

BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF SOUTH DAKOTA

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In the Matter of the Complaint by  
Oak Tree Energy LLC against  
NorthWestern Energy for refusing to enter  
into a Purchase Power Agreement

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EL 11-006

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**NorthWestern Energy's  
Post-Hearing Response Brief  
for Supplemental Hearing**

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Timothy P. Olson  
NorthWestern Energy  
3010 West 69<sup>th</sup> Street  
Sioux Falls, SD 57108  
(605) 978-2924  
Tim.Olson@northwestern.com

and

Al Brogan (admitted *pro hac vice*)  
NorthWestern Energy  
208 N. Montana Avenue, Suite 205  
Helena, MT 59601  
Phone: (406) 443-8903  
Al.Brogan@northwestern.com

*Attorneys for NorthWestern Corporation  
d/b/a NorthWestern Energy*

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## Introduction

This proceeding requires the South Dakota Public Utilities Commission to more fully examine its implementation of the Public Utility Regulatory Policies Act of 1978 (“PURPA”). The Commission has held two evidentiary hearings and multiple other hearings in this docket. Near the end of the second evidentiary hearing, Mr. John Smith stated, “The only issue, I guess, for me [is] . . . the extent to which the flexible if you want to call it that or [annualized] type values are compatible with the PURPA.” (Transcript of Proceedings 368:10–15, Dec. 5 & 6, 2012.) Shortly thereafter, Mr. Greg Rislov stated, “I would like to see the parties put together [an] exhibit that synthesizes . . . their avoided cost numbers and the elements of that avoided cost.” (Tr. 372:22–373:1.) The Commissioners generally indicated that they would prefer short or no briefs.<sup>1</sup>

In light to the Commissioners’ indications, NorthWestern responds:

- (1) that PURPA permits the Commission to predetermine rates for energy and capacity that vary by time so long as such rates are based on an estimate of avoided costs calculated at the time a legally enforceable obligation is created or at the time that energy and capacity are provided and does not require that that rates be levelized for the term of the obligation;
- (2) that PURPA does not require that the amount of capacity for which a QF will be paid be fixed at the time a rate is established; and
- (3) after the December hearing, the parties’ positions on the proper avoided cost rates for energy and capacity range from NorthWestern’s \$37.99/MWh for energy plus \$56.56/kW-year for capacity to Oak Tree’s \$69.30/MWh including capacity.

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<sup>1</sup> “I think what I’m hearing is that briefs will be in order, but we do not need a rehashing of this entire case. It needs to focus [on] the question[s] that Mr. Smith threw out. . . . And [Mr. Rislov’s question].” (Chairman Nelson, Tr. 374:23–375:11.) “And . . . if someone wants to put up a simple matrix or where . . . all three parties are at this juncture, that’s fine with me. I don’t need anything more than that.” (Commissioner Hanson, Tr. 374:15–21.)

The details of these amounts, along with Staff's estimate, are shown and discussed in Section III below.

## **Argument**

PURPA requires public utilities to purchase energy and capacity from QFs at utilities' full incremental avoided cost. Section 210 of PURPA requires state regulatory agencies to implement the rules that FERC adopted. 16 U.S.C. § 824a-3(f) (2006 & Supp. IV 2011). FERC gives great latitude to state commissions as to the procedures selected to determine avoided costs. *In re Southern California Edison Co.*, 70 FERC ¶ 61,215, at 61,677 (Feb. 23, 1995). Determination of avoided cost is fact specific. *See, e.g., Re Cal. Pub. Util. Comm'n*, 134 FERC ¶ 61,044, at 61,162 (Jan. 20, 2011). If this Commission's determination of avoided cost rate does not clearly violate FERC's rules, it is valid. The language of FERC's rules determines if there is a violation.

### **I. The Commission may set avoided cost rates that vary by year.**

Both NorthWestern and Oak Tree have proposed levelized rates for 20 years. Staff has proposed rates that vary annually to reduce the risk to South Dakotans. Oak Tree asserts that predetermined annually variable rates are not permitted by PURPA. Oak Tree is wrong.

18 C.F.R. § 292.304(d) (2012) provides:

- (d) Purchases "as available" or pursuant to a legally enforceable obligation. Each qualifying facility shall have the option either:
  - (1) To provide energy as the qualifying facility determines such energy to be available for such purchases, in which case the rates for such purchases

shall be based on the purchasing utility's avoided costs calculated at the time of delivery; or

- (2) To provide energy or capacity pursuant to a legally enforceable obligation for the delivery of energy or capacity over a specified term, in which case the rates for such purchases shall, at the option of the qualifying facility exercised prior to the beginning of the specified term, be based on either:
  - (i) The avoided costs calculated at the time of delivery; or
  - (ii) The avoided costs calculated at the time the obligation is incurred.

For purposes of this proceeding, this rule merely imposes a requirement *rates* be based on avoided costs calculated at the time a legally obligation was incurred. This rule does not require that rates be levelized, only that they be fixed and known. A fixed price is one that is predetermined. *Black's Law Dictionary* 638 (6<sup>th</sup> ed. 1990).

Hypothetically, there is no question that a rate of \$45.00/MWh for the life of an obligation meets the rule's requirement if it is based on the calculation of avoided costs at the outset. Similarly, there is no question that a rate that begins at \$25.00/MWh and escalates at 2% per year meets the rule's requirement if it is based on the calculation of avoided costs at the outset. Likewise, rates that vary with time but are predetermined and based on the calculation of avoided costs at the outset, are fixed and meet the rule's requirement.<sup>2</sup>

The table below illustrates hypothetical rate structures that meet the requirement of predetermination:

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<sup>2</sup> In fact, even rates that are even less known meet the rule's requirement if they are predictable and ascertainable because they are calculated by reference to a formula, the inputs to which, such as incremental cost of capital or the Handy Whitman Index of Public Utility Construction Costs, can be ascertained.

Description	Acceptable			
	Level Price	Constant Escalating	Constant Declining	Predetermined Variable
Year 1	\$36/MWh	\$30/MWh	\$40/MWh	\$25/MWh
Year 2	\$36/MWh	\$33/MWh	\$36/MWh	\$35/MWh
Year 3	\$36/MWh	\$36/MWh	\$32/MWh	\$40/MWh
Year 4	\$36/MWh	\$40/MWh	\$29/MWh	\$50/MWh
Year 5	\$36/MWh	\$44/MWh	\$26/MWh	\$52/MWh

Any of these rates, if based on the calculation of a utility's avoided cost at the time a QF enters into a legally enforceable obligation, is fixed and is permissible under 18 C.F.R. § 292.304.

In the oft-cited Order 69, FERC implicitly recognized that rates may vary over time.

FERC stated:

A facility which enters into a long term contract to provide energy or capacity to a utility may wish to receive a greater percentage of the total purchase price during the beginning of the obligation. For example, a level payment schedule from the utility may be used to match more closely the schedule of debt service of the facility. So long as the total payment over the duration of the contract term does not exceed the estimated avoided costs, nothing in these rules would prohibit a State regulatory authority from approving such an arrangement.

*Small Power Production & Cogeneration Facilities; Regulations Implementing Section 210 of the Public Utility Regulatory Policies Act of 1978*, 45 FED. REG. 12,214, at 12,224 (Feb. 25, 1980) (“Order 69”). If the rules required a levelized price, then FERC would not have said, or needed to say, that a levelized price was permitted.

Oak Tree mistakenly argues that a fixed contract price is a level price. Neither the language of the rule, the black-letter legal meaning of “fixed price,” nor any specific holding

of FERC or a court that NorthWestern could discover supports Oak Tree's erroneous interpretation that "fixed price" means "level price."

The Commission may, pursuant to FERC's rules, set rates that vary according to year so long as the rates are predetermined and based on the calculation of NorthWestern's avoided cost as of February 25, 2011.

**II. The Commission may require an annual calculation of the amount of capacity provided by Oak Tree.**

FERC stated:

If a qualifying facility offers energy of sufficient reliability and with sufficient legally enforceable guarantees of deliverability to permit the purchasing electric utility to avoid the need to construct a generating plant, to build a smaller, less expensive plant, *or to reduce firm power purchases from another utility*, then rates for such purchase will be based on the avoided capacity and energy costs.

Order 69 at 12,216 (emphasis added). The same rule as quoted above, 18 C.F.R. § 292.304, governs the payment for capacity. Just as explained above, FERC rules require that the rate paid for capacity be predetermined, not that it be leveled. More importantly, nothing in the FERC rules speaks to the amount of capacity or the payment for capacity.

Oak Tree correctly asserts that "FERC's PURPA regulations treat the calculation of forecast avoided capacity and energy costs identically." (Oak Tree's 2d Post Hr'g Opening Br. at 10.) However, Oak Tree inexplicably and wrongly equates avoided cost rates for capacity with avoided cost payment. The amount paid is the product of the rate times the quantity provided. Just as it would be unreasonable to assert that a QF should be paid a fixed payment for its variable energy output, it is unreasonable to assert that a QF should

be paid a fixed payment for its variable capacity contribution. Nothing in FERC’s rules requires that a QF receive a levelized payment for a variable capacity contribution.

Only recently have intermittent wind resources been deemed to provide “energy of sufficient reliability and with sufficient legally enforceable guarantees of deliverability” to be entitled to any capacity payment. In recognizing that wind resources provide capacity, the industry, including planning organizations, enforcement entities, and public utilities, has recognized that the capacity contribution of any given wind plant is variable.

The Commission must predetermine the rate that Oak Tree will be paid for capacity. But, the Commission may, and should, require that the payment to Oak Tree for capacity be calculated annually based on the capacity that Oak Tree actually provides.

### **III. The parties disagree on the level of NorthWestern’s avoided costs.**

Mr. Rislov stated that he would like to see some sort of synthesis of where the parties are on calculation of avoided cost after the December hearing. To the best of NorthWestern’s knowledge, the table below synthesizes the final recommendations of the parties.

Avoided Cost	NorthWestern Energy	Oak Tree Energy	SD PUC Staff
Energy Cost	\$37.99/MWh Levelized	\$69.30/MWh Levelized - Includes Capacity and Renewable Energy Credit Value	2013 - \$33.58/MWh 2014 - \$34.44/MWh 2015 - \$35.45/MWh 2016 - \$36.69/MWh 2017 - \$38.17/MWh 2018 - \$40.01/MWh 2019 - \$41.46/MWh 2020 - \$43.17/MWh 2021 - \$44.55/MWh 2022 - \$45.87/MWh 2023 - \$47.28/MWh



Avoided Cost	NorthWestern Energy	Oak Tree Energy	SD PUC Staff
			2024 - \$48.56/MWh 2025 - \$49.81/MWh 2026 - \$51.09/MWh 2027 - \$52.23/MWh 2028 - \$53.53/MWh 2029 - \$54.91/MWh 2030 - \$56.24/MWh 2031 - \$57.77/MWh 2032 - \$59.72/MWh 2033 - \$60.05/MWh  Capacity included
<b>Capacity Cost</b>	\$56.56/kW-year Levelized	Included in Energy Cost Generally appears to be \$7.30/MWh	Included in Energy Cost Ranges from \$20.00/kW-year to \$35.29/kW-year

NorthWestern continues to believe that its forecast is the appropriate forecast for both energy and capacity. However, NorthWestern reiterates its position that a capacity payment should not be converted to and included in a per-MWh rate. Such a conversion and inclusion would establish a fixed capacity contribution. The record establishes that wind generators' capacity contribution is variable.

As explained in its testimony, NorthWestern believes that Oak Tree's calculation is erroneous. NorthWestern will not repeat the testimonial arguments here. NorthWestern would like to respond to Mr. Lauckhart's claim that he and Mr. Rounds agree if some four changes are made to Mr. Rounds's calculations. (See Tr. 340:4-341:1.) None of the four changes made by Mr. Lauckhart is reasonable or justified. First, Mr. Lauckhart includes wholesale sales as part of NorthWestern's load. (Tr. 340:9-12.) NorthWestern has no obligation to serve wholesale load. There are no contracts requiring delivery on any amount of energy to wholesale customers. As NorthWestern's witnesses have explained,

NorthWestern sells excess power to the Western Area Power Administration only when it has an actual excess. NorthWestern's wholesale sales do not affect its incremental avoided cost in any way, and considering them would violate PURPA.

Second, Mr. Lauckhart assumed that Big Stone and Neal 4 "went away" at the end of 2015. (Tr. 340:14-18.) There is no rational basis for assuming that existing baseload plants will be shut down. Neither NorthWestern nor any of the co-owners of Big Stone or Neal 4 have indicated that either of these plants would be removed from service. This is simply a self-serving assertion that should be rejected.

Third, Mr. Lauckhart assumes that NorthWestern's cost of capacity is \$141/kW-year. (Tr. 340:20-21.) Mr. Lauckhart asserts this is the cost of capacity from the new Aberdeen plant. The Aberdeen plant does not represent any cost that was or would have been avoided by the purchase of capacity from Oak Tree. Purchasing from Oak Tree would not and will not (1) allow NorthWestern to avoid constructing the Aberdeen plant or (2) allow NorthWestern to build a smaller, less expensive plant. To the extent that purchasing capacity from Oak Tree allows NorthWestern to avoid any capacity costs, it is only the cost of market-purchased capacity. The only acceptable measure of such an avoided cost is an estimate of the market price for capacity.

Fourth, Mr. Lauckhart assumed that the capacity contribution from Oak Tree would be 20% of nameplate capacity. (Tr. 340:19-20.) This level is not supported by any operational history and is higher than the amount that the MISO would allow for planning purposes. The Commission should reject Mr. Lauckhart's unreasonable assumptions and changes.

NorthWestern believes that Mr. Rounds's recommendation is more reasonable, but suffers from some serious flaws. First, Mr. Rounds proposed a method that is not transparent and cannot be replicated for future QFs. Second, Mr. Rounds scaled the EIPC market price forecast up to the EIA AEO 2011 price forecast. This forecast is dramatically higher in the early years than the actual market prices at which NorthWestern could have executed transactions. Third, Mr. Rounds included capacity cost as part of a per-MWh charge. Finally, Mr. Rounds, even after he changed to the MISO West Region to shape NorthWestern's load, overstates the hours of heavy load. If Mr. Rounds's price forecast were applied to NorthWestern's actual load, the calculated avoided cost for energy would be significantly lower. NorthWestern believes that Mr. Rounds's forecast market prices applied to NorthWestern's actual load results in an estimate of its 20-year levelized energy cost equal to \$41.39/MWh.<sup>3</sup>

## **Conclusion**

For the reasons stated above, NorthWestern believes that its forecast of avoided energy and capacity costs is the most correct of the possibilities. NorthWestern respectfully requests that the Commission adopt its proposed rates for purchases from Oak Tree of both energy and capacity and adopt NorthWestern's proposed method for calculating Oak Tree's capacity contribution.

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<sup>3</sup> NorthWestern took Mr. Rounds's rates for each block and multiplied the number of hours in each block and divided the total annual cost by 8,760 hours to calculate the average rate per MW per year for each of the years. NorthWestern used these yearly averages in the NorthWestern model to calculate the estimated 20-year levelized energy cost of \$41.39/MWh.

If the Commission desires to set annual rates for purchases of energy from Oak Tree, the Commission should adopt the rates shown in Mr. LaFave's Exhibit 1 that range from \$22.34/MWh in 2012 to \$67.49/MWh in 2031.

Dated at Sioux Falls, South Dakota, this 16<sup>th</sup> day of January, 2013.

Respectfully submitted,

**NorthWestern Corporation d/b/a  
NorthWestern Energy**

/s/ Timothy P. Olson

Timothy P. Olson  
3010 West 69<sup>th</sup> Street  
Sioux Falls, SD 57108  
(605) 978-2924  
Tim.Olson@northwestern.com

and

Al Brogan (admitted *pro hac vice*)  
208 N. Montana Avenue, Suite 205  
Helena, MT 59601  
(406) 443-8903  
Al.Brogan@northwestern.com

*Attorneys for NorthWestern Corporation  
d/b/a NorthWestern Energy*