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

EL11-006

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Transcript of Proceedings
April 26, 2012

ORIGINAL

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BEFORE THE PUBLIC UTILITIES COMMISSION,
CHRIS NELSON, CHAIRMAN
KRISTIE FIEGEN, VICE CHAIRMAN
GARY HANSON, COMMISSIONER

COMMISSION STAFF
Rolayne Wiest
John Smith
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Kara Semmler
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Greg Rislov
Chris Daugaard
Patrick Steffensen
Ross Pedersen
Jon Thurber
Brittany Mehlhaff
Cindy Kemnitz
Deb Gregg
Demaris Axthelm

APPEARANCES
Michael Uda, Oak Tree
Yvette LaFrentz, Oak Tree

Al Brogan, NorthWestern Energy

Reported By Cheri McComsey Wittler, RPR, CRR

TRANSCRIPT OF PROCEEDINGS, held in the above-entitled matter, at the South Dakota State Capitol Building, Room 413, 500 East Capitol Avenue, Pierre, South Dakota, on the 26th day of April, 2012, commencing at 10:20 a.m.

CHAIRMAN NELSON: EL11-006. And so I can lay out and I think the parties are aware of the plan for the remainder of the morning, but for anybody listening, I just wanted to make it clear how we are going to proceed.

Oak Tree will have 30 minutes for your initial arguments. NorthWestern will have 30 minutes for your initial arguments. Staff will have 30 minutes for your initial arguments. NorthWestern will have 10 minutes for rebuttal, Oak Tree will have 10 minutes for rebuttal, and then Commissioner discussion and questions.

I just want to ask my fellow Commissioners, are you okay with waiting until the end to ask questions, or would you like to during the presentations?

COMMISSIONER FIEGEN: I'm fine waiting.

CHAIRMAN NELSON: Okay. We will just hold our questions until the end, and hopefully they will have all of them answered by that point.

Any questions on how we will proceed?

Okay. If not, Mr. Uda.

MR. UDA: As you may notice, I have a PowerPoint presentation because some of the things I'm going to be reading to you are in the record either in the testimony or the briefs in this case, and I wanted to have you guys be able to read along with me on that. And hopefully the technology will not fail us. Demaris has been most gracious in assisting me.

So the first thing that I want to talk about just briefly is the bigger picture and what I don't want the Commission to lose sight of in all this. And that is the Makens family.

They have expended a significant amount of resources in this effort to build their wind farm in Clark. And they're long time property owners, family in Clark for generation after generation. I can't even remember how many. But they've been here a long time. And I just want to remind you that this is something that's exceedingly important to them.

It's also important -- this proceeding is important in terms of setting policy for the State of South Dakota. I could be wrong in saying this, but I think this is the first qualifying facility of any size that has attempted to obtain a contract from a utility in South Dakota at least since the MDU proceeding a few years back, which apparently was never -- never reached a decision.

So in a way you could look at this proceeding as saying, well, we're setting a precedent here and so we have to be very cautious about the approach that we use. And I commend that.

But I also think -- and this is something that's happened before in Montana, and you don't have to view it as precedential if you don't want to, I think. I think you can say this is a decision that was based on the facts of the law that was before you and that if you want to take a broader look at these issues, I think you should do that.

I think the Staff in particular should be commended for taking that view. I think it would ease the administration of any potential future disputes. I know as a fact that there are other projects who are looking at the outcome of this proceeding to see what sort of guidance they might get from the Commission.

And so I think from that standpoint, you know, it is important to keep in mind the consequences of the Commission's decision.

I think that the real issue that really divides the parties more than anything is this whole question of the calculation of avoided cost. And I think there are a number of different issues. The way you could boil this down essentially comes down to three issues.

And the first is who do you trust? Who are the people that you think you can rely upon?

The second issue is what methodology did they use, and is it an established methodology? Is it something that's been tested and utilized before?

And I think the third question is are the results that you're going to get within a certain range of reasonableness? And by that I mean and Mr. Lauckhart testified about this at the hearing, and what said was he said, well, look. You don't base your expectations on the high case or the low case.

Yeah. You might have a forecast with a number of different results, a number of different outliers, but what you want to do is try to figure out where is that range of reasonableness.

And his point to you about the factors that NorthWestern mentioned in the Spion Kop proceeding, the nonprice factors, was these things are true no matter where you are. These things, including things like the benefits of diversification of your portfolio.

I know NorthWestern probably doesn't agree with this, but there's a substantial prospect that if the president gets reelected, there will be cap and trade legislation by 2016. If that happens, what is now presently very inexpensive coal generation will no longer be inexpensive.

Now this is in addition to the proceeding that Otter Tail has filed with you with respect to the justification for doing a retrofit on the Big Stone Plant to comply with EPA regulations with respect to coal-fired generation. And when you add up and you compound those factors you have to take a realistic view at the risks that you potentially face.

The second thing is there is a substantial likelihood if the president gets reelected, there will be a national RPS legislation. Because not everybody's moving in that same direction. It's possible it won't happen, but it's possible it is. These are the kinds of things you have to evaluate.

The other thing that will happen is even if, for example, in South Dakota there is not an effort to move away from coal-fired generation, there is going to be substantial numbers of coal plants that are retiring in the United States because of these regulations. And that will have several effects.

One is the natural gas now that is primarily used in the Eastern Interconnect to heat people's homes is going to be used to fire generation. Everybody is going to be chasing the same hydrocarbons. And as that happens, as that fuel switching takes place, supply will dry up.

The next issue that you have to face and you have to gauge the level of risk that you face is right now because of slant drilling and horizontal drilling in shale bed, companies have been able to take advantage of the sweet spot in these shale beds.

And what I mean by that, if you don't understand it, is essentially there are a number of valuable liquids that you're able to get by horizontally drilling through the shale. And those sweet spots is what everybody's hitting first. And when those sweet spots dry up, the cost of extracting natural gas through shale is going to go up because you will not have all of these other commercially beneficial liquids that you're obtaining by doing that.

The other issue that Black & Veatch tried to analyze to the best of their ability was this whole issue with fracking. Was what the cost associated with fracking? It's primarily a water pollution control issue. It's something that the industry thinks is manageable, but there will be costs associated with it.

So these are the kinds of things that you have to evaluate. And these are things that in the Spion Kop proceeding NorthWestern told the Montana Commission are benefits to having a wind generating facility in their portfolio. This is not what they've told the Commission here.

Now going back to this whole question of who do you trust, in its briefs and at hearing to a degree NorthWestern has tried to make an issue out of the fact that Mr. Lauckhart did not himself prepare the Black & Veatch Electric Market Perspective for the fall of 2010.

First of all, he did help prepare it. He is one of the experts in a team of experts from a variety of different disciplines that were collected and assembled by Black & Veatch, which is a nationally respected, well-known organization that puts together these forecasts twice a year at an enormous expense of about half a million dollars.

The reason that it was protected, that information was protected in this proceeding, is because they sell this information to people. They sell it to banks, in particular, to make investment decisions about the likely return on investment they will make if they provide debt financing to these projects.

So it's extremely important to keep in mind that this is an off-the-shelf product, but that's not a bad thing. In fact, this is not something that was prepared for this proceeding. Mr. Lauckhart used it in doing his analysis of the hourly dispatch models that were run and taking each hour for 20 years and saying what's the value of that energy likely to be?

So I don't think there's anything suspect or wrong about what Mr. Lauckhart did. In fact, I think it was a commendable thing for Oak Tree to spend that kind of money to come up with the data that they came up with for this proceeding.

I think the second thing is Mr. Lauckhart has 41 years of experience in the industry. He was at Puget Sound Power & Light in Washington for a number of years. I think NorthWestern's Reply Brief indicated Mr. Lauckhart's been mentioned in 37 different orders.

And it's true, as NorthWestern suggested, Mr. Lauckhart -- the commissions haven't always agreed with Mr. Lauckhart. But I will submit to you any time you've been in any industry for 41 years you can be sure that there are going to be people who disagree with you, including commissions.

That doesn't mean that you're not an expert, and it doesn't mean your opinions don't have value. It just means on those particular instances there were times when, you know, for whatever reason, the state agencies did not agree with Mr. Lauckhart's recommendation.

It wasn't all 37 times. I can guarantee you that. Mr. Lauckhart is widely respect in the industry, or he wouldn't be working at Black & Veatch.

I would also like to say on this issue of who do you trust, I have the greatest respect for Mr. LaFave and Mr. Green and Mr. Lewis, but they're not avoided cost experts. They may be experts in other areas within their field, but they are not avoided cost experts. They are not Electric Price Forecast experts.

I think the record shows that this is the first time any of them have testified in any proceeding on these issues. And this will become important later when we talk about the methodologies that were used.

I think the first thing I want to point out about forecasting is -- this was something that Mr. Lauckhart read into the record at the hearing. This is from the Northwest Power Planning Council. And this addresses the criticism that's -- you know, criticism is maybe overstating it. But Mr. Rounds's concern at hearing that February 25, 2011 we sent our -- or Oak Tree's legally enforceable obligation letter to NorthWestern that the actual trends hadn't been taken into account.

And Mr. Lauckhart testified that he looked at the numbers and looked at the way that they were moving but didn't think based upon this six-year period that it justified an update to the natural gas price input in that model.

And the point he made, it is often difficult to distinguish short-term variations in fuel prices, which are expected, from significant long-term changes that can be expected to fundamentally alter the whole range of future expectations. This is from the Northwest Power Planning Council. Actually it's the Northwest Power Conservation Council now. Rich, like I, grew up on cutting our teeth on the Northwest Power Act, and that's changed over time.

So, anyway, let's talk briefly about the methodology. Mr. Lauckhart's methodology was very simple. As I mentioned, what he did was he took this Black & Veatch energy market perspective for 2010, he took the expected output from the Oak Tree plant, and in every hour over that 20-year period he just assigned a value to that of the generation that could be expected from Oak Tree. It's a simple one-step procedure.

And this is what Mr. LaFave identified in his direct and rebuttal prefiled testimony as the market estimates method. It's a valid method. And the method that NorthWestern chose and which Staff seems to prefer is this method whereby in hours where NorthWestern is long you assign the incremental costs of operating the coal plants to Oak Tree, regardless of its value in the market, and only assign the value of the market to Oak Tree in hours where the utility is short. And I'll explain in a minute why I think that's problematic.

Now this says Confidential at the top, but I'm not concerned about that, and neither is Rich. What this shows is page 159, I believe, of the Black & Veatch slide deck that was Exhibit 5 to Mr. Lauckhart's direct prefiled testimony. And what this shows is what they knew as of the fall of 2010.

And what you will see is on that blue line there is the actuals that led up to the forecast and the volatility in the gas markets up to that point. And the red line is the Black & Veatch perspective, and the yellow line or orange line, if you can see it, is the EIA perspective. And you'll see they were almost exactly the same as of the fall of 2010.

And the larger point here is that what you do is in a fundamentals-based forecast you take into account all those factors I talked about earlier with respect to the moves that you're likely to see in the future over the next 20 years. And in this business, you know, even looking two years out can be scary business, but you try and do the best job you can to try to figure out at a particular point in time what you think the future is going to look like. And you can see that EIA and Black & Veatch were very similar at that time.

I would like to also point out just briefly that there is -- I want to move quickly to the next slide because I think this will illustrate the point better than I can make it.

Okay. This is from Mr. LaFave's Exhibit 2. And you may recall during the hearing that there was a point made that starting in 2011 and going to 2031 that Mr. Lauckhart's analysis basically showed a tripling of electric prices during that span of time.

And if you look at this particular slide, what you will see is over that period of time the average spot price in 2008 was $80.77 per megawatt hour for NorthWestern. And you can see over time it's quite likely, given again the volatility in spot market pricing, that prices can jump dramatically in short periods of time.

And, again, these are one of the things that the Black & Veatch Electric Price Forecast Energy Market Perspective tried to take into account.

The exhibit also shows from 2008 to 2011 spot prices dropped by a factor of 2.3 over three years. And that's the kind of volatility you can expect in spot market prices. And so it's not surprising that you would see an Electric Price Forecast that would say, you know, in the outer years you can expect to see a range of prices, but it's not unreasonable to expect $90 a megawatt hour. That was almost the price that was being paid by NorthWestern in South Dakota three years ago.

This slide is from the EIA 2011 perspective. A criticism that was raised at hearing of the -- of Mr. Lauckhart's avoided cost analysis was that the EIA forecast, Early Look Forecast, for 2011 was higher than the Black & Veatch forecast that had been prepared in the fall of 2010.

But as you can see, the EPA -- this is from the EIA. The EPA is expected to enact several key regulations in the coming decade that will have an impact on the U.S. power sector, particularly the fleet of coal-fired power plants. Because the rules have not yet been finalized, their impacts cannot be fully analyzed, and they are not included in the reference case.

Black & Veatch tried in the fall of 2010 to analyze the likely retirement of these coal plants. EIA did not. And that explains to a large degree the difference in those forecasts from the fall of 2011 for EIA as opposed to Black & Veatch -- excuse me. The Early Look for 2011 to the fall of 2010 Black & Veatch Energy Market Perspective.

So as I mentioned previously, the green -- the Brown Power Valuation prepared by Mr. Lauckhart was prepared using a one-step method of taking these energy prices in every hour of every year for 20 years and assigning that value to Oak Tree. The NorthWestern is a two-step process.

When NorthWestern is short they get the value that NorthWestern has calculated for hours in which it's short. And then when NorthWestern's long they get the incremental cost of the coal plants. But there are several flaws in NorthWestern's forecast.

First, Mr. Lewis's gas price forecast is wholly unrealistic. It makes three fundamental errors. For Oak Tree calculations, NorthWestern assumed no increase in the real cost of natural gas from 2015 to 2031. This isn't a credible assumption. No credible forecasting agency is assuming that. And I believe Staff has taken the position in this proceeding that that is not a reasonable assumption.

Two, for Oak Tree calculations, NorthWestern assumed no change in the relationship of spot electricity prices to spot gas prices from 2012 to 2031. Again, this is an unrealistic assumption.

The relationship between spot energy and spot natural gas prices will change, particularly as you make this transition to a environment where coal plants are being retired and being replaced with natural gas generation.

Three, for the Oak Tree calculations, NorthWestern Energy did not give Oak Tree its spot market value whenever NorthWestern thought it would be long on power. I want to talk a little bit more about that last one and why that is not an appropriate measure of avoided cost.

The thing to keep in mind -- and I don't want to overstate this too much, but the thing to keep in mind is that -- this is according to Mr. LaFave's testimony in his response testimony to the Commission.

On page 2, line 8, "In 2011, 53 percent of the time NorthWestern customers were served by internal generation only." So, in other words, there were market purchases being made.

This percentage is affected by load growth and base load plant outages that the forecast internal generation percentage for 2015 is 35 percent of the time. Whatever that percentage is, it's going to go down over time, according to NorthWestern. And as a result of which, there will be many hours in which NorthWestern is going to need energy, and this will help NorthWestern avoid those costs.

Now one of the big issues that came up recently is this whole issue of the fuel adjustment clause, and I want to talk about that real quickly. This is from NorthWestern's electric rate adjustment clause or power purchase adjustment clause. This is the relevant passage.

We have a bunch of stuff in our brief about this to explain essentially how power cost adjustment clauses are supposed to work. But they're really supposed to be for fuel. They're supposed to be for changes that can erode a utility's revenue position between rate cases so that they don't get caught in the market and they're not completely short.

What this clause essentially says is that they're allowed to include power purchases in the power cost adjustment clause if they're doing it in order to take advantage of market opportunities when their cost of generation is higher than market.

But there's no reason to be putting Titan Wind or potentially Oak Tree in the fuel adjustment clause. And the reason that NorthWestern has said, and Staff I think agrees, is that sales that are being made pursuant to these wholesale power purchase agreements with, for example, Titan Wind and prospectively with Oak Tree can't be credited to rate payers is because of the fuel adjustment clause.

Well, first of all, it shouldn't being going into the fuel adjustment clause anyway. This is for adjustments to fuel. If they believe this is going to erode their revenue requirement, they can file a rate case.

So, anyway, the point is look very carefully at this because this is a major issue in the case. It's broader than this case, but it's an important issue nonetheless.

I want to briefly summarize some other problems with NorthWestern's avoided cost forecast because I think it's important to point it out.

So I described the methodology where they're short. We get the value when they're long. We get the incremental cost to the coal plant. But that really is the way they did it up until 2014.

After 2023 NorthWestern estimates that it will be purchasing spot market power at all hours of the year starting in the year 2023. And for this they use the Lewis Electric Price Forecast, which as we pointed out, contains some wholly unrealistic assumptions.

So what did they use for the years between 2014 and 2022? Well, this is really interesting. What they did was they took the 2013 number from Mr. Green and the number from Mr. Lewis in 2023 and drew a straight line between them. And now that's really simple, but really? I mean, it seems pretty unrealistic to me.

You compare that to the effort that goes into producing something like the Black & Veatch Energy Market Perspective, and you'll see that this is just not a very realistic assumption.

Now I want to quickly jump to the next slide. Now I was talking earlier about your range of expectations, you know, whether you base it on your low case, your high case, or your intermediate case. You can see that the first bar is the Guldseth value of Spion Kop, which was 75.52.

Mr. Lauckhart as of February 25, 2011 estimated a brown value avoided cost for Oak Tree at 78.92. Oak Tree then made an offer substantially below what Mr. Lauckhart was calculating at 65.12 levelized over the 20 years. And the cost of Titan Wind updated to 2011, in other words, starting the production in 2011 produces an avoided cost of 65.27.

And then the last bar, the one to the right, substantially less than all the others, is $35.80 a megawatt hour, which is the NorthWestern Energy value of Oak Tree.

So this sort of graphically shows you, I think, the range of expectations and what would be considered to be the low case and what would be considered to be the high case.

Real quickly, I want to run through the last slides because I know I'm running out of time. This is the language from 18 CFR 292.304(d)(2). The main point I want to make here is the plain language of this doesn't mention the Public Utilities Commission at all. We have substantial briefing authority to the effect that these are decisions that have to be made by the qualifying facility and that makes sense because the qualifying facility is the one that has to go to market, obtain financing.

If anybody other than the qualifying facility can determine the length of the commitment, it substantially changes the return on equity. It substantially changes the cost of service to the debt.

And, in fact, the Commission could set it for anything they wanted. They could potentially destroy anybody's effort to actually try to arrange financing. Since the utility is the one who has to make the commitment, it makes sense to the utility to identify the length of that commitment.

I think there's probably some range of reasonableness there again. Like if I said 50 years, you could probably say no, that's ridiculous, and you think you'd be right. But I think 20 years as Staff has suggested is a reasonable lengths of time.

This is from FERC Order 69. Many commentators have stressed the need for certainty with regards to return on investment in new technology. The Commission agrees with these latter arguments and believes that in the long run overestimations and underestimations of avoided cost will balance out.

And then the last phrase from the same order, paragraph D2, "Permits a qualifying facility to enter into a contractor or other legally enforceable obligation to provide energy or capacity over a specified term." There's nothing in there about utility commissions. There's nothing in there about the utility being able to determine that term.

Thus, under our regulations -- this is from Cedar Creek Wind, which was cited just a few months ago. "Thus, under our regulations, a QF has the option to commit itself to sell all or part of its electric output to an electric utility. While this may be done through a contract, if 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 noncontractual but still legally enforceable obligation will be created pursuant to the state's implementation of PURPA."

In this state they ordered NorthWestern to negotiate. We think the record is very clear that Mr. LaFave did not believe that he could negotiate at anything other than the short-term avoided cost that was established for projects of design of 100 kilowatts or less. This is contrary to your 1982 order.

Now --

CHAIRMAN NELSON: Mr. Uda, I think at that point we've hit 30 minutes, and I'm going to respectfully ask that we stop at this point, understanding you'll have 10 more minutes at the end.

MR. UDA: Thank you, Commissioner Nelson.

CHAIRMAN NELSON: Thank you.

Mr. Brogan, 30 minutes.

MR. BROGAN: Good morning, Chairman Nelson, Commissioner Hanson, Commissioner Fiegen, and Staff. It's good to be back before you, and I appreciate your consideration in this matter.

Mr. Uda is eloquent and dramatic. I can't and won't try to match that. I'm kind of a simple person. But what I want to try to do is have a discussion with you about what this case is about and is not about.

We have already a Complaint, an Answer, two days of hearings, and, by my count, 167 pages of Posthearing Briefs. I'm confident that the Commissioners have all read all of that material. But, unfortunately, I have to say that in all of that there is a fair amount of irrelevant and unnecessary material that tends to obfuscate the real issues before you in this matter. And I guess I'd like to try to separate the grain from the chaff. What is the key issue?

Simply you must determine what would NorthWestern pay for energy and capacity if it did not purchase that same energy and capacity from Oak Tree? What would it cost NorthWestern to generate the electricity? And to the extent that NorthWestern cannot generate the electricity, what would it cost NorthWestern to buy it?

That's the simple question. And it is all based on the touch mark of what we have to go by which is 16 U.S.C. 824(a)(3)(D), which defines incremental cost. And it says, "The cost to the electric utility which but for the purchase from" the QF -- I've substituted QF for longer words there -- "such utility would generate or purchase from another source."

That's really the touchstone of what we have to decide. Or what you have to decide.

With that as the main issue we can see that some of what has been talked about is chaff. For instance, how does and how will NorthWestern Energy recover its power purchase agreement costs? That's not an issue. That has nothing to do with what it pays or would pay to purchase or to generate.

We've had talk about how does South Dakota allow NorthWestern to treat off system sales? Again, that has nothing to do with this particular docket and with what you're asked to decide here. It's not an issue.

Now the South Dakota Commission had good reasons to establish the policy that it establishes in the 1980s. You may change that policy in NorthWestern Energy's next general rate case, but it's not an issue here. It doesn't do anything for answering that question, what would NorthWestern pay but for purchasing from Oak Tree?

We've had talk about the regulatory compact. That's a broad area. And it's great for academic discussions. And, you know, as trained as both an economist and an attorney, I find it fascinating. I'd love to talk about it. But it has nothing to do with the cost that NorthWestern would incur but for purchasing from the QF. And so it's not an issue in this docket.

Since the incremental cost is the issue, then we come to the main sub issue: How do you determine that incremental cost? How do you determine it?

Oak Tree says use our estimate of market prices, what they'll be for each hour within the next 20 years. Use that because Black & Veatch is credible, because they made realistic assumptions, and that they bought their gas forecast from a national firm, and so it must all be good.

Inherent in this is some sort of assertion that the complexity and expense of a model is what determines its accuracy. There's no empirical evidence of that.

NorthWestern says wait a minute. It's not appropriate for you to set NorthWestern's avoided cost based on market prices for those hours that NorthWestern's not buying in the market. Pure and simple. And then NorthWestern told you about five methods that had been used in one form or another by other states.

With respect to those five methods, I think we need to remember a couple things. One, there's no magic to what any other state has done. Some of those decisions by states have been good ones. Some of them have been real tragedies.

Mr. Uda just quoted Order 69 that indicated FERC thought that the overestimation and the underestimation would be balanced out, and yet there's testimony in this docket that shows that hasn't been the case, that the overestimation has vastly exceeded any underestimation.

Furthermore, there's nothing that requires a use of one of those methods. Not every state uses one of those five methods. Some of them use different ones. One that comes to mind is that there are some states that actually set avoided cost as a market index. The QF is paid whatever the market index is.

In some cases it even has to be shaped by another index. Nevada comes to mind for that. Other states actually require QFs to be paid not off of an index but some sort of actual market price.

But NorthWestern has offered what we've called a -- or what has been called. Not NorthWestern called it, but what has been called a hybrid. It's said the avoided cost during those hours when we are generating power and we're generating all that we need or can generate all that we need, is the variable cost of that power, the variable cost of that generation. For other hours newspaper until the size of the QF, it's whatever we're purchasing up until the size of the QF.

Now NorthWestern believes it's offered an appropriate method with appropriate inputs. Mr. Uda says there's lots of problems with it. That the gas price is wholly unrealistic. It had no real increase in the cost of gas from -- to 2031.

But if we look at EIA for 2010, which would have been the EIA report available at the time that Mr. Lauckhart -- or excuse me. Black & Veatch was preparing their forecast, for natural gas for electric generation EIA was projecting from 2008 to 2035 an annual decrease in the real cost of gas of .3 percent. So it is fair to say that at least some people at that time felt that there wasn't necessarily going to be a real increase.

Mr. Uda complains that Lewis assumed that the market heat rate, as we would call it, the relationship between the price of gas and the price of electricity, would stay the same over that period of time.

That's true. Mr. Lewis did assume it. And I would suggest that that's probably an assumption that benefits QFs and Oak Tree. In all likelihood, as new and more efficient natural gas plants are built and come online, you will get more megawatts per dekatherm and is that heat rate will improve instead of staying the same.

And, finally, Mr. Uda complains that NorthWestern doesn't offer to pay the market when it's long energy. That's right. And that's exactly what fits under the statutory definition.

I want to back up a bit, though. Why does NorthWestern even care? Now if the Commission tells us to buy power from Oak Tree at $100 a megawatt hour, we will. We will recover that from our customers, and our customers will pay.

If the Commission tells us to buy power from Oak Tree at $35 a megawatt hour, we will. We will recover that from our customers, and our customers will pay it.

So NorthWestern's real concern is not -- at least in the short run, not its bottom line. Its real concern is what will this do to our South Dakota consumers?

We can talk about forecasts. They can talk about methodologies. We can probably go until we're blue in the face. Your task as a Commission is to do the best you can, taking into account known facts.

I think one thing is certain: If you rely on forecasts, you will be wrong. It's how you are wrong that affects South Dakota consumers in different ways. If you estimate too high, customers are going to pay a lot more. Based on what Mr. Uda said, I would suggest not just for the Oak Tree project but for other projects that are watching this docket.

And, quite frankly, if you estimate too low, that's not good either. Because then meritorious QFs that should be built probably would not be.

The important part is to whom you want to assign the risks and how do you want to manage those risks? That's what it boils down to.

One other issue that Mr. Uda took with the way NorthWestern proposed its system is NorthWestern said in

2023 we will be in the market for at least 1 megawatt each hour of the day. We're not going to be in the market for 20 megawatts each hour of the day or even 10, but we'll be in there for at least 1.

But since we're there for at least 1, we're going to give Oak Tree the market price for the whole thing Oak Tree generates. That's whether or not we're in the market for that whole amount. That's an assumption that benefits Oak Tree.

Similarly, Mr. Uda complains that we just did a straight line analysis. As Mr. LaFave explained in his testimony, we did do the straight line analysis, and that probably -- that probably overstates market purchases. Especially in off peak hours.

I want to talk briefly about the LEO issue. And I think we all recognize that the purpose of the LEO is to just present utility -- prevent utilities from refusing to purchase from qualifying facilities. But I think we need to talk about this in terms of utility resource allocation or acquisition.

When a utility goes out to acquire a resource the first thing it has to do is be prudent. It's going to come before this Commission to show you that it made a prudent decision so that it can recover its costs associated with that decision.

That's true whether it's a new generator, some sort of power purchase agreement, or a QF power purchase agreement. And to be prudent utility has to first look at its need, what does it need, and then it has to figure out how to meet that need and to show that the best -- that it's chosen the appropriate way.

It does that through competitive solicitations sometimes. It does that by comparing resources to alternatives. But it has to be able to show you that it acted prudently.

Well, when we're dealing with say a QF or somebody who may be a QF, that affects how we negotiate. And at least at the time that the negotiations were taking place NorthWestern truly believed it would not be prudent, it could not prove to you that it was prudent, to pay more than the tariffed rate. And that was the conundrum that faced Mr. LaFave and the rest of NorthWestern.

I would also like to point out one problem that I think has been observed throughout the country. If the test for establishing an LEO does not include a true, real obligation, a QF -- let's say a QF could easily create an LEO by telling a utility I'm glad to sell you my power at $150 a megawatt hour. Even knowing that that is above the avoided cost. But there's no real enforcement mechanism in that process.

So they go before the Commission. The Commission says, oh, no. The avoided cost today is $40. The LEO walks away.

Let's say, though, that was close to the avoided cost and then market prices moved up. We're not really talking reality here, I hope. I hope we're not talking 200 or $250 per megawatt power. But let's say then that before there was ever a contract actually signed the avoided cost was suddenly 250 because the market's moved up.

That QF can do the same thing. Says, well, no. I'm not going to honor that LEO, and you can't enforce it against me. I want a new LEO based on the price today. And if there is no real obligation to deliver in whatever created that LEO, a QF can do that.

The first one might have been called Bull Run 1, LLC, and it just says I'm not going to deliver. But the next one is Running Bull 2, LLC. Same principle, same place, but they can legitimately ask for an LEO based on a new avoided cost. I think that's a real problem. I think it's a problem that we have seen throughout the country.

I want to close with just one thing to really emphasize how important this can be. About 10 days ago -- and it just hit the public media this Monday -- a utility a couple of states over filed its annual tracker asking for a $43 million increase of which it said $30 million was due to its PURPA obligations. Those are the stakes that are before you if you get it wrong.

Thank you for your time.

CHAIRMAN NELSON: Thank you, Mr. Brogan. 30 minutes for Staff.

MR. SOYE: Thank you, Mr. Chairman, Commissioners. This is Ryan Soye. I'm part of Staff.

I'll start out again by saying that due to Staff's role as a third-party participant, there may be overlap in arguments. We're going to apologize in advance for that.

There are also certain arguments Staff feels it has addressed sufficiently in its Posthearing Brief, and we'll just shortly recap those here. We don't want to delve into repeating our entire arguments again.

In addition, there are certain arguments that we feel do not need to be addressed that were brought up in the posthearing briefing stage, such as the credentials and qualifications of the witnesses. The Commission's already decided this issue and has determined the witnesses to be credible so we will not be addressing that issue.

In addition, Staff will not focus on proceedings that took place in Montana. Staff realizes that these -- the issues brought up about Montana certainly speak to the credibility of certain arguments. However, we feel that the difference in systems does have certain considerations that must be covered so we will only be looking at the facts or discussing the facts as they exist before us in this case.

Hold on one second. My notes are a little bit off here.

Simply stated, this dispute comes down to the Commission's obligation to implement PURPA. Throughout this proceeding there's been a great deal of evidence that has been provided, some of which Staff believes can help the Commission in fulfilling its obligation under PURPA and some of it which cannot.

The bottom line, however, as seen by Staff, is that Oak Tree and NorthWestern have not provided the information sufficient to enable this Commission to make a final decision in this case.

As such, Staff has urged this Commission to forego making a final decision until the parties can provide the needed information. Further, the only way Staff believes this can be achieved is for the Commission to provide the parties with some direction on what they feel needs to be addressed and then return for additional proceedings to make a final decision on that issue.

Oak Tree has said additional proceedings will not likely resolve the disputed issues. Staff agrees that not all the issues will likely be resolved through additional proceedings. However, what Staff used as the primary issues will -- addressed in these primary issues will assist the Commission in bringing the avoided cost disparities, if you want, or the avoided cost estimates within a more proper scope for the Commission to make a decision.

Staff understands this recommendation of additional proceedings will certainly place Oak Tree in a difficult position with the possible looming expiration of the production tax credits at the end of this year. Oak Tree has explained that the production tax credits are the key element that has allowed it to offer its output at $65.12 per megawatt hour over the 20-year period and suggests that the expiration of these production tax credits will represent a lost opportunity to NorthWestern's customers and affordable wind in South Dakota.

No doubt a decision today will assist Oak Tree in meeting its deadline and begin construction and operation of the proposed wind farm. And arguably this is the most effective way to promote small power production and cogeneration in South Dakota and fulfill the Commission's obligations under PURPA.

On the other hand, whether Oak Tree will, in fact, benefit NorthWestern Energy's customers depends on whether Oak Tree's avoided cost rate is -- proves to be at or below NorthWestern's actual incremental costs over the long term. As this assumption carries a great deal of uncertainty, Staff feels it is necessary to obtain this additional information to ensure the pricing element is properly explored.

Basically the potential expiration of the production tax credits Staff feels is secondary to determining the avoided cost, to properly determine the avoided cost. Whatever benefit may be realized, the production tax credit, this is beyond the scope of PURPA. It is not one of the requirements in PURPA. And until all of the controlling factors or elements of PURPA have been satisfactorily fulfilled, Staff would say that production tax credit consideration should not be a consideration at all.

PURPA states the rates must be just and reasonable to the electric consumer and in the public interest, nondiscriminatory to qualifying facilities, and they shall not exceed the utility's incremental cost of alternative electric energy.

Just and reasonable is a very ambiguous term. However, this is clear that the rates must be just and reasonable to the utility, its consumers, and the QF. The public interest includes NorthWest Energy as well as Oak Tree. There is a need to protect customers against high rates, but this must be balanced against the obligation to give PURPA affect through promoting cogeneration in small power production.

In its Posthearing Response Brief Oak Tree argued that a simple finding of full avoided cost fulfills the just and reasonable prong. And there seems to be a great deal of authority to back that up. However, the problem is, as we have seen throughout this proceeding, what constitutes NorthWestern's full avoided cost is certainly open to interpretation depending on what modeling methodology has been selected and what inputs have been used, so on and so forth.

As to the nondiscriminatory element, given Staff's belief that NorthWestern's calculated incremental cost is below its true incremental costs, apply and separate would discriminate against Oak Tree as a QF. However, it is true that PURPA does not require, and Staff agrees, that there be a rate that makes a project financially viable. That is also not an element in the

PURPA restrictions.

As stated in briefing, and quickly repeat this here, the incremental cost standard is intended to leave rate payers economically indifferent through the source of the utility's energy ensuring purchasing the QF does not exceed the cost in the absence of the qualifying facility.

I apologize. I probably shouldn't have brought coffee to make sure I don't get dry mouth.

Now true customer indifference cannot be achieved when setting a long-term power purchase agreement. Long-term forecasting is very uncertain, and both parties have provided evidence that rates will either be above or below the true avoided cost but rarely equal.

If it is below, the customers are paying more. If it is above, the customers are paying less. Both scenarios actually violate the customer indifference, as the customer is either better off or worse off as they would be without the qualifying facility. And FERC has addressed these issues saying that these long-term purchase agreements need not be at the actual incremental cost.

Although customer indifference can only be seen as a guiding rule, it is something this Commission needs to seek and strive for while recognizing it can never be achieved. And this is the basis for Staff's recommendation of additional proceedings. We need to get as close as possible over the long-term of an avoided cost estimate that will leave customers indifferent. Right now Staff feels we have two bookends and nothing in the middle that we can rely upon.

Staff will briefly recap its issues that it has with each of these models. Oak Tree has offered an avoided cost Staff believes is far too high. One bookend. This is based on the particular modeling method chosen by Oak Tree and certain assumptions it's used to apply it.

And, again, Staff wants to make clear and distinguish that it is not disputing the market price or market estimates model. It's been referred to as both. It does not dispute or object to this modeling approach under PURPA, and it is certainly a viable and appropriate modeling approach in certain circumstances. It is simply that Staff does not believe it is as accurate and appropriate under the circumstances of this case.

This is based on Staff's understanding of the requirement of PURPA with respect to setting a rate at or below the incremental cost and the fact that the market price approach does not properly consider when NorthWestern's internal generation is sufficient to fill its service requirements.

During these times Staff agrees that NorthWestern's incremental cost is the measure of the variable costs of internal generation and these are the only costs to be avoided. Whether or not they can actually be avoided is another issue.

Under Oak Tree's model, whether NorthWestern is long or short an avoided cost is always measured at the spot market rate. As such, NorthWestern Energy pays more for energy than -- to Oak Tree than it can provide its customers through internal generation.

Oak Tree has argued this approach does not reflect NorthWestern's full avoided cost because it does not consider the benefit of market sales or economy sales. However, during these times NorthWestern Energy -- I'm sorry. During the times when NorthWestern Energy is long they are not actually avoiding any costs.

They can either turn down their own plants or shift this additional energy to the market. But NorthWestern would then pay forecasted price in these times, and rate payers assume the risk of the long-term price forecast.

Also in countering Oak Tree's argument that the customers will receive a benefit, NorthWestern's current tariff again does not provide for a credit of customers on asset based and nonasset based margins.

Finally, Staff will quickly address the remaining concerns of natural gas price forecast and the carbon cost assumption in Oak Tree's avoided cost estimate. While there has been a lot of back and forth even in these closing arguments -- or, I'm sorry, oral arguments on whether a change in circumstances unforeseen at the time the avoided cost estimate was developed justifies updating the model which Staff has suggested, this is a judgment call to be made by the Commission.

However, Staff believes the threshold here has been met. And reviewing the natural gas price forecast is required due to the significant increase in the EIA's estimate of technically recoverable unproved shale gas resources. I had to practice saying that several times. And this estimate came out shortly after the avoided cost estimate was prepared.

CHAIRMAN NELSON: Let's take just about a 10 second recess.

(Discussion off the record)

MR. SOYE: Thank you, Mr. Commissioner.

Staff will now move on to its concerns with NorthWestern's avoided cost model. In contrast with

Oak Tree, Staff believes NorthWestern's avoided cost estimate is too low. This is primarily due to the inputs used by NorthWestern in developing this avoided cost calculation.

As has been made clear, Staff puts great weight on selecting the proper avoided cost calculation method. Under the circumstances, Oak Tree has suggested that the hybrid peaker market method cannot be used, it is not an accepted method, and points to the fact that Mr. Bleau LaFave did not identify this or list this as one of the acceptable methods in his testimony.

However, much of the information that was presented on the accepted methods for calculating an avoided cost was also included in the document prepared for the Edison Electric Institute, which was included as BPR 1. Exhibit No. BPR 1 is part of Staff's prefiled testimony.

On page 11 of this document it specifically talks about hybrid methods and the use of hybrid methods by certain states. It does not contain any information that the use of a hybrid method is any less reliable or inappropriate as compared to strictly applying one of the listed methods.

As such, Staff does not believe the Commission is committed to applying any particular method in its pure form and it's able to select a proper method under the circumstances. Even it means intermixing certain elements of each. And, again, FERC does not require any one particular method be used.

That being said, although Staff believes that NorthWestern has chosen the correct modeling method under the circumstances, in theory, Staff believes NorthWestern has, unfortunately, failed to utilize this method and has not given the Commission any evidence that will allow it to make a decision in this case.

First and foremost, NorthWestern provided a five-year energy only forecast. It does not provide a 20-year avoided cost forecast. And as pointed out by Oak Tree, that leaves only one 20-year avoided cost forecast which the Commission has seen.

In addition, the inputs relied upon by NorthWestern in its short-term energy forecast result in avoided cost Staff argues cannot be relied upon. Specifically, NorthWestern has included no capacity element in its calculation. An avoided cost rate that does not include a capacity element is contrary to the specific directive of PURPA and the Commission's order in F-3365. It is simply not a full avoided cost calculation.

Second, NorthWestern's natural gas price forecast. On this Staff agrees with Oak Tree that the assumption that there will be no real price increases between 2015 and 2031 is just unsupportable. NorthWestern's witness, Mr. Lewis, even plainly admits that he knows of no other entity, expert, or individual in this industry making that same assumption.

Next NorthWestern includes a carbon component, something that also seems to be commonplace in this industry, and although NorthWestern has suggested that this is too speculative to be included, Staff reasserts its position that this Commission is more than capable to determine if it feels a carbon cost element should be included and at what level.

By not including this in the avoided cost rate calculation, all the Commission can determine now is that the NorthWestern's model is incomplete.

As to the LEO issue, whether an LEO was established, the parties have spent a great deal of time researching and explaining how other states have handled this issue. Staff feels how other states have handled this issue or approached the LEO is of little or no value. All that's been determined is that almost every state has a different method and a State Commission can adopt any method consistent with PURPA.

So, again, Staff urges the Commission to forego setting any precise method of establishing an LEO and recommends adopting a policy of reviewing issues on a case-by-case basis concerning the actions of the parties in any particular circumstance.

So in this case PURPA and specifically the LEO was created to prevent utilities from simply refusing to enter a purchase power agreement with a nonutility producer. So we must ask does this case present a situation where -- in which PURPA and the LEO was meant to prevent?

Staff believes there is clear evidence to show the negotiation process was unsuccessful in this case. And this was due to NorthWestern's refusal to negotiate a purchase power agreement consistent with PURPA.

This is primarily due to the refusal to negotiate the -- or the refusal to negotiate above the short-term rate offered small power producers under NorthWestern's tariff. NorthWestern seems to argue that this methodology or its methodology for determining this small power producer's rate -- I'm sorry. 100 kilowatts is below. It's the same as it will use or should be used to the 100 kilowatts above. Or above.

This would be a valid argument if the methodology accounted for its avoided cost when NorthWestern is short on coal generation or long-term nature of these negotiated contracts. However, Staff does not believe NorthWestern's methodology included these factors.

NorthWestern argues an LEO has not been created because the price offered by Oak Tree was not at or below its true avoided cost rate. To this point Staff believes NorthWestern's true avoided cost rate or incremental rate has not yet been determined.

So Staff would argue at the time that Oak Tree made its offer to negotiate it was working off of the information that was available to it. It utilized an industry accepted method for determining avoided cost and did all that it could to begin the negotiation process with NorthWestern Energy prior to sending its letter and executed PPA on February 25, 2011, to which NorthWestern again pointed to its lack of need for capacity and its rate of $20 per megawatt hour for 100 kilowatts or below.

As such, Staff believes the circumstances under this case are of the type that PURPA meant to prevent and would suggest that the Commission find a LEO was created on September 25, 2011. Creating the LEO would then bring us to capacity needs.

As mentioned before, there is no doubt capacity credits must be included in the avoided cost rate for any purchase power agreement resulting from this dispute.

However, when those capacity credits should begin has been a continuing issue in this case. A lot of back and forth. It is clear that NorthWestern -- well, Staff believes it is clear through the contracts signed with Basin Electric that it was clear that NorthWestern didn't need capacity and would suggest that the capacity elements apply throughout the life of the project of Oak Tree.

We realize that this is a deviation from our initial suggestion. However, it is due to the additional evidence that was provided throughout this case that Staff has altered its view on this point.

As to the accredited capacity the project should receive, Staff would again just simply reassert its view that Oak Tree should be treated no differently than the Titan 1 project. If the Titan 1 project is accredited through the MISO method, then that's how Oak Tree should be treated. If the Titan 1 project received a stamp value of 20 percent or accredited value, then that's what Oak Tree should receive.

Finally, as to contract length, once again, Staff will simply repeat its view that it sees absolutely no reason why Oak Tree should not receive the 20-year contract length it has asked for. It seems that

NorthWestern continually plans on this planning horizon, and Oak Tree should be treated the same.

In conclusion, Staff believes there are issues presented in this case such as LEO, contract lengths, so forth, that can be resolved on the evidence that has been provided. The other issues such as the proper avoided cost rate, we again assert that there is insufficient evidence and would recommend this Commission hold additional proceedings.

Thank you.

CHAIRMAN NELSON: Thank you.

Mr. Brogan, 10 minutes for rebuttal.

MR. BROGAN: Thank you, Chairman Nelson. I will do my best to not use all 10 minutes.

CHAIRMAN NELSON: Very fair.

MR. BROGAN: Staff indicated that NorthWestern had not provided a 20-year avoided cost forecast. That is correct.

But Staff then said NorthWestern had only provided a five-year forecast. Exhibit BJL 1 is NorthWestern's 20-year estimate of incremental costs broken down by year, by peak, and by off peak period. So the Commission does have another forecast to look at.

Staff reiterates its concern that NorthWestern vastly underestimated the cost of natural gas going forward. I think we all realize there's a lot of difficulty in determining the cost of natural gas. I think we realize that in NorthWestern's model if I recall, Mr. Lewis was estimating AECO prices at this time of natural gas for 2012 in excess of $4. I think we all know that in the last week they traded at $1.50 or $1.49. So it's not absolutely clear that NorthWestern vastly underestimated the cost of gas.

With respect to the negotiation process, Staff seems to say that the breakdown in negotiations was due to NWE's refusal to increase its rate. NorthWestern in its Brief and Posthearing Briefs has also shown that a substantial part of the breakdown in negotiations was due to the demand of Oak Tree for the type of contract that it asked for.

And, in fact, not only did or does that contract exceed by a substantial margin NorthWestern's true avoided cost, in about 65 percent of the 175,000 plus hours for which it's estimated, that contract price exceeds Mr. Lauckhart's market forecast price.

There was substantial responsibility, I believe, on both parties' part that led to the failure of the negotiation process and to somehow decide that because of the negotiation process we're going to determine there was an LEO seems to fly in the face of what it should take to establish an LEO.

Finally, Staff says go with the fixed rate 20-year contract; that's consistent with planning horizons, and Oak Tree should be treated the same as the utility.

But if the utility brings in a resource, it doesn't necessarily have a 20-year fixed rate. If the utility brings in a resource and it justified the prudency of that resource on some sort of gas cost and it turns out that five years down the road gas costs are a lot less, well, the price from that plant's going to be a lot less. Because the actual gas cost is what's going to be passed through to customers.

If it brings through a resource and five years later is in with a new rate case and the financial markets have changed and the, you know, borrowing cost is down and the authorized return on equity is down so that the rate of return is down, the utility is going to have a lower return and get a lower price for that asset, for that rate based asset. They're not going to get the fixed price that they estimated at the beginning. So giving a QF a 20-year fixed price is not treating it the same as a utility.

Finally, I think that Staff raises the biggest issue, and that is what do you do now? And it recommends additional procedure. While NorthWestern's not necessarily opposed to that, I think we would point out we believe that what you will end up with is more competing and conflicting expert opinion. Probably no different than what we have today.

I personally am not sure that you gain a lot by that. And I think it's back to what I had said earlier. It's up to you to decide how much risk you want South Dakota consumers to assume.

Thank you.

CHAIRMAN NELSON: Thank you. Mr. Uda, 10 minutes.

MR. UDA: Thank you, Mr. Chairman. I think I want to just talk a little bit about the Staff -- first of all, I want to thank the Staff for what I think is -- they have made an extraordinary effort to get their arms around what is obviously a very highly complex and technical case. I think they've done a really good job of going kind of from 0 to 100 miles an hour in a relatively short period of time.

And we're not opposed to having additional proceedings. I mean, I think the concern is two-fold.

First is, and I think as Mr. Soye acknowledged, you know, we do have this looming expiration production tax credit. We do the potential loss of bonus depreciation. You know, we've done our pro formas and we've sort of figured it out.

And I understand that the Staff's position is that it's not the obligation of the utility under PURPA to make sure their avoided cost permits the financing of projects, and we respect that.

But it leads us to our second issue, which is, okay. Let's suppose Mr. Lauckhart's forecast is wrong. It's possible. Of course, it's wrong. But as we showed in one of the slides, look at the other contracts, and then look at NorthWestern's.

And do you believe in your heart that there's been a 24 percent error in the avoided cost for a project of this kind? And I submit to you there is no evidence that that's true.

As I said, we're not opposed to doing this, but if the production tax credit expires and the bonus depreciation expires, our proposal is probably going to have to be higher than it would have been if the decision had been made earlier and permitted us to start construction by the end of the year. Or actually complete construction by the end of the year I believe to get the production tax credit.

So this is a huge issue. This was an issue for NorthWestern in Montana. This is why they told the

Commission there you have to act on this now.

And I respect the Staff's position there are differences between the Montana system and the South Dakota system, but you have to understand the avoided cost does not look at what's going on today and say, okay, well, in the market gas is really low now so we have to assume that's going to continue forever.

I can remember a time in 2000, 2001 where gas prices went to $15 a dekatherm. I can recall a time in the 1990s when gas was $2 a dekatherm or $1 a dekatherm. It changes in response to markets. And to try to get your arms around that is a very difficult exercise. And I understand that.

But you don't say, okay, let's just ignore all the fundamental analysis of the market and say, okay, well, we need to use this method because it seems to be the way that NorthWestern operates.

The real question is if NorthWestern is obtaining value from selling its generation when it's long on generation, why aren't you giving that value to Oak Tree?

Well, the response seems to be because that's not permitted by the power cost adjustment clause. And my point is if that's going on now, that should stop immediately. These are utility rate based assets that have been paid for by customers. And in some portion of that analysis they should be getting some return on that.

So because the language of the tariff doesn't permit it doesn't mean it's right and doesn't mean it's consistent with avoided cost.

Now I want to talk briefly about this LEO issue. I don't really think it's really that much in dispute. I mean, Oak Tree did everything they could do. What else were they supposed to do? Okay. We made phone calls. We sent letters. We said, hey, negotiate with us. If you've got any questions call us.

The response back was, well, we don't need a need for capacity and our short-term rate is $20 a megawatt hour. If you want to negotiate at or below that rate, that's fine. There was really nothing else we could do.

So we tried to do the best job we could do because we couldn't get any avoided cost information from NorthWestern. They weren't producing any of the stuff pursuant to 18 CFR 292.302 that they were supposed to be producing before. So we hired a expert who used an off-the-shelf forecast not prepared for this proceeding, supposed to be an objective look at the market and came up with the best judgment we could.

And we said, you know, hey, here's this and here's this contract. How many hours are over or below that rate -- our rate really is 54.50. And it's levelized to 65.12, but it's really a two and a half percent escalator per year. It's very similar to the Titan contract. And we submit that that's kind of -- even though it's not an avoided resource, it's relevant, nonetheless, to how this particular project is treated.

I think it's beyond peradventure that when a utility puts an asset in rate base it's entitled to a reasonable return on its investment. And if it turns out that project is underperforming and they're not getting that return on their investment, they can come to you and ask for more money.

We, once we lock in a contract we take the risk of that performance. We don't have rate payers as a recourse. We are stuck. So I think you should also take that into account.

I think the final point I want to make is this goes to this issue of credibility. All of the errors that NorthWestern made in its forecast all go in the same direction, producing a $35.80 rate. That's not an accident. It's not an accident they didn't negotiate with us.

FERC recognized long ago when PURPA was adopted that utilities refuse to negotiate. They don't like dealing with QFs. Understandable. We're competitors. Either they build the resource or we do.

Okay. If you ask Coca Cola should they make some kind of accommodation for Pepsi, I think they'd probably say no way. But that's the nature of the beast. This is a policy call that Congress made it's still the law of the land, even under the Energy Policy Act of 2005. Especially for small projects under 20 megawatts. They still don't have nondiscriminatory access to markets.

I want to close on a note here because, you know, you have a recent filing by Otter Tail, and it's in your records. I think you can take administrative notice of it. But Mr. Lauckhart did an analysis of the gas price forecast used there to justify instead of retiring Big Stone, retrofitting it, putting new pollution control equipment on it, and they had to do an analysis of what it could would cost to replace it with natural gas fired generation.

He came up with $9.50 an MMBtu levelized for 20 years. It's a rough approximation. They used $5.14 in this proceeding, and Black & Veatch used $8. What I'm talking about here is consistency of positions. Before the Montana Commission they said all these benefits you'll get diversification, hedging against EPA regulations, carbon tax. That's a very important issue, something that shouldn't be looked over.

They might think ours is too high. They've got zero. Okay. There is a risk that is going to happen. Waxman-Markey passed the House. It's a reality we have to deal with.

Finally, the capacity issue. They told their board as of April 25, 2011 they needed more capacity. They told us they didn't need any. They told you even in briefing here they didn't need any. This is entirely inconsistent with the record in this case. And, again, it goes to the issue of credibility, which goes back to the first issue that I talked about is who do you believe?

Mr. Lauckhart has testified for utilities. He's testified for qualifying facilities. He's helped banks. He doesn't have any particular ax to grind other than he wants to implement PURPA in South Dakota in the most efficient way possible.

Did Mr. Lauckhart get it right with his market estimate approach? It's one of the recognized approaches. Is it totally appropriate for South Dakota? I think it is, given the fact that 53 percent of their load is going to be served by their own internal resources by 2015? They are going to need -- and you have to look at this over the long-term. There's this incremental need for more capacity.

The errors that were made in NorthWestern's forecast all go in the same direction. Mr. Brogan thinks that they're favorable to us, but I think every reputable forecasting agency in this country would disagree. I'm talking Ventyx, Black & Veatch, everybody else who does these things for a living.

In closing, what I would like to say is we did make a commitment. We sent them a contract. If they had signed the contract, we would have had a deal. They didn't like the contract. They said, well, the contract terms were a huge issue. They never told us that.

Look at the correspondence. I don't have to make that up. They never said a word about our contract terms. If they had said, hey, we don't like your contract terms, we would have said fine. If they had said we think your rate is too high, we would have said fine.

CHAIRMAN NELSON: One minute.

MR. UDA: But they didn't say those things. They forced us to come before the Commission. I'm not saying that -- I'm not saying that we had to file litigation. We didn't have to do that. We could have gone away.

But all the investment, all the money, the time, and the studies, and costing out the turbines, and preparing the land, and the consulting work, and the avoided cost forecast, all of that would have been for nothing.

Congress requires that State Commissions implement PURPA. They're supposed to encourage the development of cogeneration and small power production. That's the directive from PURPA.

CHAIRMAN NELSON: Thank you, Mr. Uda.

MR. UDA: Thank you.

CHAIRMAN NELSON: Great place to stop.

With that, we are now open for Commission questions with no time limit.

Commissioner Fiegen.

COMMISSIONER FIEGEN: Mr. Chairman, may I have like a 5-minute recess?

CHAIRMAN NELSON: Certainly. We are in recess.

(A short recess is taken)

CHAIRMAN NELSON: Okay. We are back in session.

Mr. Brogan, do you have an issue that needs to be addressed or not?

MR. BROGAN: No, I don't believe I do.

CHAIRMAN NELSON: Okay. Thank you.

With that, Commissioner questions.

COMMISSIONER FIEGEN: I'll start with a couple.

CHAIRMAN NELSON: Commissioner Fiegen.

COMMISSIONER FIEGEN: I'll start with a couple for Oak Tree.

First of all, on the natural gas. Is it reasonable to think that in your forecast that natural gas will change? Because, you know, your forecast was done early before maybe a lot of shale gas and et cetera. So is that reasonable that you think your natural gas forecast would change?

MR. UDA: I guess, Commissioner Fiegen, if I can answer that question this way: You know going in when you make a forecast that you're going to be wrong. You don't know the margin, the degree, the magnitude of which, but the slide that we showed you showed you that basically EIA and Black & Veatch were moving together in the fall of 2010.

And, you know, the point that Staff made as well, you know, EIA came up with this increased amount of approval reserves subsequent to that forecast.

And that's true, but there's a lot of other analysis that would go into that on a fundamental natural gas based forecast to determine what the significance of that increase was because it could be that you have an increased amount approval in reserves but there's an increased cost associated with it. So you have to try to figure out how all of those pieces fit together. It's a complicated exercise.

Is it reasonable to assume that things will change? Yeah. I mean, of course. I think that's the fundamental assumption.

COMMISSIONER FIEGEN: Another question on your 259-page report, and it talks a little bit about wind energy and the different states in -- on page 173.

Why isn't South Dakota included in that?

MR. UDA: I couldn't really answer that question. I think that would be a better question for Mr. Lauckhart. My presumption is the reason it's not specifically included in there is they for whatever reason didn't choose to separately account for it in that way.

I know that based on Mr. Lauckhart's testimony they did assume the amount of wind that existed as of the fall of 2010, and they added additional wind into this region because they had assumptions, for example, that coal plants were going to be retiring and they replaced them largely with natural gas fired generation and renewables.

COMMISSIONER FIEGEN: I'm going to go to your -- you really talked a lot about coal retirement today.

MR. UDA: Uh-huh.

COMMISSIONER FIEGEN: Do you know what coal retirement is being retired in South Dakota because of the new EPA regulations?

MR. UDA: Well, I think it's an issue. Obviously, as you're seeing with the Big Stone filing, it's an issue that every utility is having to grapple with. And so the answer is I don't know. And I think part of that's going to be up to you guys.

I think part of it's going to be depending on the showing that it's not going to be less expensive for rate payers to switch to natural gas fired generation as the kind of base load kind of resource than it is to kind of retrofit and use coal.

I mean, I think there's two factors. One is the EPA issue, the cost-effectiveness of upgrading the pollution control equipment both as capital cost and fixed costs over time and the variable cost of operating those facilities. And also the risk of any carbon legislation that comes down. Because you could have a double whammy in a very short period of time where you get the EPA regulations kicking in requiring these improvements, and then on top of that you get cap and trade legislation, Waxman-Markey or something like it.

So I think it will be up to you guys to decide what the most cost-effective generating portfolio is going to be for NorthWestern. But the answer to specifically your question do I know that any of them are planning on retiring in South Dakota? No.

But I also know that South Dakota is in a region which is connected in the Eastern Interconnect. And I know that Black & Veatch is forecasting I think in the Eastern Interconnect 44,000 megawatts of generation they're going to retire by 2020. I know that in Oregon, Portland General Electric decided to shut down its Boardman plant rather than try to retrofit it because they didn't think it was cost-effective.

I think the other factor is, you know, what is the Natural Resources Defense Council going to do about continuing coal generation. I can tell you from my experience in Montana when people have tried to build new coal plants you've had environmental organizations extremely opposed that idea.

And one of the costs that every developer has to take into account is how long, you know, projects can be tied up in environmental litigation and the costs associated with it.

COMMISSIONER FIEGEN: Okay. I think that's all for now. Thank you.

CHAIRMAN NELSON: Additional questions? I have none.

COMMISSIONER HANSON: Okay. Mr. Chairman.

CHAIRMAN NELSON: Go ahead.

COMMISSIONER HANSON: I have a few questions. And I'm mainly dealing with the LEO, trying to establish a few things in my mind.

Staff stated that they believe a LEO was created and that -- I believe the discussion from Staff is that we need to look at each LEO on an individual basis. And I'll just make the comment that I believe we need to have some parameters regarding what establishes a LEO as opposed to leaving it up to some ambiguity because there were so many different I would say machinations that could be considered in one. So I think as a Commission we do need to establish something of that nature.

Staff -- well, I'll just ask Staff if they have any comment on that, on my comment?

MR. SOYE: Staff would -- I believe it was --

COMMISSIONER HANSON: No fair to take the Fifth but --

MR. SOYE: I believe Staff suggested at one point that if we were going to establish rules, we would prefer to do it through a rule making docket and not here. And that's if the Commission would prefer some more concrete rules to -- or something to be met to create an LEO, we're more than willing to put something together and propose it based on what the Commission thinks should be included in that.

But in terms of this specific case, we just don't think that we're going to be able to put something together and make any concrete recommendations here.

COMMISSIONER HANSON: Thank you.

Mr. Uda, NorthWestern contends that Oak Tree never had any real intention of being operational before September 2012 and never guaranteed that it would deliver capacity at any time.

Do you agree with that statement? By the way, I will be quoting from a few places in NorthWestern's Response Brief, Posthearing Response Brief.

MR. UDA: So could you restate the question, Commissioner Hanson? I think I lost the first part of it. I'm kind of tired. I've been burying you in paper for the last few days.

COMMISSIONER HANSON: Sure. On page 17 of NorthWestern Energy's Posthearing Response Brief they state -- it's not numbered, but it looks like it's line 5 that Oak Tree never had any real intention of being operational before September 2012 and never guaranteed that it would deliver capacity at any time.

MR. UDA: Okay. I think this issue of intent is an interesting one. They had Mr. Makens on the stand, and they could have asked him about what Oak Tree's intentions were. The best way to establish intentions in this case is to look at what Oak Tree did.

Oak Tree signed an Interconnection Agreement. Oak Tree spent all of these money on studies. Oak Tree did their environmental work. Oak Tree paid Black & Veatch $15,000 for an Energy Market Perspective so they could prepare an avoided cost analysis.

They retained Mr. Lauckhart before they sent their LEO letter. Then they sent a signed contract saying they were going to deliver all of this stuff by May 15, 2011. That's what the contract says.

If they have signed the agreement and sent it back, we would have been bound. So we had every intention based on the record to do exactly that and to sell whatever capacity was available from our project.

We estimated it at 3.9 megawatts, which is the 20 percent calculation. NorthWestern's resource adequacy, whether that number's right or not, whatever capacity we had, we were willing to sell to them. And there's no question but that they needed the capacity, and if they needed the capacity, they were required to buy it from Oak Tree.

COMMISSIONER HANSON: NorthWestern also stated that Oak Tree did not reveal the price for any capacity until after it filed the Complaint on this docket.

MR. UDA: That is untrue. It's actually in Mr. Lauckhart's analysis. I believe it was his reality check. But I think that all the spreadsheets were made available to NorthWestern when we sent the LEO letter on February 25, 2011. I would say that's true, subject to check. I haven't looked at that in awhile, but I believe that was all part of the levelized cost of the Oak Tree offer.

COMMISSIONER HANSON: And are you referring to the offer of May 17, 2011?

MR. UDA: The offer of February 25, 2011.

COMMISSIONER HANSON: You stated that they sent a signed contract. They being Oak Tree sent a signed contract on May 17, 2011.

MR. UDA: I'm sorry. If I said that, I misspoke. I meant to say February 25, 2011. And along with the contract we also sent the avoided cost analysis for both green and brown power to NorthWestern. Brown power calculation based on Black & Veatch's energy market perspective, and the green power calculation based on a methodology that has been used in Montana, which was the surrogate unit proxy method or something like that.

It's basically saying assuming you were going to build something like this, this is what it would cost for you to build that same thing, and we'd like to displace that.

COMMISSIONER HANSON: NorthWestern, do you have any comment on that?

We have here two completely opposite statements. Not that that's unusual in these type of proceedings but --

MR. BROGAN: Commissioner Hanson, what was given to NorthWestern in February 25 -- or on February 25 of 2011 was an 11-page contract. We are not aware of any capacity values that were disclosed to NorthWestern at that time.

To the best of our knowledge, the first time we saw capacity values or how they were calculated was in Mr. Lauckhart's Exhibit 3. And I guess that would just be the response. That was filed with the -- with Mr. Lauckhart's testimony.

COMMISSIONER HANSON: Forgive me. With all of the evidence and discussions that we've had on this and with all of the other dockets that we have, I do not recall reading or looking at that contract.

Do we have that contract in evidence? We do, don't we?

Okay. Thank you.

Oak Tree. Mr. Uda, a utility, according to NorthWestern, is not required and should not now be required in their words to pay for capacity that it does not need. What do you think of that?

MR. UDA: Well, I think there are sometimes, you know, confusion about what we're talking about with respect to capacity. When I'm talking about capacity I'm talking about the specific component of electricity that's separate from the energy component of it.

Is that what you're referring to, Commissioner Hanson?

COMMISSIONER HANSON: Well, what I'm getting at and I won't be coy about it, is the concern that -- I don't want to be California, and I don't want to be Minnesota. I don't want to open up the gates where QFs are just allowed to overflow the state with capacity so that -- in a fashion where the utilities are obliged to purchase capacity that they don't need, that is intermittent, that is of higher cost, that is going to drive up the costs to the consumers.

MR. UDA: Okay. I think I --

COMMISSIONER HANSON: That eventually is going to have to be curtailed and simply millions of dollars will be spent for unneeded capacity.

MR. UDA: Well, I have a long answer to that.

Is that okay?

COMMISSIONER HANSON: I guess I have all the time in the --

MR. UDA: You know, I think that's -- I think there's -- that's a valid concern. You know, I mean, obviously you have a situation in some states where, you know, they've had to grapple with these issues more than others.

I don't think it's an issue in California. I think California has effectively dealt with their issues. I think, for example, Idaho Power, which may have been the entity that Mr. Brogan was referring to, has struggled greatly with those issues.

But, I mean, you have to understand I think Idaho Power's -- I want to say Idaho Power's system has a peak of like -- I could be getting this wrong. This is just from recollection. I went to a rates conference not too long ago. I think their peak is like 3,000 megawatts, and I think they've acquired 1,500 megawatts of wind generation.

And that's a hell of a lot to absorb. And that causes all kinds of issues for the utility. I mean, it causes problems with the integration. It causes problems with intermittency things, resource adequacy, those kinds of things.

I think the Idaho Commission has dealt with that in terms of sort of shutting the door to a certain extent after a certain amount of megawatts were put in. The Montana has tried to deal with that uncertainty in that way.

The real issue is, though, I think, that you're not deal -- you know, there's that old commercial that this is not your father's Oldsmobile. This is really not your father's PURPA anymore because you're dealing with a new world, and the new world is moving towards renewable generation.

And there's a likelihood there's a substantial amount of fossil fuel generation is going to be replaced in the next 20 years, and you're going to be looking at a situation of how you hedge that risk.

Now coming down to the question of should the utility be required to buy the capacity they don't need? I think they need the capacity. I think they need the capacity as a hedge. I think they need the capacity because they're showing that they're going to be resource deficient in a relatively short period of time.

And there's also the possibility that when you guys look at the actual costs of continuing on with Big Stone and adding the retrofit onto it, it's not going to be as cost effective as switching to another form of generation. And if they lose that capacity, there's a substantial amount of capacity that will not be available to them.

And so in terms of resource management, these are all very complicated issues, but I would suggest that these are issues that are much, much broader than the little Oak Tree 19 and a half megawatt project, which is, I think, fairly small in relation to any bills that consumers pay.

And we've tried to do an analysis, but it's not in the record. I'm not going to say what it is, but I can tell you the impact is going to be relatively small.

And, finally, what I would say is -- and I think this is a really important thing to keep in mind is we're here in front of you saying, look, you know, it's going to be really hard for us to do this project at 65 if we don't get the project completed by the end of 2012.

My understanding from going to this rates conference recently was there are no major wind development companies. And big ones. Not the little guys like Oak Tree. But, I mean, the big outfits that build, you know 250 -- none of them are planning on building anything until they know that the production tax credit and the bonus depreciation treatment -- at least the production tax credit is going to be renewed. And nobody knows whether that will happen.

So I don't think you're going to get a -- you know, we used to talk about in Montana the QF gold rush. And the QF gold rush in Montana on a system between 12 and 1,500 megawatts, somewhere in there, on a peak basis has gotten required 50 megawatts of wind since 2004. And I don't think their system is swamped or overwhelmed by that.

COMMISSIONER HANSON: Thank you.

Mr. Soye, knowing the creative individuals that you work with on Staff and the talents that are there and understanding that your position -- Staff's position is that -- in regards to avoided cost that you used the term bookends, which I think is a good way of explaining the difference of the high and low here, did Staff take any serious effort -- not that you were required to by any means -- to take a shot at what they believed using the inputs that Staff believes should be a part of an avoided cost analysis, come up with what they thought might be a reasonable avoided cost?

MR. SOYE: Mr. Commissioner, we actually did contemplate performing such an analysis. However, we did start out this case by admitting that we are not experts in developing long-term avoided cost forecasts, and we never have before.

The information that we looked into utilizing was that available off of the EIA website. But in terms of getting the specifics, we would just be relying on others' information. And we didn't feel that -- well, we certainly thought it would be objected to if we did do it so we thought it best not in this case to develop our own forecast.

COMMISSIONER HANSON: That was a yes or no, but I wasn't going to -- I promise I wasn't going to follow it up if you had. I was just curious if you had.

NorthWestern, there's a gorilla that walks in and out of the room every so often with the Titan project for me at least. I keep wrestling with it. And I may -- I'll oversimplify this question to you.

But if NorthWestern was willing to purchase power, provide a purchase power agreement or purchase power, build Titan, whatever, at a higher cost on -- I believe one of the reasons was that because there's a renewable energy goal as opposed to a portfolio standard or requirement in South Dakota.

In anticipation of being a good corporate citizen, why not oblige the Maken family and -- seem like a nice group of people, work hard. They did a lot of due diligence here. Gosh. It just seems like something a company would want to do. Why Titan?

MR. BROGAN: Commissioner Hanson, I think the answer to that is in the record. And it's two-fold. Now I haven't quickly opened the record so I may be wrong on my dates here a little bit. But, you know, I want to say subject to check of the years. I believe it was in 2008 that NorthWestern held or conducted a competitive solicitation for renewable resources.

At that time Titan was the result of that. The market was significantly higher at that time, and when NorthWestern evaluated the Titan market as the result of the competitive solicitation in 2008 it looked like something to go forward with.

COMMISSIONER HANSON: Let me slow you up here because everybody -- everyone here is very familiar with that discussion because it's gone around and around and around, and we've read it several times. And obviously my question was asked because I'm just not buying that argument.

You know, we know that natural gas jumps around a lot. We know that costs are going to increase. We know that capacity is going to be retired. We know all of these things. So why not jump in ahead of that on a capacity that is environmentally sound, which provides -- I mean, I'm going to regurgitate all the arguments that Oak Tree has been putting out here.

I just don't understand -- there isn't a compelling argument here why you wouldn't jump out and say -- and latch onto this.

MR. BROGAN: Commissioner Hanson, first off, I need to correct my first part of my answer. That was in 2007 that we had the first competitive solicitation.

The next point was in 2009 we had another one. There the lowest bids came in. Now NorthWestern, rightly or wrongly, determined the lowest bids were still too high because of the change in the marketplace. But those lowest bids in 2009 were substantially lower than Oak Tree.

And it seems to NorthWestern that it would have been very difficult for us to convince you that it was prudent for us to contract with Oak Tree at $65 when we could have got it for 50 something in the competitive solicitation.

COMMISSIONER HANSON: Thank you.

And appreciate Oak Tree's testimony and Staff's testimony.

Thank you, Mr. Chairman.

CHAIRMAN NELSON: Further Commissioner questions?

Seeing none, I can continue, but, Cheri, would you like us to do a lunch break?

THE COURT REPORTER: I'm fine.

CHAIRMAN NELSON: Commissioners, would you like a lunch break, or shall we move forward?

COMMISSIONER HANSON: What would you move forward with?

CHAIRMAN NELSON: Well, at this point I've got some observations. And I guess I would like to let everybody know kind of what my position is, and hopefully we can play off of that and see where we're going to end up here today.

Cheri's okay? Just making sure we have no further questions.

What I would like to do, and taking the Chairman's prerogative, first of all, I'd like to say to both sides I found this to be a greatly enjoyable docket. It has real meaning in a lot of different contexts, and I've enjoyed wrestling with this.

What I'd like to do for everybody is let you know where I'm at on the various issues, and then there's some questions that I think need to be answered. And I'm going to use Staff's last filing and particularly work off of their conclusions. Because I think they really summarize the questions that we have to answer here today.

And I'm on page 17 of Staff's last Brief. In the Conclusion section Staff recommends that NorthWestern Energy's hybrid method is the proper model to calculate the avoided costs of NorthWestern Energy of South Dakota's system. I concur with that.

Secondly, Staff says that NorthWestern Energy is obligated to purchase Oak Tree output based on the existence of an LEO created February 25, 2011. As such, all model inputs shall be based on said date. I concur with that conclusion.

Third, Staff says a capacity credit shall be incorporated into the hybrid method beginning in 2012. I concur with that assessment.

Fourthly, Staff says the proper avoided cost contract term is 20 years. I concur with that assessment.

The fifth item that Staff put in their conclusion was that the parties have not provided suitable inputs for this model, and as a result the Commission cannot establish the proper avoided cost. I would agree that neither party despite their efforts gave us an accurate avoided cost number.

I would also agree that with all of the testimony on both sides it may be difficult to find exactly what that right number is. And there is a part of me that would like to accept Staff's recommendation that we task both parties with coming back using some specific input guidance with a more appropriate number.

But I will say I am -- I am very sympathetic to Oak Tree's reality of the production tax credit likely going away.

Now I will agree with Staff. That's not a PURPA consideration. I feel it is a significant consideration for this Commission. I mean, we've had a proposed business come to us with a reality that faces them that this PTC may go away at the end of the year, and so I'm very sympathetic to that.

And so I'm faced with really two options at this point. One is that we accept Staff's recommendation and ask for a further proceeding with some specific guidance. And, you know, we can get into that if we need to.

The alternative to that that I would like to propose is I've put together a number. Mr. Soye indicated they didn't want to go there. I did. And I'm going to pass these sheets around in both directions so everybody knows what I'm talking about.

In preparing this you will find figures on here and numbers that are part of the record. I firmly agree with NorthWestern that there are really two components here. There is the component of NorthWestern's generation that is being offset, and there is a component that is being purchased. And so that the percentages you see at the top of 58.4 and 42.6 represent those two components, and those numbers I believe come from one of NorthWestern's filings or testimony.

Mr. LaFave's Exhibit 1 he talks about NorthWestern's generated avoided cost in 2013 as being $23.35. And so for the generation component I've started with that number and added 2 percent a year to that.

For the purchase component I have accepted the Black & Veatch numbers. Not that there aren't things there that can't be quibbled with, but I think there's things that can be quibbled with on the generation component side also. But I've accepted those. And utilizing the appropriate percentage of purchase power you can see how those numbers shake out, and a final number in the last column with an average levelized cost of $46.47.

As I have already said, I believe capacity payments need to be part of this. I accept the $17,000 per megawatt year, and I've added an increase of 2 percent per year to that. The capacity calculation I can accept 3.9 megawatts for 2013, but following that it would absolutely need to be based on the MISO method that NorthWestern is already familiar with.

Mr. Brogan this morning said that NorthWestern would be willing to purchase at $100 if this Commission Ordered or $35 if this Commission ordered. I found it interesting that my number is between those two figures, and so I will take it that NorthWestern is willing to purchase at that figure if this Commission so orders. And so that really takes one side of this equation off the table, if you will.

That leaves Oak Tree. And I think what that leaves is a choice on your part at least from my perspective. And I'm speaking as one. I have no idea what my two fellow Commissioners are thinking here. But the choice that I think I'd give you at this point is I'm willing to order this particular number if you are willing to accept it, and if you are not totalling accept it, I'm willing to pursue and accept Staff's recommendation that we go to further proceedings.

And, hence, that's my position. At this point I guess I'd appreciate maybe knowing what my fellow Commissioners -- what their thoughts are.

COMMISSIONER HANSON: Thank you, Mr. Chairman. I'll work from the same platform that you established by using Staff's recommendations here.

And as I -- as I read through them, I'll just simply state that I completely agree with you on the first four statements that you made regarding -- I won't reiterate those because you listed them slightly differently by referring to number 5 as their statement on page -- their being the Staff's statement. The parties have not provided suitable inputs for this model, and as a result the Commission cannot establish the proper avoided cost.

I agree with Staff's position on that. I think there's sufficient testimony and information that's been provided to us, and Staff made a very good job of articulating that position.

I would say that in regards to the amount of work that you did here, I appreciate the creativity and the considerable effort in putting your proposal together. I think it shows a real attempt by this Commission, by yourself, as attempting to resolve this matter in an expeditious fashion, and I congratulate you on putting it together.

My concern is that -- well, I don't want to place those on record just because it would be argumentative.

I would add one more item to Staff's recommendations. Staff recommended that -- a request for additional information and to schedule additional proceedings to determine four items. And those are found on page 18 of Staff's Posthearing Brief.

And I would simply add to that, that my inclination is that we establish some parameters of what establishes and when a LEO is created. I think that's something that's important to come out of not necessarily these specific hearings but of a future analysis so that people will be guided by that.

But I do agree with the Commission -- excuse me. Well, with the Commission's Staff on the five points that they have provided to us here.

CHAIRMAN NELSON: Thank you.

Commissioner Fiegen, would you like to respond?

COMMISSIONER FIEGEN: What I have -- you know, I just received Chairman Nelson's proposal so I certainly haven't had time to look at that. I would need time to look at that.

But when I looked at Staff's proposal, I would agree with the five proposals or the five points that they are making and just remembering that we have to look at carbon costs, which you talk about, and getting an inflated cost on natural gas will be important.

It will be interesting to see on capital credits and et cetera what we need to do there. But I need to continue to research that. And I believe we just need more time on this docket.

CHAIRMAN NELSON: Okay. With that, I appreciate both comments. What I'm going to do at this point is I'm going to turn to Oak Tree, and I'm going to ask a simple question. My proposal, is this something that you would like to at all entertain, or is it a can't do it, no way?

MR. UDA: I don't know the answer to that yet. Can I confer?

CHAIRMAN NELSON: Absolutely. And here's where I'm going. If it's something that you would at all entertain, then I think I need to ask that same question of my fellow Commissioners, and we would need to figure out how much time you need.

If it's something no way, can't do it, then that answers that question, and we move forward. So let's just take a five-minute recess and allow you to confer.

(A short recess is taken)

MR. UDA: Mr. Makens would like to speak for himself. As you know, he can speak for himself.

CHAIRMAN NELSON: Okay. Knowing that, let me just make sure we've got everybody back at the table.

MR. UDA: It's not a no, but it's not a definite yes yet.

CHAIRMAN NELSON: Understand. Understand. We will be back in session, and, Mr. Makens, welcome to come to the microphone.

MR. MAKENS: Thank you, Chairman Nelson. I want to say thank you for putting something out there that's a goal to reach a negotiation. That's been our goal through this whole process.

And wow. I'd love to say, yes, let's do it. I'm not a financial expert on a 20-year $40 million commitment. So I need to crunch these numbers and make sure that we can build it at this price.

And I think there's a hopeful possibility that we can go with this, and if we can, we absolutely will. But we need to talk to our financial consultants. We need to -- we need to make sure these numbers are accurate and right and reflect how it will be and make sure we're all on the same page here.

My understanding here you've got a mix and match of both sides' methodologies and numbers, and you have an energy price levelized total here of the 46.47. And then the capacity would be the extra. Recs aren't anywhere on here. So those would be extra.

So we need to look at everything, run it by financial consultants, and hopefully come back with a yes, we can do this or no, it's not reasonable or -- I can't answer that right now. I'd love to be able to say yes or no, and I thank you again for putting something out here middle ground. And I'd love to say yes, let's do it, but I need to run it by our team and financial experts.

And hopefully -- you know, it's the end of the week here. Hopefully, early next week we could have an answer as to whether this is a go ahead. Because we're coming up on a time crunch, and we want to get going on this.

So if this is going to work, yeah, we'd love to say yes. And, again, I want to thank you for putting something out here. That's a good starting point of something that both parties can agree to a negotiation, which we've been working towards this whole time. So thank you.

CHAIRMAN NELSON: And your understand is certainly understandable. As long as at this point it's not a definite no, that gives us something that we can maybe move forward to.

I guess with that then I'd look at my two fellow Commissioners. And I think maybe you've got two choices. One would be to move forward with Staff's recommendation of additional proceedings, and the other choice would be to give the Oak Tree folks, you know, the weekend to decide whether or not this is something that they would accept and that each of you would accept.

And I'd open it up for your commentary.

COMMISSIONER HANSON: Well, there's a few things. I appreciate the opportunity to speak to the creativity and the offer that you've presented here.

First, I'd just like to make a comment regarding Commissioner Fiegen pointed out on page 18 of Staff's memo that we've been referring to that they talked about a number of items there. And carbon costs was one of those items.

They used the word "proper" and I think they did that obviously with a great intention because they used it each one of the -- I probably should say proper parameters of what establishes a LEO. Because that makes great sense.

Because somehow we have to reach a conclusion of what really should be the inputs. What are the -- what specifically we can best define to be the proper application of the hybrid method, the natural gas costs, the carbon costs, the capacity credits. All of those things we need to define as much as we possibly can.

And that's where I'm coming from in reaching a conclusion of what is avoided cost. Or excuse me. At least in that particular method of establishing avoided cost.

And the reason I would struggle with a proposal that -- there are a few reasons, but probably the main reason -- one of the main reasons is that I look at avoided cost as being avoided cost. What is the cost that a utility avoids by allowing a QF to sell into its market?

And to me it's not what the next generating unit costs in the future. It's what is the cost that is avoided by allowing that entity to sell into that marketplace.

And we can come up with the cost of nuclear capacity, the cost of any amounts of capacity. And that really -- and we can use all sorts of carbon costs. And that really distorts the -- what the actual avoided cost is. And certainly we need to look at it on a 20-year period.

I believe a LEO has been established here. At the same time, the avoided cost price is -- as was pointed out by Mr. Uda when he was starting out, is the most contentious part of this entire proceeding, obviously.

But I just cannot come to a conclusion that we as Commissioners could come up with a dollar amount to -- even though we're taking it from different parts of expert testimony, that we could take those parts and make a -- for what I would consider a proper avoided cost.

And that's what I struggle with.

CHAIRMAN NELSON: Thank you. And I concur, frankly, with all of those comments. And if we go ahead with additional proceedings, I agree with you then. We're going to have to really drill down and define the exact costs for each of those elements. And that would be, frankly, in my mind, the purpose of additional proceedings.

Let me just make one final comment.

My purpose in the proposal that I laid out was not to firmly define each of those individual components but rather to come up with a number that I felt comfortable with, had some basis in what was on the record but more as an offer to the parties to say is this something you can live with? Is this something you can do business with? As opposed to we're going to define each of those individual components. And given the time constraints, that's the only way that I could see to do it.

Commissioner Hanson.

COMMISSIONER HANSON: Just one last comment. And I really appreciate -- by my comments did not wish to in any way infringe on the generosity of your proposal. But I would like to know from NorthWestern Energy as well what their comments would be from -- in regards to that number.

I know that they said that they would accept whatever we required of them to do, but I would -- anyone's going to have to accept whatever we require them to do. So I would like to know what their comment would be. And at that later date as well.

Thank you.

CHAIRMAN NELSON: Commissioner Fiegen.

COMMISSIONER FIEGEN: I believe next week will be an opportunity for us to come back and to study this and take it under advisement and see where we go from there.

CHAIRMAN NELSON: So I take that as meaning you are willing to wait for an answer from Oak Tree as to whether this is something that would be acceptable to them?

COMMISSIONER FIEGEN: I'm willing to look at all options and look at them next week.

CHAIRMAN NELSON: Okay.

In fairness, Mr. Brogan, I think Commissioner Hanson raised a good question. Are there any comments that you'd like to make at this point that don't put a bull's-eye on me?

MR. BROGAN: With all due respect, Chairman Nelson, I'm more concerned about putting a bull's-eye on myself. Because comments that I may make probably are substantially above my pay grade.

That said and never having been smart enough to be cautious, I would say two things. First, a minor thing and that's with respect to the capacity payment. As we have stated in both our Briefs and our Response Brief, we think that the escalation of the capacity payment should stop at a point certain. Not that the payment should stop but the escalation of it. So I think we have some concern with that.

I think it's also obvious throughout this docket that we certainly think that the Black & Veatch market forecast is highly inflated. That said, again, we still -- I think we're bound by law to do what you tell us to do.

CHAIRMAN NELSON: Thank you. I appreciate those comments. Anything else from the perspective of the Commissioners?

Now I don't know if both parties are aware but we have set aside or reserved temporarily some time on our schedule Wednesday morning to reconvene on this issue. Are you all aware of that?

You weren't. Okay. Because we weren't sure how this was going to play out today. We weren't sure if we would have a final answer today or if we would need to come back next week.

Let me just turn to both sides. Is that time frame something that you could make available to us?

MR. UDA: Speaking for Oak Tree, I will do whatever the Commission needs me to do.

CHAIRMAN NELSON: Wednesday morning.

MR. BROGAN: Mr. Chairman, if I might ask a question first. Are you contemplating the parties being here in person again on Wednesday?

CHAIRMAN NELSON: You know, frankly, I don't know that I see the need for that. I think -- I think it's going to be fairly straightforward. A lot of it will depend obviously on what the answer is from Oak Tree. And if the answer is no, based on what I heard from my fellow Commissioners, I'm thinking this could be a pretty short deal. And if the answer is yes, then it might be a little more involved.

And let me just make sure my fellow Commissioners -- that I have not misspoken at all.

COMMISSIONER FIEGEN: I just want to make sure that the parties know that I'm sure the Commission appreciates conference calling and you can always call in and we accept that as testimony face to face.

MR. BROGAN: I think for myself and I don't have my calendar in front of me but this is important enough obviously that I can change anything else that's on my calendar. I can't speak for my South Dakota sponsor, Mr. Olson.

CHAIRMAN NELSON: Mr. Olson, are you on the line yet?

MR. OLSON: Yes. I'm on the line, and I can be available at the Commission's convenience on Wednesday morning.

CHAIRMAN NELSON: Thank you.

MR. BROGAN: So with that in mind, yes, we could be available.

CHAIRMAN NELSON: Would it be -- and I'm going to turn to my counsel. Would it be appropriate for Oak Tree to have provided their answer to us in advance of that so that all sides can be prepared to wrestle with that?

MR. SMITH: That would probably be beneficial, I suppose. And we just heard at least one observation from NorthWestern so maybe we should make that reciprocal. And we do have Staff here too. Maybe we want to hear what they have to say because they've never seen this.

What do you think, Mr. Uda? Do you have --

MR. UDA: Well, here's the thing. For us this isn't about necessarily -- I understand why the Commission feels the obligation, and I think you're right to feel that obligation to, you know, really drill down into these numbers and get them right. But this is a practical endeavor for us.

So could we find ways to fly speck this and say, well, we don't agree with this assumption, we don't agree with that assumption? Sure, we can do that. We'd rather not.

And at this point I think if we can make this work, that's what's important to us. Because we want to build our project. And that's pretty much all there is to it. So that's all -- but I would say that it is reasonable from our standpoint that we get to you something hopefully, you know --

CHAIRMAN NELSON: Can we say 5 o'clock on Monday?

MR. MAKENS: We'll do our best. It's not all dependent on me. You know, there's a lot of inputs that go into the -- and I've been -- the last month I've been working on getting updated inputs and costs and everything, and it's a long process so we'll do our best and run it by the financial consultants. And we'll get something to you by 5 o'clock Monday.

CHAIRMAN NELSON: And that offer certainly goes to NorthWestern and to Staff. And we're not talking 30-page briefs here. Okay. So we understand we're all on the right page. Because John Smith doesn't want to read 30 pages.

MR. MAKENS: We'll keep it simple. And I want to reiterate we understand this is a move towards negotiation and not a Commission stance on avoided cost and anything related.

CHAIRMAN NELSON: With that, my assumption would be we would probably be looking at 9 o'clock on Wednesday morning, but we'll confirm that and John will put together some kind of order.

MR. SMITH: We can do that. Is that okay for the Mountain Standard folks? Are you okay with that?

CHAIRMAN NELSON: Yeah. I guess we can go 10 o'clock if it works better.

MR. UDA: Well, I'm not really an early morning person, which comes as no surprise to anybody who's dealt with me. So the later the better, but 10 o'clock works.

CHAIRMAN NELSON: That works.

MR. BROGAN: Unlike Mr. Uda, I am an early morning person. So 10 o'clock certainly works. And if you wanted to go at 7:00, that would be fine too.

MR. UDA: I would still be asleep.

CHAIRMAN NELSON: Okay. I think we've got a tentative plan. We will reconvene and certainly telephone access is certainly acceptable for what we need to do but you're obviously welcome to be here in person.

Mr. Smith.

MR. SMITH: I'm assuming since we're doing this on the record with a reporter that I don't need to send out any kind of formal notice or anything like that; right?

MR. BROGAN: No.

MR. UDA: No.

CHAIRMAN NELSON: With that, anything else for the good of the order?

Is there a motion?

COMMISSIONER HANSON: Mr. Chairman, I'll move to adjourn.

CHAIRMAN NELSON: Motion to adjourn. All those in favor vote aye.

Commissioner Hanson.

COMMISSIONER HANSON: Aye.

CHAIRMAN NELSON: Commissioner Fiegen.

COMMISSIONER FIEGEN: Fiegen votes aye.

CHAIRMAN NELSON: Nelson votes aye. We're adjourned.

STATE OF SOUTH DAKOTA)
:SS CERTIFICATE
COUNTY OF SULLY)

I, CHERI MCCOMSEY WITTLER, a Registered Professional Reporter, Certified Realtime Reporter and Notary Public in and for the State of South Dakota:

DO HEREBY CERTIFY that as the duly-appointed shorthand reporter, I took in shorthand the proceedings had in the above-entitled matter on the 26th day of April, 2012, and that the attached is a true and correct transcription of the proceedings so taken.

Dated at Onida, South Dakota this 14th day of May, 2012.

Cheri McComsey Wittler,
Notary Public and
Registered Professional Reporter
Certified Realtime Reporter

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