevant to determining the existence and creation of a LEO.

4. Oak Tree Has the Ultimate Burden of Proof

In a proceeding before the PUC, the party bringing the action has the burden of proof. ARSD 20:10:01:15.01. In this matter, Oak Tree has the burden of proof. The evidence that Oak Tree has presented, in the form of testimony of one of its owners, is offered to meet that burden. Mr. Makens's testimony as it relates to the negotiation process and the litigation process are relevant to this proceeding, regardless of their effect on NWE's case. Therefore, Mr. Makens's testimony should be admitted in its entirety.

Ultimately, it is the decision of the PUC to determine whether Oak Tree has met its burden. Mr. Makens's testimony does not have to convince the PUC of any particular issue to a significant degree; rather, his testimony must only assist in making any fact the least bit more or less probable. *Supreme Pork, Inc.*, 2009 S.D. 20, 764 N.W.2d 474; *State v. Bowker*, 2008 S.D. 61, 754 N.W.2d 56. Mr. Makens's testimony, especially the testimony NWE wishes to exclude, is relevant to more than one issue in this case. Thus, it is imperative that Mr. Makens's testimony be admitted in its entirety.

C. The Testimony of Thomas Anson

NWE plainly does not wish for the South Dakota PUC to hear the testimony of Oak Tree's expert Thomas P. Anson. Mr. Anson is a national expert on FERC policy regarding the creation, timing and enforcement of LEOs. Recall that one of the three issues that the PUC has identified for hearing is:

> Whether Oak Tree is currently bound by a legally enforceable obligation, and if so, when that legally enforceable obligation commenced and what impact

that has on the avoided cost calculation.

With respect to the testimony of Oak Tree witness Thomas Anson, NWE offers a number of arguments, all of which fall short of being a reason to exclude the testimony. First, NWE argues that Oak Tree should have included this testimony in its direct prefiled testimony. Although Oak Tree may have had some conception that NWE would argue the LEO issue, Oak Tree did not know that NWE intended to offer Mr. LaFave as an expert on the LEO issue. Nor did Oak Tree know that NWE intended to argue against Oak Tree's statement that it incurred an LEO until it saw Mr. LaFave's testimony. Oak Tree also did not know that NWE would attempt to claim (without any basis) that an LEO requires a QF to submit all sorts of information to a utility before an LEO can be created. Mr. Anson's testimony effectively rebuts NWE's argument that an LEO requires anything other than a commitment to sell by Oak Tree to NWE.

Even assuming that Oak Tree could have put Mr. Anson's testimony in its case in chief this fact would not render it improper rebuttal. For example, in *Everett v. Parks and Associates, Inc.*, 697 F.2d 250, 252 (5th Cir. 1983), plaintiff introduced evidence of an oral agreement regarding commissions. The defendant then introduced evidence that auditors had to sign a written contract to get the commission. The district court thereafter permitted the plaintiff to offer rebuttal evidence that the defendant had paid other auditors the commission without signing a writing. The Fifth Circuit upheld the district court's decision stating:

> Evidence that other auditors had been paid commission rates of fifty percent without written contracts was not truly relevant until Parks presented its defense. See *Weiss v. Chrysler Motors Corp.*, 515 F.2d 449, 457–59 (2d Cir.1975), citing 6 Wigmore, Evidence § 1873, at 517 (3d ed. 1940) ("[F]or matters properly not evidential until the rebuttal, the proponent has a right to put them in at that time .... Matters of true rebuttal could not have been put in before ....") (emphasis omitted). Even assuming that evidence that Parks had paid other auditors a fifty percent commission rate without written contracts would have been more appropriate as part of the case-in-chief, that fact "does not preclude the testimony if it is proper both in the case-in-chief and in the rebuttal." *United States v. Luschen,* 614 F.2d 1164, 1170 (8th Cir.), *cert. denied*, 446 U.S. 939, 100 S.Ct. 2161, 64 L.Ed.2d 793 (1980); see, e.g., *Smith v. Conley,* 584 F.2d 844, 846 (8th Cir.1978); see also Fed.R.Evid. 611.

Id.

Here, Oak Tree did not even know for certain that NWE would attempt to refute Oak Tree's position on the LEO issue. It certainly did not know that NWE would attempt to offer Mr. LaFave as a legal expert on the creation of LEOs. Thus, Mr. Anson's rebuttal on this score did not become really relevant until Oak Tree saw Mr. LaFave's testimony. Finally, even if Mr. Anson's testimony could have been part of Oak Tree's direct testimony, it was not improper to include Mr. Anson's testimony in Oak Tree's rebuttal.[4]

Second, NWE objects stating that Oak Tree is attempting to offer a legal opinion through Mr. Anson. Oak Tree notes that Mr. Anson's testimony is in rebuttal to Mr. LaFave's testimony which offers any number of opinions, many of them potentially legal in nature, regarding the creation of an LEO for the Oak Tree project. Mr. Anson's testimony simply refutes Mr. LaFave and recites FERC policy rather than offering a legal opinion in response. Oak Tree was very careful not to have Mr. Anson offer any legal opinions, but rather a recitation of the facts regarding FERC's current policy regarding LEOs. Mr. Anson offers no legal opinion on whether the Oak Tree project properly created an LEO (as does Mr. LaFave), and Mr. Anson does not opine on South Dakota or any other state law.

Even if Mr. Anson's testimony was legal opinion (and it is not), Mr. Anson's testimony does not invade the province of the PUC as an expert on the law. Typically, "expert testimony on legal matters is not admissible." *Southern Pine Helicopters, Inc. v. Phoenix Aviation Managers, Inc.,* 320 F.3d 838, 841 (8th Cir.2003). This is because opinion testimony that is couched as a legal conclusion or that merely tells the fact finder what result to reach is not helpful to the finder of fact. *Hogan v. American Tel. & Tel. Co.*, 812 F.2d 409, 411 (8th Cir.1987); see also *Farmland Indus. v. Frazier-Parrott Commodities, Inc.,* 871 F.2d 1402, 1409 (8th Cir.1989) ("The special legal knowledge of the judge makes the witness' testimony superfluous."). "Matters of law are for the trial judge, and it is the judge's job to instruct the jury on them." *Southern Pine*, 320 F.3d at 841.

Here, the PUC is not a jury but rather a policy-making body. It is also not a body of legal experts. However, even if it were, legal expert testimony is admissible, even in court, regarding technical matters such as rate case issues: "[c]ourts have frequently recognized the value of expert testimony defining terms of a *technical nature and testifying as to whether*

[4] NWE's argument that it would be "unfair" to permit Mr. Anson to testify is without merit. There is no such legal standard, and Mr. Anson's testimony is proper to rebut Mr. LaFave's testimony.

such terms have acquired a well-recognized meaning in the business or industry." *Nucor Corp. v. Nebraska Pub. Power Dist., 891 F.2d 1343, 1350 (8th Cir.1989)*(emphasis added); see also *Southern Pine, 320 F.3d at 841* (explaining that "industry practice or standards may often be relevant ... and expert or fact testimony on what these are is often admissible"). In *Nucor,* the Eighth Circuit found that the district court did not err in admitting expert testimony regarding the meaning of terms of art such as "fair," "reasonable," and "non-discriminatory," in a case alleging that the power company's rates were unfair, unreasonable and discriminatory, and on whether the power company's ratemaking methods were used elsewhere in the industry. *Nucor,* 891 F.2d at 1350.

In this proceeding, Mr. Anson's testimony, even if it is legal opinion (and it is not) would be admissible under the ruling of *Nucor.* Just as the expert in *Nucor* was allowed to testify before a judge regarding utility industry-specific terms to clarify the meaning and use of those terms and how those terms were used elsewhere in the electric industry, Mr. Anson's testimony is describing the specific meaning of the phrase "legally enforceable obligation" in the context of PURPA and how FERC has interpreted that term.

Regardless of how NWE chooses to characterize Mr. Anson's testimony it is undoubtedly admissible. Mr. Anson's testimony is factual testimony regarding FERC policy brought before the PUC, a state regulatory commission charged with implementing FERC's policy rules. However, even were Mr. Anson's testimony thought to be proffering legal opinions, Mr. Anson's testimony is nonetheless admissible as it does not opine on the ultimate issue in the case (i.e., did Oak Tree create an LEO), and it does not invade the province of a body that is primarily an expert on the law, namely the PUC. Finally, even if Mr. Anson's testimony were not ordinarily admissible as legal opinion, it falls neatly into a well-recognized exception on the proscription of the introduction of expert legal opinion when the testimony is proffered to explain unique terms and how they are utilized in the electric industry.

NWE also states that it agrees with PUC Staff Analyst Mr. Rounds that the policy issue of when and how an LEO is created in South Dakota should await a rulemaking process whereby all interested stakeholders can participate. Oak Tree does not object to the South Dakota PUC undertaking a rulemaking or other procedure to establish such rules in South Dakota, but Oak Tree also notes that it believes it has a right to a contract and NWE has no

reasonable basis for resisting. Whatever happens, Oak Tree has a right to determination that a LEO existed as of February 25, 2011, and should not have to wait resolution of some other proceeding. Additionally, the PUC should be aware that any further delay substantially jeopardizes Oak Tree's ability to obtain production tax credits (PTCs). Potential loss of these PTCs would result in a higher rate for South Dakota's ratepayers, and thus time is of the essence.

III. CONCLUSION

For the reasons set forth herein, Oak Tree Energy respectfully requests that NWE's motions to exclude the testimony of Oak Tree witnesses Richard Lauckhart, Michael Makens, and Thomas Anson be denied.

Respectfully submitted this 8th day of March, 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 8th day of March, 2012, upon the following:

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