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
October 2, 2012

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BEFORE THE PUBLIC UTILITIES COMMISSION,
CHRIS NELSON, CHAIRMAN
KRISTIE FIEGEN, VICE CHAIRMAN
GARY HANSON, COMMISSIONER (by telephone)

COMMISSION STAFF
John Smith
Karen Cremer
Greg Rislov
Chris Daugaard
Brian Rounds

APPEARANCES
Michael Uda, Oak Tree
Al Brogan and Timothy Olson, 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 2nd day of October, 2012, commencing at 1:30 p.m.

CHAIRMAN NELSON: I will call the meeting to order. Commissioner Fiegen and Commissioner Nelson are present in the committee room. Commissioner Hanson is with us on the line.

Gary, just for your information, Yvette LaFrentz is also on the line. Everybody else is present here in the committee room.

COMMISSIONER HANSON: Thank you.

CHAIRMAN NELSON: I just want to go over the timelines that we've got. I think the last time we met we thought we were maybe making some progress and several of you have had questions about that progress. So hopefully we can get that resolved today.

What we would like to do is in -- and just for the record in EL11-006, and we're dealing with Oak Tree's motion for partial reconsideration and NorthWestern's application for reconsideration. We plan to give Oak Tree 30 minutes for your initial arguments. NorthWestern 30 minutes for your arguments. 20 minutes for Staff arguments.

Then we'll come back to NorthWestern for 10 minutes of rebuttal, go to Oak Tree for 15 minutes of rebuttal, and then allow 5 minutes for NorthWestern rebuttal limited to Oak Tree's rebuttal. And then after that we will go to Commissioner questions, discussion,

and/or action.

Any questions on how we will proceed today?

Any questions?

Okay. If not, Mr. Uda, you may proceed.

MR. UDA: Thank you, Mr. Chair, members of the Commission, Staff. First of all, I know it's been a long time since we were in front of you. And I wanted to sort of remind you a little bit about the nature of the project. It's a 19 and a half megawatt project in Clark, South Dakota.

I think this is a good project and would provide reliable energy and some capacity to NorthWestern's rate payers in South Dakota. But in addition to that, and I think even more important is I think that the Makenses are good people and I dealt with some developers who are just in it for the money. And I think the Makenses are in it for the long haul. And I think that they will be responsible developers. And I think that makes it an important part of your consideration.

With that, I'll turn to our motion for partial reconsideration.

Could I have the first slide, please. Thank you, Sherry.

Okay. So what we have here -- and this isn't meant to represent anything real. This is just demonstrative, and it's just kind of an example of how -- on the first half of the slide what we see here is two hypothetical days of load generation capacity.

And as you can see, the red line is coal operating at a steady state. The green line is coal plus gas. And the blue line represents load. And what you can see from this slide is that the incremental cost of operating coal and gas -- or the incremental generating capacity is in excess of NorthWestern's load if you add those resources together. And, again, this is for demonstrative purposes only.

The second half of the slide on the bottom is the associated incremental cost and market prices. And this is where Oak Tree has a problem with the hybrid methodology. As you can see, the blue line represents the cost, and the -- of the incremental cost of NorthWestern's resources, again, for illustrative purposes only, and the red line represents market.

And the problem Oak Tree has with the hybrid method is as follows: In the hours where NorthWestern has represented on the right side has insufficient coal to serve its own load, it relies on the market. And that's a prudent decision, and that's something that it should do. It does not use its peaking resources because presumably they're more expensive than the market

alternative.

The problem for Oak Tree comes in the hours where there is sufficient low cost coal to serve NorthWestern's load. Because in those hours the market is higher than the incremental cost of operating NorthWestern's own coal resources. And what NorthWestern does in those hours is it sells into the market.

And, again, that's a prudent thing for the utility to do. It's maximizing the value of those resources.

The problem comes in that when you really look at this what happens is that anytime market would help us specifically in the hours where there is sufficient low cost coal to meet NorthWestern's resources we get the cost of the coal.

In the hours where there's insufficient resources we get the market. So to us what happens is anytime market could help us on either side of the equation, either in the hours where NorthWestern has insufficient coal or in the hours where NorthWestern has sufficient coal, we get the lower of the two alternatives.

Now the definition of avoided cost is essentially what it would cost the utility itself to purchase resources from a third party or to generate that

power itself by acquiring a facility.

So in this case you could use either one. You could use the incremental cost of operating NorthWestern's resources, including the peaking resources in the hours where NorthWestern needs resources instead of resorting to the market. And then in those low cost hours, in those hours where the utility has sufficient low cost coal to meet its load you could assign the value of incremental cost to the coal plants.

Or alternatively you could assign the market across all hours. That's what Mr. Lauckhart did. He used Black & Veatch's analysis, he used their power curve and calculated a number. And it's very simple and it's very straightforward. And I can just tell you from my experience most qualifying facilities don't like getting the market rate because it's typically lower than the alternative.

What you've done here with the hybrid methodology is essentially you're playing a heads we win, tails you lose game.

Now I want to address briefly the objections that I've heard to this, the argument I've just made. And the argument is Oak Tree is indifferent if you used incremental cost of NorthWestern's resources or the market. We just don't want to have a situation where

we're getting the worst of both worlds on either side of the equation.

And the response we've heard to this is essentially two arguments. The first one is, well, this represents more accurately what NorthWestern does. And that's not the case. NorthWestern isn't backing down its coal plants. It's selling that power in the market when it has sufficient capacity to do so. As I said, that's a prudent decision.

So there's not a mythological world or even real world example of where what NorthWestern is doing is backing down its generation when it has sufficient coal resources to meet its load. It's doing the prudent thing and selling it into the market. So it doesn't represent reality.

The second argument I've heard is, well, the definition of avoided cost is, well, what it costs. But if you look at what NorthWestern actually does, the incremental activity, and this is really if you look at it what they're really doing is using the market. And if you've got a market you have to consider in that activity that's where the incremental activity is taking place. And when NorthWestern makes the decision to sell into that market, what it's doing is essentially selling its output to a third party who presumably is backing down another unit of generation. This has to take place from a load resource vantage point. And that value is being transferred to NorthWestern in return for backing down. So that resource in the market is being displaced and that's the fundamental principle of avoided cost.

You can either assume there's a market or you can assume there's no market. What we're asking you to do is just be consistent in that determination. We're not telling you what the outcome of that determination needs to be but we're saying that this methodology is inconsistent with avoided cost because of this heads we win, tails you lose scenario.

I want to turn next to -- well, before I proceed, one point I want to get to is NorthWestern cites in response to our motion for reconsideration two cases for the proposition that a hybrid methodology is appropriate. The first cited is the Arkansas Entergy decision. But that case did not deal with long-term avoided costs for prospective QFs. It dealt with calculating an avoided cost for existing QFs that did not need to build a resource.

The second decision they cite is from Virginia. The Virginia decision did not use the market at all when it determined avoided costs for Virginia Electric Power. The reason is is that using the PROMOD model and it did

not use the market dispatch portion of that model when it made its calculation. In fact, it relied solely on the utility's incremental cost of its own resources.

Now I want to quickly move to carbon costs. And okay. The carbon cost figure that was used by the PUC here is $10 by 2015, I believe, $15 by 2020, and $20 by 2025. And this figure is simply out of the range of normal expectation for what carbon costs will be. And if I could -- Sherry, if I could have that second slide real quick.

CHAIRMAN NELSON: Okay. Do we need to -- everybody in the room, you're comfortable with this?

MR. UDA: I'm fine.

CHAIRMAN NELSON: Okay. And so far as your verbalization of this, do we need to go off the record?

MR. UDA: I don't think so. Because I'm going to describe it pretty generally.

CHAIRMAN NELSON: Okay.

MR. UDA: This is from the Black & Veatch Fall 2010 Energy Market Perspective. And they did a calculation of various different scenarios. And they included EIA carbon cost scenarios in it.

And as you can see from the slide, the 5, 10, 15 is way below any assumption that anybody is using. And as you can see, the Black & Veatch forecast is actually

-- the blue line in the middle is actually at the low to low mid range of those estimates.

And this is something that we've talked about extensively in our briefs, and I would commend you to those. But one of the points that we've made about this whole issue of calculation of carbon costs is NorthWestern both in 2009 and 2011 when it did its procurement plan in Montana used a very different calculation.

Their proposal in this proceeding is 0. The 5, 10, 15 was adopted by the Commission. But if you read what they've said in their procurement plan, they assume now as the 2011 procurement plan delayed implementation of Waxman-Markey until 2019, and some of those costs are very high in the outer years but it averages out levelized to about between 23 and $25 per ton, not 5, 10, and 15. And that's assuming delayed implementation of Waxman-Markey.

And that's essentially what Black & Veatch did too is they delayed the implementation of Waxman-Markey because it had stalled at that point and was not at that point a viable legislation.

The basis for NorthWestern's calculation is the NorthWestern Power & Conservation Council's sixth plan where they do an estimate of carbon costs. And I commend

that to you. I think that's a pretty good analysis of what you can expect.

The game changer, of course, is the recent I believe it was June of 2012 decision in Coalition For Responsible Regulation versus EPA 684 F.3d 102 in 2012, as I said.

The reason that decision is so important is because in 2008 a number of states, coastal states not surprisingly, sued EPA because EPA had yet to make a determination as to whether greenhouse gases were a threat to human health and safety under the Clean Air Act.

The United States Supreme Court said that not only does the EPA have the authority, the jurisdiction to consider that issue, it had the obligation to do so. So EPA went back and it made an endangerment finding. And not only did it make an endangerment finding, it proposed regulations for stationary sources as well as for mobile sources.

The D.C. circuit reviewed that decision and said that it did not find that it was in error. And so we have, although not implemented yet, we have the looming threat of the EPA essentially forcing limitations on greenhouse gas emissions. Now I don't know how they're going to do that, but my expectation is it could be extremely expensive. And it may be an impetus, for example, for Congress to move back toward the cap and trade approach, which seemed to be the preferred approach prior to 2010.

And another point related to this is the Staff has said, and I agree with them, that you need to take into account when calculating potential greenhouse gas emission regulations, or carbon costs as we've shorthandedly referred to it here, you need to consider the likelihood of it being adopted and what gets adopted. I think that's a fair point.

And I think that's what happened in both the Black & Veatch forecast and in the Northwest Power Conservation Council and NorthWestern's own calculations. They said, well, we don't think it's going to get adopted this year. If you look at NorthWestern's calculations, they don't have any carbon costs until 2019. So even though it's very expensive in the outer years, it's discounted by those early years where there's nothing there. So I think that discount has already taken place.

Now I want to make a point about the EIA forecast because I think this is really important. The EIA forecast has -- the AEO has a number of different scenarios. They have a reference case. The reference case what it does is it says basically if nothing

changes, this is the number.

It doesn't take into account either legislation that's been passed or regulations that have been adopted, for example, the EPA's HAP regulations dealing with hazardous and toxic pollutants because that has not been funded yet. And the same thing is true for EPA's regulations. So at this point that EIA reference forecast does not include those items.

But they do, the council does have a forecast that includes various different scenarios including a $25 per ton carbon cost calculation, and you can run those scenarios side by side.

Okay. We know that retrofitting those plants, one of the criticisms Mr. Lauckhart had of the EIA forecast is it didn't take into account retirement of coal plants based on these regulations. We know both in North Dakota and South Dakota that that is going to be a considerable expense if you just take Big Stone standing alone. There are going to be considerable costs associated with that. And a lot of utilities, at least according to Black & Veatch, a lot of utilities are going to be retiring coal plants rather than proceeding to use them and displacing them in their generation portfolios.

The last issue in our motion for reconsideration is current information. The use of current information.

Now it wasn't clear to me whether this was an unintentional issue, but 18 CFR 292, 304(d) 2 gives a right to a qualifying facility to have a rate forecast at the time the legally enforceable obligation is incurred.

Given that, and the Commission's finding that the LEO occurred as of February 25, 2011, I think it would be contrary to the law to permit the use of current information. I think that for whatever you want to call it, a lock-in or whatever else, I think it would be inappropriate to do that.

I want to briefly refer to a couple of arguments. And I believe Staff agrees with us on this issue. This has to do with the current-information issue. NorthWestern argued that Mr. Lauckhart either ignored or failed to consider information available to him on February 25, 2011, including the game changing November 2010 EIA AEO forecast. And Mr. Lauckhart's testimony makes it clear he did consider it, but he didn't think that it was sufficient at that point to change his calculations.

And to the extent that you think the November 2010 EIA AEO was game changing because it showed an increase in technically-recoverable reserves, take a look at the 2012 forecast. That number has dropped precipitously. That may be an indication of a

fundamental change in the market or not but it's not anything you need to consider because current information should be used.

They also argued that Mr. Lauckhart had access to the Black & Veatch Energy Market Perspective for spring of 2011, but he didn't. The spring forecast came out in late spring or early summer, something like that. He was involved in the process but he was not privy to the outcome of that process as of February 25, 2011.

And I would point out that under the Commission's current order NorthWestern can argue that Mr. Lauckhart's calculations were wrong but that doesn't have anything to do with the use of current information. They can argue he should have considered this, he should have considered that and his calculations are incorrect. But they can't say that he didn't consider it.

Now two quick points just -- how much time do I have left, Mr. Chairman?

CHAIRMAN NELSON: You have 11 minutes.

MR. UDA: Okay.

This is on NorthWestern's motion for reconsideration. First, NorthWestern argues that inclusion of carbon costs would violate the avoided cost principle. This makes no sense.

The reason it makes no sense is because if you're trying to figure out what price you need to pay to a qualifying facility, you need to figure out what costs you're avoiding.

So if in the resource plan, for example, the utility says, well, we need to hedge our risk against gas prices in the future by having other resources, for example, renewable resources, whether it be wind, hydro, whatever, and in doing so they consider, for example, the risk that there's going to be greenhouse gas regulation, if they do that and they incorporate in that forecast a carbon cost of some kind, it makes absolutely no sense not to at the same time say, well, this is what the qualifying facility would get. You have to know what costs are being avoided.

If carbon costs are being avoided by purchasing from a qualifying facility it must be included in the avoided cost rate. That's as straightforward a decision as you need to make.

The second point I would make is if you don't do it, you're discriminating against qualifying facilities by paying them less than you would pay the utility to build its own resource. Now maybe the argument is that you don't give either one a carbon cost.

Perhaps, but if you think that inclusion of carbon cost is important and appropriate as a hedge

against future risk, then you need to do it for both. I think that's pretty simple.

I guess another point I would make is, you know, you made a determination that there needed to be carbon costs included in the calculation, and you picked this forecast that Lands Energy came up with, which as near as I can tell was based on Mr. Lewis talking to some of his colleagues at Lands Energy.

Now that might be a perfectly appropriate way if you are, you know, trying to decide who you think is a better player, you know, Buster Posey versus Ryan Braun. But it's not an appropriate way to set avoided cost.

The EIA, for example, does this thing called the National Energy Modeling System which is so complicated nobody really knows how it works but they spend a lot of time doing it and they come up with a pretty good idea of what they think the range is. Black & Veatch does the same thing and any number of professional forecasting entities put a considerable amount of time and effort into figuring these things out.

And what I'm saying is is that I think that there is substantial support for your decision to include carbon costs. I'm not sure you got the carbon costs right, but I do think that rather than making a decision about what that appropriate cost is today it's one of

those things that could be when we have a hearing on the technical matters involving the calculations, the rate should be included.

Neither of the cases also cited by NorthWestern for the proposition that you don't include avoided costs in -- you don't include carbon costs in the calculation of avoided cost but you do it in resource planning.

First of all, in Montana the issue about whether you include carbon cost is an issue presently before the Montana Commission. We believe that the Whitehall Wind decision in Montana said that they have to include it if it's in the integrated resource plan and that's what their electrical procurement plan is.

The Utah decision, Rocky Mountain Power, included carbon costs in their calculation of avoided costs. The Utah Commission said this isn't consistent with what we've told you to do. Explain. And rather than explain, Rocky Mountain Power took it out. So I don't think either one of these cases is precedential for the proposition NorthWestern cites.

Time, Mr. Chairman.

CHAIRMAN NELSON: 7 minutes.

MR. UDA: On the issue of legally enforceable obligation let's recall what the record shows here.

The record shows that in early 2010 Oak Tree's representatives approached NorthWestern about obtaining a contract. They didn't really get anywhere so they started writing letters and saying, hey, you know, we'd really like to sell you our output. And the response they got back was, well, here's our avoided cost. If you can provide it at that rate, we'd be happy to talk to you.

The testimony from Mr. LaFave at hearing was he didn't even think he could go beyond the short-term avoided cost rate which is like $22 a megawatt hour at that point.

And the interesting thing about that is of course we weren't there to get a short-term avoided cost rate. We were there to get a long-term avoided cost rate so we could obtain financing for the project. And so a short-term rate of $22 was plainly a nonstarter. So we kept trying to engage the utility, and the answers we got back were the same.

And nobody in this case, not even NorthWestern, is now maintaining that their long-term avoided cost was $22 a megawatt hour.

CHAIRMAN NELSON: 5 minutes.

MR. UDA: So what NorthWestern has argued is that, well, you sent us a contract with a bunch of terms on it and we don't agree to those terms so, therefore, there's no legally enforceable obligation. Understand that there's a difference between a legally enforceable obligation and the contract terms themselves.

Legally enforceable obligation, and FERC has made this clear a number of times, most recently in Cedar Creek Wind, the legally enforceable obligation is created when the qualifying facility commits to sell its output to NorthWestern. As you may recall, the testimony of Mr. Makens was they tried everything they possibly could and the only purchaser that made sense, the only party to whom they could really sell it was NorthWestern. So they continued to push on that front, and they are continuing to push today, obviously.

But I think the most important aspect of this is at any point if NorthWestern had decided to negotiate, which your order from 1982 orders them to do, they could have said we don't like this term, we like this term, we don't like your price, can we negotiate on that. Can we negotiate terms. They have the power today to do that. But they haven't done it because they're not interested in it. Basically at this point their answer is no.

And at that point FERC says if the utility refuses to negotiate, at that point a legally enforceable obligation has been incurred and it was incurred and

that's your order from February 25 -- it occurred on February 25, 2011, and that's supported by the record evidence in this case and there's no need to change that.

I think the remaining issues in this case are more technical issues, and they have to do with the proper calculation of the avoided costs including what gas price forecast you use, what escalation factors you might use. And I would suggest the issue of the calculation of carbon costs should be one of those issues. Because I think it's a technical issue. I don't think that the evidence in the record to date from Lands Energy is sufficient to stand on its own.

And with that, Mr. Chairman, I will conclude my remarks.

CHAIRMAN NELSON: Thank you. With that, we will turn to NorthWestern for 30 minutes.

MR. BROGAN: Good afternoon, Commissioners. It's good to be back in Pierre. I have to say I'm not sure what to say today. I think nearly all, if not all of what I could say and what I -- hopefully not what I will say is in the briefs. Therefore, I fully intend or fully hope not to use anywhere near my allotted 30 minutes.

I do think, however, in the briefs there is a

great deal of obfuscation, irrelevancy, and plain mischaracterization.

Given that I -- I fervently hope that South Dakota does not repeat the mistakes that Montana made 30 years ago with respect to setting avoided cost and promoting qualifying facilities, mistakes that are costing NorthWestern's Montana consumers over $600 million, that I can shed some light on the things that are of significance in this proceeding.

You have before you today NorthWestern Energy's application for reconsideration and Oak Tree's motion for reconsideration. Mr. Uda has talked about both. In my initial presentation I will only try to talk -- at least I'll try to restrict my comments to support of NorthWestern Energy's application for reconsideration. We have the difference of terminology, "application" and "motion." "Application" comes from the rules. I'll try to refer to both of them as "request" but if I slip into "motion," please accept that I mean it as a request. If I say "application," please accept that I mean it as a request.

NorthWestern asked for reconsideration with respect to inclusion of carbon costs and the calculation of avoided cost and with respect to the Commission's determination that an LEO had been created on

February 25, 2011. First a few comments about the carbon costs.

I think it's undisputed that as of today there are no carbon costs. And I think what NorthWestern has been saying all along is that rate payers should not pay for something that doesn't exist.

Now it's possible, I think Mr. Uda would say even probable, that there will be carbon costs of some kind in the next 20 years. But as of today when we are trying to estimate, or I should say calculate, NorthWestern's avoided cost for the next 20 years they don't exist.

Oak Tree has made much of the fact that NorthWestern and, quite frankly, other utilities consider things that may happen in their planning, in their resource planning. But consideration of carbon costs for planning does not justify including it in avoided cost.

It's not something that as of now the utility avoids. If the utility -- or to be specific, if NorthWestern is looking at what resources to build, buy, or purchase power from today, especially if it's looking long-term as to what resources it might build, certainly it's going to as part of that resource planning consider things that may happen.

You know, we all in business and in our

individual lives try to anticipate things that may happen, but that doesn't necessarily mean we start paying for them at this point.

But what Oak Tree is asking is that you include a speculative carbon cost in calculating the avoided cost.

Keep in mind this doesn't affect NorthWestern. This affects NorthWestern's customers. It isn't NorthWestern that pays it. It's NorthWestern's customers that pay it. And there's no reason that they should be paying for something that we can't show that NorthWestern is actually avoiding. It may well be that down the road it's possible, but at this point it's not.

My last comments at this point with respect to carbon is that the parties definitely disagree as to the value of carbon if they are included. As I said, that's part of Oak Tree's motion. I'll discuss it during my rebuttal -- or I guess I would call it response as opposed to rebuttal.

So let me turn next to the issue -- the second issue that NorthWestern applied for reconsideration on, and that was the issue of the legally enforceable obligation.

This may be surprising considering that this is my fourth time here in less than a year to discuss this

particular docket but I think the parties actually agree on what an LEO is. I think we do. But I think we disagree fundamentally on what it takes to create an LEO.

NorthWestern Energy's position is that it takes an unconditional commitment by a potential QF or an existing QF to sell at the avoided cost as determined by a regulatory body.

If I understand Oak Tree's response to NorthWestern's application for reconsideration, Oak Tree seems to assert that an LEO can be created by an unenforceable, conditional offer to sell the output of a future project.

I think we need to step back a little bit. When we talk about legally enforceable obligation I think the first question we have to ask legally enforceable by whom? Who are we talking about having the right to enforce this LEO?

We have to remember it's the utility. This comes from both FERC and court cases who have repeatedly said a QF by binding itself to deliver binds the utility to purchase. We need to think about that real carefully. By binding itself to deliver it binds the utility. But if there is no -- if the QF does not bind itself to deliver it cannot have created an LEO.

It's well settled that an LEO is not a mere

option in a QF's fate. They can't say I've created an LEO, now I'm going to see if I can build the project. Because if that were the case, there was nothing for the utility to enforce. And, unfortunately, that's what we have here.

Oak Tree offered to sell at a price much higher than NorthWestern's avoided cost. And the record evidence also shows that when this Commission asked NorthWestern about -- or excuse me. Asked Oak Tree about what it would do if the Commission set an avoided cost at a given level, Oak Tree would not commit to delivering.

You know, if merely offering to sell at some price and negotiating it later is enough to create an LEO, then anyone can offer to sell to a utility at any price. Say $1,000 a megawatt offer. I've offered to sell it to you. I've committed to doing it. Then they can Petition the Commission to determine that there was an LEO based on that offer, find out what the price is, then shop the project around. During all of this time, of course, the utility can't do anything else with respect to resource acquisition because it may have this QF.

And then once the Commission sets the true avoided cost rate if the QF in shopping it around doesn't find anybody that will finance it for them or any way

that it can build it, they just walk away, and the utility is left holding the bag.

And that's how come an offer to sell at a rate other than avoided cost cannot create an LEO.

Now I'm not saying -- in case somebody wants to go there, I'm not saying that the parties have to agree on that price before an LEO can be created. I'm not saying that they have to have entered into a contract before an LEO can be created.

An LEO doesn't take what attorneys normally consider to be the fundamentals of contract. You know, a meeting of the minds, a mutual agreement, certain terms. An LEO doesn't require any of that, but it does require a commitment to deliver power, to sell power at the price equal to a utility's avoided cost. Not at a price that makes a QF financially viable.

There's nothing in PURPA that requires utilities to pay a rate that makes QFs financially viable, only that they pay the avoided cost.

In a very brief summary I would point out that the utility is essentially a three-legged stool. And the legs of that stool are the utility shareholders, the utility's employees, but I think most importantly for our discussion today a utility's consumers.

Sometimes we forget about the consumers when we start talking about PURPA and QFs. PURPA did not forget about consumers. PURPA included language that required consumers to be indifferent and prohibited utilities and prohibited regulatory commissions from requiring utilities to pay any amount greater than true avoided cost.

Now that's full avoided cost but it's the true avoided cost, not speculative or hypothetical.

For those reasons NorthWestern respectfully requests that the Commission grant its application for reconsideration, reverse its determination of the inclusion of carbon costs and avoided cost, and reverse its determination that an LEO had been created by an illusory commitment.

Thank you.

CHAIRMAN NELSON: Thank you. We will now turn to Staff for 20 minutes.

MS. CREMER: Staff relies on its previously filed Answer regarding Oak Tree's motion. That said, I will summarize Staff's position as it applies to both parties' motions, however.

As to the issue for reconsideration that the hybrid method is inconsistent with PURPA, Staff believes that the hybrid method is the only appropriate avoided cost calculation methodology to use under the

circumstances.

This is due to NorthWestern's status in South Dakota as a vertically-integrated utility that predominantly relies on its own internal generation.

The Commission cannot base an avoided cost rate exclusively on market estimates or incremental costs of operating NorthWestern's internal resources as this does not reflect the true nature of its South Dakota systems in the costs associated with operating that system.

In addition, strict reliance upon either of the cost components does not give proper effect to the requirements of PURPA.

Regarding current market conditions and a legally enforceable obligation, Staff agrees with the Commission that the LEO was established as of February 25, 2011. Thus, Staff does not support NorthWestern's request to reconsider finding 4.

However, the Staff does support Oak Tree's request to reconsider the portion of the Commission's order requiring the parties to utilize current market conditions and projections in order to determine the avoided cost rate.

The language contained in 18 CFR 292.304(d)(2)(ii) requires an avoided cost rate be based on information available when the LEO

was created.

Staff feels that carbon costs should be incorporated into the hybrid method and, therefore, does not support NorthWestern's request to reconsider finding 2 and finding 3, which stated that NorthWestern had not incorporated carbon costs in the model, required inputs to be modified, and adopted Lands Energy's carbon cost projections.

Staff supports Oak Tree in its request to reconsider the carbon cost estimates to be included in the calculation of Oak Tree's avoided cost rates. Carbon costs should be based on the evidentiary record presented by the parties in this matter. The carbon cost estimate provided by Lands Energy does not carry sufficient evidentiary support to be used in this proceeding.

No evidence was presented in the record to support Mr. Lewis's carbon price estimate.

Oak Tree provided the Commission with a carbon price estimate based on the actual proposed legislation but did not discount the price based on the likelihood of any carbon legislation becoming law. Staff feels it is appropriate for the Commission to exercise its judgment to establish a carbon price projection guided by potential legislation and discounted based on the assumed probability that -- of that legislation becoming law.

In summary, Staff recommends denying the portion of Oak Tree's motion asking the Commission to reconsider the use of the hybrid calculation method. Staff recommends granting the portion of Oak Tree's motion asking the Commission to reconsider the use of current market conditions and projections to determine proper natural gas and electric market price inputs.

Staff recommends rejecting NorthWestern's motion to reconsider the establishment of the LEO. Staff further recommends rejecting the portions of NorthWestern's motion asking to exclude the consideration of a carbon price in the hybrid method. And Staff recommends granting the portion of Oak Tree's motion to reconsider the use of Lands Energy's carbon price estimate.

Finally, Staff recommends that the Commission exercise its judgment to establish a discounted carbon price projection guided by potential legislation.

Thank you.

CHAIRMAN NELSON: Thank you.

NorthWestern, 10 minutes.

MR. BROGAN: Mr. Chairman, thank you. And I'll try to go very quickly but I may use the whole 10 minutes. I'm not sure.

As I said earlier, I intended to use this time to respond to Oak Tree's motion. The first part has to do with the hybrid method. And it has to do with things that Mr. Uda said during his initial oral argument.

He complains that the hybrid method creates a heads we win, tails you lose approach or result for Oak Tree -- or for NorthWestern. Obviously, we disagree.

In his oral -- in his initial argument he says the problem is that in the light hours NorthWestern sells into the market and seems to suggest that NorthWestern selling into the market somehow affects the costs that NorthWestern avoids by purchasing power from Oak Tree.

Remember, that's what we're -- that's what we're trying to figure out. What costs does NorthWestern actually avoid by taking power from Oak Tree? Shouldn't be that hard, but obviously it is.

He says that the problem is Oak Tree gets the lower of cost of our market. They get the cost in the low load hours and they get the market in the high load hours. He says that doesn't represent what NorthWestern does because NorthWestern doesn't back off its coal plants.

That may be true, but it's totally irrelevant. What NorthWestern does isn't the issue. What costs can NorthWestern avoid? During the light load hours NorthWestern can only avoid the variable cost of

operating its base load plants.

During the heavy load hours when NorthWestern's base load resources are not sufficient to meet its load, the only costs that NorthWestern can avoid are the costs of acquiring that energy in excess of what the base load plants produce. And NorthWestern acquires energy at the lower of market or the cost of running its peaker plants.

In the recent past and probably foreseeable future that will be market and not operation of the peakers plants. The hybrid method accurately and correctly determines the costs that NorthWestern can actually avoid.

Mr. Uda said the fundamental principle of avoided cost is displacement of resources and that by selling into the market NorthWestern is displacing its base load resources.

To the extent that the fundamental principle of avoided cost is the displacement of resources, it's the displacement of resources by purchases from the QF, not by selling into the market. And, again, it would be to some extent arguable that because NorthWestern doesn't back off its coal plants and won't if it purchases from Oak Tree, the avoided cost relative to the light load hours should be zero. That would be one way of looking at it. But that's not the way that anybody's asked to

look at it.

I want to deal very briefly with the issue about current market conditions. If, indeed, an LEO was created it's possible that looking at anything that happened after that would be violative of PURPA. However, that doesn't mean we should blindly accept what one expert has said.

Because there are differing views and because there is ample evidence in the record that there were a lot of things that were known or should have been known by February -- by the end of February of 2010 that don't appear to be reflected in a Black & Veatch fall of 2010 report. And the mere fact that Mr. Lauckhart thought those things weren't substantial enough to require some sort of adjustment to that fall plant should not be dispositive.

Also I would point out, of course, that if the Commission grants NorthWestern's motion for reconsideration of the LEO issue, then clearly it can consider anything up until it finds an LEO was created or until certainly the end of the hearing.

Finally, let's talk about carbon costs. And, Mr. Chairman, how much time do I have left?

CHAIRMAN NELSON: 4 minutes.

MR. BROGAN: I'm going to have to be very quick

and I apologize to the court reporter if I start talking too fast. First off, the demonstrative slide that's on the screen, this is something that I guess I was not aware was coming today. I thought we were going to be talking about Exhibit 2 to Oak Tree's motion for reconsideration. That slide includes things that are not on that initial exhibit.

I also would -- so I would point out it's difficult for me to respond to something that I've never seen except that it, you know, basically is the exhibit plus some Black & Veatch estimates. It's up to the Commission to determine the credibility of Black & Veatch estimates as presented by Mr. Lauckhart.

Secondly, Oak Tree asserts that the carbon costs from Mr. Lewis have no evidence in the record. Staff supported that. Basically when we get to carbon costs we're talking about opinions. And experts can use many ways to come up with their opinions.

And to say that an opinion is reached through mathematical analysis when we don't know the assumptions, when we don't know the equations, when we don't know the model doesn't give it any more credibility than an expert saying I reached this through my considered judgment and consultation with other experts.

So again, to the extent that the Commission agrees -- thinks that carbon costs should be included, it has reached the proper decision by using the Lands Energy figures.

Staff suggested that we need to consider the probabilities. I think we would have a lot of disagreement as to what's the probability of carbon costs. Mr. Uda suggests it's high on the basis of the EPA actions. Others would suggest, I think, and I'm trying to be careful not to try to provide any testimony or evidence but I think others would suggest that the probability is very low.

CHAIRMAN NELSON: 1 minute.

MR. BROGAN: Finally, I do want to correct a statement that was made with respect to the EIA reference case. Mr. Uda referred to it as if nothing is adopted, this is what happens. That's not what EIA says about its reference case. What EIA says, this is what may happen. It doesn't say this is what will happen.

Mr. Chairman, I thank you for your indulgence.

CHAIRMAN NELSON: Thank you. At this time we will go to Oak Tree for 15 minutes' rebuttal.

MR. UDA: Thank you, Mr. Chairman.

We talked a little bit about carbon costs and why it's important to include them. And I didn't hear an explanation from Mr. Brogan or NorthWestern Energy why

including carbon costs violates the avoided cost principle. What he said is this is uncertain.

Everything in an avoided cost calculation is uncertain. We've heard testimony that, you know, gas prices have been historically wrong, that inflation factors can be off. We're estimating things here. What we're trying to get our arms around is what makes sense. What is a reasonable approximation of what we think will happen? We have to do that.

So just to say that today NorthWestern isn't experiencing any carbon costs doesn't mean you shouldn't consider it. You have to consider it. And, in fact, NorthWestern in Montana says it would be prudent for a utility to consider those issues. They're not saying it in this proceeding because essentially they're opposed to the idea of Oak Tree building a project.

The LEO issue is kind of humorous because I think Mr. Brogan is correct that, you know, we agree generally. I think where we disagree is in the actual practical application of the LEO doctrine.

So let me ask you, so you go to NorthWestern, you're a developer and you say I want to build a project. And they say, well, nuts to you. I mean, you can -- you can say that they didn't say that but essentially that's what they said.

So how are you supposed to bind yourself to deliver to something? If they had signed the contract that we sent them along with our LEO letter on February 25, 2011, we'd be delivering power today. We would have gotten the production tax credit, and we would be delivering a valuable resource to South Dakota today. And it would have been, we think, within the range on avoided costs.

Now Mr. Brogan says, well, we don't have to agree on the price. Okay. We didn't. We don't have to agree on the contract terms. Yeah. We didn't.

What we said is we're going to do an Interconnection Agreement with NorthWestern. We're going to commit the resources to do that. We're going to make an offer to sell which is unconditional. If we sell to anybody it will be NorthWestern. We're not going to sell it to anyone else. And the rights that are created under PURPA are not for the utility. They're for the qualifying facility.

Now whether you agree with the decision or not, Congress made the decision that qualifying facilities were going to be a special category, and it's the job of every state public utility or service commission to enforce that obligation.

And one of your obligations as State Commission

is to encourage the development of these resources. If you can say, well, you don't get an LEO because no matter what price we set, you have to deliver. And, you know, no one is going to do that. You know that. That's a practical issue.

So if NorthWestern wanted to put contract provisions in place that said if you don't deliver as of this date, whatever price you have to pay a penalty, that would have been a subject of negotiation. But the undisputed record is they didn't negotiate. Your February, 25, 2011, decision on the creation of an LEO is correct. It's based on the record.

I want to talk briefly about the hybrid methodology. I think this is a point where I think we're talking past each other. What happens when NorthWestern is short of low cost coal -- or excuse me. Is long on low cost coal and is selling it into the marketplace? It's never really long. I mean, it's selling in the market. What happens in that case if they buy from Oak Tree?

Yeah. Mr. Brogan's right. They're not going to back down their coal plant. But what they are going to be doing is reselling that in the market and somebody in the market -- and this is why I say you can either pretend the market exists or it doesn't. You're asked to pretend it exists over here when it hurts Oak Tree and down here when it hurts Oak Tree -- or you don't recognize it down here when it hurts Oak Tree.

And my point is you either pretend the market exists or it doesn't. You either give us the incremental costs of NorthWestern's own resources or the market, but you can't discriminate by doing one when it hurts us and the other when it hurts us. Because that's what happens, it automatically lowers avoided costs.

The point is a resource in the resource stack that NorthWestern is -- is part of the market is being displaced, and that's part of the calculation of avoided cost.

Mr. Brogan said that one way of looking at this because they don't back down their coal plants is that avoided cost should be zero. It would never be zero because there will always be a value associated with operating those coal plants.

NorthWestern continues to have an obligation to buy it. The only question would be what is that cost? What we're saying is the simplest method, the best method is to just adopt a market forecast approach because it takes into account all hours and all variabilities within the market, including any times when you get zero or less than zero, you get negative avoided cost.

The point is is that NorthWestern doesn't operate in the hours that it doesn't need resource -- that it doesn't need resources as though the market doesn't exist. It plays in the market. That's where the incremental activity takes place. And I think that's an important consideration when you take into account this hybrid methodology, which I really do think is a heads we win, tails you lose kind of methodology.

The last issue I want to talk about just briefly is the current market conditions. I think Staff is correct if you read the regulation. If you believe that a legally enforceable obligation was created on February 25, 2011, that's the date on which the information matters.

And I believe Mr. Brogan's argument has to do with whether or not Mr. Lauckhart's avoided cost calculation was correct, not the point at which that calculation was made. That is -- my understanding is there's another hearing for that to determine whether he calculated avoided costs properly. But it's not the issue of whether current information should be considered. In other words, information today or anything that happened after February 25, 2011. That's a completely different issue.

Now the issue of carbon costs, I think Staff --

we agree on this issue. Staff has said that they don't think Lands Energy's forecast is supported by very much. And Mr. Brogan's argument seems to be that all opinions are equal so, you know, why have a hearing? Why have multiple experts? Why have a clash or a debate over those issues? Just listen to whoever comes up with something.

I'm not saying that Mr. Lewis is not an expert, but what I am saying is Mr. Lewis is not creating sophisticated models to try to figure these things out to the best of his ability.

There are organizations that devote considerable resources to this. Now could they be wrong? Sure, they could be wrong. But are you more likely to be wrong if you just talk to a couple of people you work with, or are you more likely to be wrong if you do an exhaustive study of the issue, take into account all the opinions, and yes, actually crunch the numbers. Because sometimes we're wrong about things like that.

For example, I'm using baseball again. Some people will say a certain player is better than another player, and there's any number of metrics you can look at to measure it. But that doesn't mean the debate isn't worth having. Because sometimes you can convince yourself that there's a better way of looking at things.

But that doesn't mean you stop with the first opinion that's based on nothing else than your conversation with a couple of other people.

You should really look at this more as a scientific matter and I think that's the kind of technical issue that this Commission would benefit from in terms of having a hearing on it and considering all the different opinions and then you can explore with Mr. Lewis what was the basis, what was the foundation for this? What else did you consider? Those things were not discussed at hearing, and I think that's absent from the record now.

I believe the evidence you'll see in the record is that Mr. Lewis's forecast is on the lower end. And this was actually part of Mr. Lauckhart's prefiled direct testimony, I believe. I can't remember what exhibit it was, but it was attachment 5. So this was always in the record. So I don't know why Mr. Brogan's confused.

Anyway, in closing what I'd like to say is on the three issues that we raise, we think the hybrid methodology is discriminatory. We think that it sets too low an avoided cost. We are not saying what it is but that's what we think. We think that it automatically would produce a lower result than another methodology.

The second issue with respect to carbon costs, I think we made clear what our position is on that. Current information the same. We think the Commission should find that there should be carbon costs, and we think you shouldn't use current information. With respect to NorthWestern's argument that somehow carbon cost inclusion would violate PURPA, I submit to you it makes no sense.

And, second, the second argument on the LEO, I honestly don't know what else Oak Tree was supposed to do. They were left in a position where they were bargaining against air. And if you're ever in that situation and -- I think sometimes we all end up in that situation, you know that you have no leverage.

The fact is the utility owns the marbles. They have to let us be willing to play in their game. If they want to tell us that we have to bring, you know, purees or some kind of other marbles to the game, we would have considered that. We would have discussed it with them. The problem was no discussion took place.

If anything comes out of the Commission's decision here, it should be that it's very clear that the utilities have an unconditional obligation to negotiate. Because then you don't end up in these situations where

there's arguments about whether an LEO was created based on the lack of bargaining. You end up with a clearer situation where you can then determine what rates should apply.

And, for example, even though there were disputes, you know, there are ways of handling those disputes. And I think that one of the things that you can clearly say about everything that's happened in this particular case is we've been trying, and I've got the Makenses here today. They're still committed to selling to NorthWestern. I don't know what else they could have done. They did everything within their power to bring this process to a conclusion.

So with that, I would like to thank the Commission, Mr. Chair, Staff, for your indulgence, and thank you for all your consideration.

CHAIRMAN NELSON: NorthWestern, time for your rebuttal, limited to Oak Tree's rebuttal on your application. 5 minutes.

MR. BROGAN: Thank you, Mr. Chairman. And I'll try to be very brief but 5 minutes is brief.

First off, with respect to the LEO issue, Mr. Uda has basically indicated that NorthWestern failed to negotiate. I think that's untrue.

The record establishes that in early 2010 Oak

Tree approached NorthWestern. Yes, NorthWestern believed its avoided cost was what it stated and kept indicating that it needed to -- could only pay up to its avoided cost.

What Mr. Uda did not say then is after the exchange of letters over a several-month period Oak Tree disappeared for six months and didn't contact NorthWestern, and then suddenly in January there's a letter and in February there's a letter that says agree to our price or we're going to sue you.

And then Mr. Uda says he doesn't know what else Oak Tree could do. Quite frankly, I think it would have been very, very simple. In the pricing term in the contract that Oak Tree submitted strike out the dollars and the inflation portion and say Northwestern offers to sell you our power and commits to sell you our power at the avoided cost as determined by the Commission. That's all it would have taken.

They did not do that. I have a lot of other things I'd like to say about the hybrid method, but I won't. That's not within our motion so I won't say it.

With respect to the carbon costs, I just want to point out one thing very quickly. Mr. Uda just said that Mr. Lewis's carbon cost is at the lower end. He didn't say it was out of the ballpark. It's at the lower end of

estimates.

And as the Commission will recall, NorthWestern has said all along that when you're binding rate payers to pay something for 20 years you should make conservative assumptions and that the lower end is a conservative assumption.

Like Mr. Uda, I thank the Commission for its indulgence. I'm sorry that we're having to have so many hearings. I look forward to the Commission's order in this matter and then probably our final -- hopefully our final hearing for the technical matters as Mr. Uda referred to them.

Thank you.

CHAIRMAN NELSON: Thank you. And I appreciate both sides -- appreciate your written submissions and your brevity today. I did expect this to go longer.

At this point we will turn to Commissioner questions.

Commissioner Hanson, do you want to go first or would you like us to?

COMMISSIONER HANSON: Mr. Chair, I believe I've had every opportunity I ever wanted to in a docket to fully apprise myself of issues, especially on this one. So I'm fine.

Thank you.

CHAIRMAN NELSON: Commissioner Fiegen?

COMMISSIONER FIEGEN: You can start.

CHAIRMAN NELSON: Okay. I do have questions. Mr. Uda, and I think you hinted at this, but I just need to ask it very, very directly. Once this Commission sets the avoided cost does Oak Tree have an absolute obligation to deliver at that cost, given our finding that an LEO was created?

MR. UDA: Mr. Chairman, it would be tempting for me to say that no matter what the rate is they have an obligation to deliver. And I think that technically that might be the case. But I think financially if they can't do it -- I mean, can I just clarify what I'm trying to say?

CHAIRMAN NELSON: Feel free. We've got time.

MR. UDA: Okay. So let's suppose the following circumstance happens. Let's suppose that you know that in order for you to actually build the project and make any money you need $50 a megawatt hour. Let's just suppose that as a hypothetical. And suppose the Commission comes back at 10. Now at that point you can't even buy your equipment. So obviously in that case if you say, well, it's an unconditional commitment, does that mean that you have to build your project and operate it at a loss?

I think that's not what FERC intended. What I think FERC intended is to say, okay, once you have a legally enforceable obligation, and by that they mean you commit to sell your output to a utility, you have an obligation at that point to deliver that output to that utility. You can't sell it to somebody else. You can't sell it into the market. You can't play the market. You have to sell it.

If it's not financially feasible for you even to build the project, at that point, then even though there might be a legally enforceable obligation, it's just not going to happen.

So I think that's one way of looking at it.

And I think this is kind of what Mr. Brogan was kind of hinting at. You know, the point is is that we tendered a contract to NorthWestern and there isn't any performance penalty in it.

So, for example, if they wanted a performance penalty, that's something they could have negotiated for. They didn't say anything about it at all until this proceeding commenced. So they're obviously unhappy with the lack of that. But I think that's one way you can ensure performance.

But the other way you can ensure performance is that you get the avoided cost calculation that actually

reflects the utility's avoided cost. Because once you establish that avoided cost, then you will get projects that can perform at that level.

The problem here is that we had an enormous difficulty getting any information out of NorthWestern about what its avoided costs were and, in fact, a lot of that information didn't appear until we had to file a Motion To Compel in this matter.

So, you know, for us to say that we know as a matter of fact whatever rate the Commission sets we have to deliver, I don't think that's the legally enforceable obligation issue. I think that's a practical issue.

Is NorthWestern out anything if it doesn't get output from NorthWestern and NorthWestern fails to perform? Well, I suppose if they had this in their resource queue and they were forestalling other investment decisions, it might be possible that they do.

But if that's the case, there's a solution to that. And, for example, Idaho is dealing with this issue of delayed performance, liquidated damages, and that's an issue that I think the Commission could decide. But that's a separate issue from whether or not a legally enforceable obligation exists in the first place. It's a

term of art and it isn't intended to bind a qualifying facility to deliver no matter what rate the Commission sets.

CHAIRMAN NELSON: Thank you. The other question that I've got for you, several, is there a carbon cost today? Mr. Brogan has told us there isn't. Do you concur with that?

MR. UDA: I do. But if I might add to that, Commissioner Nelson, we are trying our best to get a handle on what the situation is going to be. And I think that's kind of the case for all estimates of everything that goes into the avoided cost calculation.

CHAIRMAN NELSON: Is it possible that there will not be a carbon cost over the next 20 years?

MR. UDA: I think that that is a vanishing improbability. I think that if Congress doesn't act to do something like Waxman-Markey, EPA is going to do it. I think the Supreme Court has told them they have to do it. I think the D.C. circuit has affirmed the method that they have used is appropriate. The question of costs is going to be something that's going to have to be considered.

But I think that in the alternative to Waxman-Markey, I would suspect that if people are doing a carbon cost calculation today based on what EPA is going to do, it's going to be substantially more expensive than a cap and trade. That's my opinion and not based on anything in this record.

But I think that's one of the reasons having a technical hearing on this issue might clarify some of these better. You wouldn't have to listen to me. You could actually listen to someone who actually knows what they're talking about.

CHAIRMAN NELSON: Ms. Cremer, you've talked -- on the same issue of carbon costs, you talked about the fact that we should include calculating the probability. Is there anything in the record that speaks to probability?

MS. CREMER: As you know, I wasn't the attorney on that so I will let Mr. Rounds who was at the hearing address that.

MR. ROUNDS: Yeah. I think the only thing that you're going to find in the record is my own testimony.

CHAIRMAN NELSON: And can you refresh me on that.

MR. ROUNDS: Yeah. I had just made the suggestion that because utilities typically when they're doing resource planning and taking carbon costs into account they'll look at a case in which there is a carbon

cost or there is a low carbon cost and they'll look at a case where there's a high carbon cost, and then based on -- they can use the information that they glean out of the results of those two scenarios with other variables held constant.

So if --

CHAIRMAN NELSON: Go ahead.

MR. ROUNDS: For example, if, say, in the no carbon situation the decision is going to result in a cost of $50 million but in the case of a -- the high carbon price you see the cost of -- or a benefit of $100 million, it gives them that information to know what their risk is given those futures.

CHAIRMAN NELSON: Well, and I understand that you can run scenarios using high numbers and low numbers to get a range of what's -- of what those different possibilities would be, but that still doesn't give us any testimony as to what the actual probability is of either of those actually happening.

MR. ROUNDS: Right. And my testimony on that, as I recall, was that we think that is a pretty subjective decision and that's why we thought it was a good decision for the Commission to make.

CHAIRMAN NELSON: I agree. Mr. Brogan, you indicated in going to the LEO issue that you were not

saying that the parties have to agree on a price in order for it to be created. And then I think you talked about the fact that if Oak Tree had simply said we're going to leave it up to the Commission.

And so is it your understanding that really the only way a LEO can be created is if that price question is left to a Commission in every case?

MR. BROGAN: Mr. Chairman, no. I don't believe that.

I believe that's the situation in this case. I would point out as an example that is different is that in the state of Texas, for instance, the Public Utilities Commission has adopted a rule that an LEO cannot be created until the QF can show it can deliver energy within 90 days. Which basically as a practical matter I think we would all agree means the QF has to build before it can create an LEO. And that provision has been upheld by the courts.

But, you know, the point is that to create an LEO, in my opinion, at a minimum a QF has to commit to deliver power at the avoided cost. And I think I would add that, you know, utilities are prohibited from paying more than avoided cost and they're prohibited from paying less.

CHAIRMAN NELSON: Thank you. No further

questions.

COMMISSIONER FIEGEN: Mr. Chairman, I have a quick question on, on February 25, 2011 we're trying to figure out the costs of the inputs, and I believe you went back to the fall of 2010 and the Commission kind of wanted current. And we understand that maybe that's not perfect either. And the report actually didn't come out until the spring of 2011, but I'm sure a lot of work was done by February 25 or March 1 or whatever.

How can we acquire that information or how can we work together to try to get the information that is more current on February 25 instead of the old information from the fall?

MR. UDA: That's a good question, Commissioner Fiegen.

What actually transpired. First, I'll just tell you what we did. We used the November 2010 Black & Veatch Energy Market Perspective, the fall one, didn't come out until November. It usually takes them six months to get everything put together because they have all these different groups that are working on it, national gas group, markets group, people who are working on transmission constraints and issues like that. They do this for the whole country so it's an exhaustive exercise.

So when Mr. Lauckhart was relying on it, that was the most recent work that Black & Veatch had done that was actually a final product. I mean, to a certain extent, I mean, he was aware of the work that was going on and he assisted in preparing the spring 2011 forecast, but he was -- you know, for one thing he couldn't have said anything or published anything public about what was being said because of his agreement with Black & Veatch.

But second of all, he looked at the direction the market was heading. And I think it's still his opinion today that that -- the forecast that he used was in the money. And it was an accurate forecast when he prepared it. And he looked at the movement and various different things, the EIA, AEO forecast and so on and said that he didn't feel like the fundamentals in the market had moved enough to change his forecast.

So the question of how you get that. If, you know, the technical hearing is going to I assume get into that as to what is the appropriate information to use at that point in time, then I think what you have to do is to see what other information was available and whether or not other information should have informed that decision that was available as of February 25, 2011.

And I think if you look at the various

forecasts, I think that, you know, you could say some were higher and some were lower. And I think Mr. Lauckhart and Black & Veatch's estimate was somewhere in the middle.

Did I answer your question?

COMMISSIONER FIEGEN: Did I like the answer to your question?

MR. UDA: That's a whole different thing.

COMMISSIONER FIEGEN: Another quick question on the hybrid method. Because all the time we've spent on trying to figure out avoidable cost, of course, is the main concern. And, you know, how can you make that workable, the hybrid method?

MR. UDA: How could you make the hybrid method workable?

COMMISSIONER FIEGEN: Uh-huh.

MR. UDA: You know, there's probably somebody way smarter than me that could answer that question. But, you know, I guess my feeling about it is is that -- and this is in a way sort of my opinion about guidance for the Commission in the future. But I think you need to come up with something that's easily replicable.

I mean, one of the things that we've struggled with, for example, in Montana and I think Idaho has a better handle on it, although there's still

disagreements, is how you come up with a method that basically can be fairly easily calculated and updated that reduces some of the fights about the methodology itself.

The difficulty is is what are you going to say that avoided cost is in any given situation. So, for example, when you're looking at a utility and it's not using its peaking resources because it's relying on the market, do you say, well, in some hours we're going to assume that they're not relying on the market and were using peaking resources? That is sort of antithetical to reality because that's not what's going on.

In the hours where there is sufficient coal, base load coal, to meet NorthWestern's base load needs do you say, well, we're going to use the incremental costs of operating those coal plants? Because that's not in reality what's really happening.

What's really happening is regardless of the hour, they're playing in the market. So is it possible that you could come up with something that sort of fixed the hybrid methodology? You could but I think you'd be -- I'm not sure -- my law professor used to use this expression, "The game's not worth the candle." I guess it was at a time when people played games late at night and they had to decide whether they were going to use

another candle or not. But I'm not sure that in this circumstance that particular game would be worth the candle because I think you'd end up complicating things more.

So I think the simplest thing to do is to come up with a method that's replicable that everybody kind of understands and that gives a proper signal both to the utility and to prospective QFs about how this method will be calculated in the future.

COMMISSIONER FIEGEN: So currently the Commission's order is that we have chosen the hybrid method. How can you make that workable?

MR. UDA: Well, I mean, one of the things we don't know, the unknown is we haven't had the technical hearing yet. And if it turns out that we employ the hybrid methodology in that setting and it produces a good result, and by good, not necessarily good for my client. I mean, a good result in the sense that it produces something that's reliable and replicable and so on, I think that at that point the Commission has done its job.

I think the issue comes down to -- for us, is it comes down to is that approach -- is that fair? And we don't think it is, but that doesn't mean that, you know, you might not think it is.

But I think that you looking at the hybrid methodology and getting the inputs right, that's an important part of that equation. Because, I mean, just having the methodology is one thing, but it's like the old saying, "Garbage in, garbage out." I mean, if you get bad inputs, you're going to get bad results.

CHAIRMAN NELSON: I'm about to go to Staff to see if they have any questions, but, Cheri, are you okay for a few more minutes?

John or Greg, any questions?

MR. SMITH: I have one.

CHAIRMAN NELSON: Go ahead, John.

MR. SMITH: Back on the status of carbon costs, be it through some kind of cap and trade tax or the other potential high kind of cost scenario would be regulation, what is the exact status of the EPA now? Is there a NOPR currently outstanding, or is there just talk about a NOPR?

MR. UDA: No. There are actual rules that were reviewed by the D.C. circuit in June. And the proposed rules, I haven't read them, but the D.C. circuit reviewed them and did not find them arbitrary or capricious.

MR. SMITH: And do you have any comment on that, Al?

MR. BROGAN: Mr. Chairman, Mr. Smith, it's my

understanding that those rules do not actually impose a carbon cost on NorthWestern at this time. I would have to review them carefully to comment more.

CHAIRMAN NELSON: Mr. Rislov?

MR. RISLOV: Thank you. This would be directed to Oak Tree. I am looking at a document and it has a real long name but it's NorthWestern Energy's Answer in Opposition to Oak Tree's Motion.

MR. UDA: Uh-huh.

MR. RISLOV: And specifically I'm looking at the bottom of page 6 and the top of page 7.

MR. UDA: See if I have that, Mr. Rislov. Just maybe you could just tell me what it says.

MR. RISLOV: Okay. It says, "Mr. Lauckhart failed to consider that the Waxman-Markey Bill was dead." And then it goes on to say that the carbon costs, and I'm going to go on to the top of page 7, the carbon costs reflected in your filing have diminished what I would say is significantly, looking at the bottom paragraph on page 6 and the top paragraph on page 7.

And my question is -- well, number one, my question to you would be what is your response to those two paragraphs?

MR. UDA: Well, first of all, as I think I mentioned previously, I believe in my opening remarks,

Waxman-Markey, I wouldn't say if -- if it's dead, it's definitely undead. I think that in light of EPA's intention to regulate greenhouse gas emissions -- and I think Mr. Brogan may be correct. There's no actual cost imposed on NorthWestern Energy as of yet by that particular legislation -- by that particular regulation, you know, there are going to be costs associated with it. And I think those costs will be substantially higher.

And maybe this is just my cynical view, but I think part of this is, the reason the EPA did what it did, other than being a little bit chastised by the Supreme Court was to force action on something like Waxman-Markey. I don't know that Waxman-Markey will be the model, but I think everybody in the industry would prefer the cap and trade approach. So even if Waxman-Markey is technically dead, and I think it technically is dead, I think it's more likely to be undead and I think it will come back in some form.

MR. RISLOV: Okay. Number two, I'm going to be more specific.

MR. UDA: Okay.

MR. RISLOV: We talked about the forecast, the fall of 2010 and that's what you included in your filing. And I believe if I read this correctly the costs that I'm

reading here came out in the subsequent six-month projection by Black & Veatch; is that correct?

MR. UDA: I'm not sure, Mr. Rislov, what you're referring to when you say --

MR. RISLOV: The revised numbers that appear on the top paragraph on page 7.

MR. UDA: Yes. I think that comes back to the question of current information, what information did Mr. Lauckhart have available to him when he calculated the avoided costs in the first instance. I don't think he had that particular thing.

And I would point out that if you looked at Black & Veatch's employment forecast, those numbers are significantly higher.

MR. RISLOV: Again, focusing on February 25, 2011.

MR. UDA: Right.

MR. RISLOV: In knowing that that fall forecast was already old news, although albeit not that old news, but still when you're doing six-month forecast it becomes old news fast. In this case do you believe it could be argued that these numbers shown on the top paragraph of page 7 were more accurate as of February 25 than those that were shown in the fall forecast?

MR. UDA: Well, two things. I think, firstly, 65

you have to consider whether that information was actually available on February 25, 2011. And the accuracy of it notwithstanding, those numbers reflect Black & Veatch's opinion sometime into the future. And you're right. I mean, when you're doing it every six months the numbers become stale relatively quickly.

But, you know, in any event, what you're doing is estimating. And so, you know, there's a margin of error in any of those estimates. And what will happen is if you see the EIA forecasts and the various different scenarios they run and look at the Black & Veatch or any of the other forecasting entities, those forecasts change over time.

So, you know, is it more accurate? I don't know. It might be less accurate. I mean, they didn't have -- for example, Black & Veatch didn't have the EPA decision that just came out in June. I think that would substantially affect their opinion.

MR. RISLOV: And I would ask you this question: To the extent that fall 2010 forecast came out reflected that prior six -- I don't know exactly which six months in 2010, but I would assume the one that came out subsequently, February 25 was in that study period for the following six months.

Would you agree?

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MR. UDA: You know, I don't know that that's exactly how it was done. I mean, Mr. Lauckhart is more the expert on that than I am. I'm not sure the process that they go through. I don't know if February 25 was a period they were including in the subsequent forecast or not. I don't know what they based the subsequent forecast on.

What I do know is that Mr. Lauckhart only had the November 2010 forecast in its final form when he used it and I assume that if we had filed this later or earlier those numbers would be different. I don't know what direction they would have gone in.

MR. RISLOV: I have one more question for you. And that was in the Staff's answer to Oak Tree's motion on page 3 of 7. And I would expect being this is the first time for this Commission through this matter that the definition of avoided cost can be an issue of sorts.

But about halfway down the page we see A, B, and C that are quoted from PURPA. And then the following paragraph which cites a couple of cases.

MR. UDA: Uh-huh.

MR. RISLOV: And it begins reading, "The incremental cost to the utility means the amount it would cost the utility to generate or purchase the electric

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energy but for the purchase from the cogenerator."

MR. UDA: Uh-huh.

MR. RISLOV: Is that not what the hybrid method offered by NorthWestern, in fact, does?

MR. UDA: Mr. Rislov, Mr. Chairman, members of the Commission, no. It doesn't. Because NorthWestern is not operating in a vacuum. Before there were organized markets, utilities used their incremental costs of their generating resources as the basis for avoided cost. And if you look around the country you will not find another one that's using the hybrid methodology. And the reason they're not using the hybrid methodology is because it's illegal.

What they're actually doing with this incremental cost is if they were assigning the incremental costs in all of the hours I would agree with you. That's not what's going on with the hybrid methodology.

MR. RISLOV: And I would like to turn to NorthWestern and go back to the first question I had asked with regard to the numbers that appeared, the significant lower numbers that appeared in the subsequent report. I assume it was called the spring of 2011 report put out by Black & Veatch. And, again, referring to your answer in opposition to the Oak Tree motion. Bottom of

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page --

MR. UDA: Before we get too far into this, Al, was there an issue about confidentiality on this?

MR. BROGAN: Mr. Commission, Mr. Rislov, Mr. Uda, I believe there is. I'll be very careful with my answer.

MR. UDA: Thank you.

MR. BROGAN: Mr. Rislov, if I understood your first question, it had to do with Mr. Uda's response to the statements that were made at the bottom of 6 and bottom of 7. And if I understand your question to me and I guess I'm asking for clarification is is this from a spring 2011 Black & Veatch forecast? Is that what you're asking?

MR. RISLOV: That would be a good start, yes.

MR. BROGAN: And I would refer you to footnote No. 22 that indicated that it did come from the spring 2011 forecast slide No. 67.

MR. RISLOV: I believe you heard the questions I asked Mr. Uda, but what is your belief with regard to -- and this is making some assumptions I realize you have not necessarily agreed to. But if we assume that an LEO was created on February 25, 2011 -- well, it's in your document. I guess I don't need to ask that question. I'm going to ask a different question. Excuse me.

Did you compute a levelized cost related to these numbers?

MR. BROGAN: Related to the updated Black & Veatch numbers?

MR. RISLOV: That's correct.

MR. BROGAN: No, we did not.

MR. RISLOV: That's all I had. Thank you.

CHAIRMAN NELSON: Any other questions from the Commission?

(A short recess is taken)

CHAIRMAN NELSON: We will call the hearing back to order. We need to do a rollcall of who is on the telephone line.

Commissioner Hanson, are you with us?

COMMISSIONER HANSON: Yes, I am.

CHAIRMAN NELSON: Yvette LaFrentz, are you with us?

MS. LAFRENTZ: Yes, I am.

CHAIRMAN NELSON: Do we have anybody else on the line?

MR. MAKENS: Matt Makens.

CHAIRMAN NELSON: Matt Makens. Thank you. Anybody else on the line? Thank you.

With that, we are at the point of discussion and/or action on any of the points. And maybe the first

thing, I'm just going to visit with the two fellow Commissioners and see if they are ready to move forward at this point. At this point, I will say that I am ready to move forward.

Commissioner Fiegen, your thoughts?

COMMISSIONER FIEGEN: Mr. Chairman, first of all, on the motion to reconsider is that where we bring it to reconsider and then we go to another hearing or could you clarify that, John?

MR. SMITH: No. It's -- we're not -- with our rule on reconsideration it's like a similar motion in a court proceeding. It's not a parliamentary motion.

COMMISSIONER FIEGEN: Okay.

MR. SMITH: It's not like in the legislature or in that kind of a setting. So they have a right to reconsideration. That's a right under our rules. It's just then you need to make a decision on the merits. So that's where we're at.

When they're talking about the subsequent hearing, they're talking about the follow-on hearing that is referenced in the interim order that was originally scheduled for June 19, which we cancelled when all the motions to reconsider were filed.

I think that's what you're referring to, is it not, Mr. Uda and Mr. Brogan? Yeah.

And what that was meant to do is then with the various inputs that we requested in the order, the Commission did, that was meant to allow the submission of additional evidence and analysis and then to hold a subsequent follow-on hearing to again get information that complied or comported with the interim order. That was the point of that and that's what they're talking about.

COMMISSIONER FIEGEN: Thank you. First of all, I enjoyed everybody's information today. This is a big case, and the avoided costs, I started talking to my 11 year old the other day about avoided costs when he was dealing with an issue. And I just looked at myself like, okay, Kristie, I know you've dealt with avoided costs for a long time with this hearing but you don't have to bring it to your 11 year old.

But I think we do need to get it right and I still have some questions about the hybrid method and the appropriate avoided costs. And I just want to make sure that we make the correct decision and would like some time certainly on that one.

There's some of these that I could vote on today. I would rather just bring a whole package on Tuesday to the Commission with my final decisions on all of them.

CHAIRMAN NELSON: Commissioner Hanson, your thoughts? Commissioner Hanson.

COMMISSIONER HANSON: Can you hear me all right?

CHAIRMAN NELSON: Oh, now we can, yes.

COMMISSIONER HANSON: All right. Well, apparently I had it on mute when I didn't believe I had it on mute. I always give deference to fellow Commissioners on matters when they feel that they would like to have some additional time or additional information. I've been in that position myself a few times, and certainly Commissioner Fiegen is absolutely correct from the standpoint of wanting to get this right.

It is a very complex issue and we do want to make certain we get it correct. Because as has been pointed out in testimony and as is very much cognizant to each one of us is the fact that this will affect a significant number of rate payers -- and, in fact, it will affect rate payers in the future. So from that standpoint I would give deference to Commissioner Fiegen's desire to have additional time.

With regard to the hybrid method -- sorry. I seem to be --

CHAIRMAN NELSON: Yeah. You are cutting in and out on us, Gary.

COMMISSIONER HANSON: In regards to the hybrid method, I believe that the hybrid method is the correct method to use, and I certainly would encourage my fellow Commissioners to support that. I very much appreciate the questions regarding CO_2 and the appropriateness of whether we should make those considerations.

Both sides have argued vehemently for accuracy, and yet this is an extremely challenging number of issues to have accuracy with. There's a lot of guessing as to what the future is going to look like with this. And from that perspective I think we need to have as many inputs as we can to have it accurate.

And when I look at the CO_2, you know, that number can be danced around with and used in so many different directions that I'm frankly uncomfortable with it and I'm very uncomfortable with, as I know my fellow Commissioners are, the judicial activism and bureaucratic activism and that has created the situations that we have today that causes some of the difficulties that we're faced with on this issue.

So those are just some of my comments at this time, and I would certainly, as I say, give deference to my fellow Commissioner.

Thank you.

CHAIRMAN NELSON: With that -- and so just so I understand, there's none of these six issues that you

would want to handle today? Correct? Wait and work on them as a package?

COMMISSIONER HANSON: Unless Commissioner Fiegen has one or two that -- whatever she and you are comfortable with deciding at this juncture, I'm comfortable with deciding any of them; however, whatever you folks want to tackle, I'm happy to tackle. If you want to give until Tuesday, that's fine with me too.

CHAIRMAN NELSON: Okay. Thank you. Commissioner Fiegen.

COMMISSIONER FIEGEN: You know, I would just prefer to bring the whole package on Tuesday.

CHAIRMAN NELSON: We will defer until the meeting on Tuesday, October the 9th. Yeah. And certainly your presence by telephone is just fine.

Anything further for the good of the order?

COMMISSIONER FIEGEN: Because my assumption on Tuesday, it is very brief. We will have our decisions made. We will discuss it as a Commission. It should be done and I'm not expecting to ask any more questions unless something comes up.

CHAIRMAN NELSON: You don't think we're going to get into any heated debate?

COMMISSIONER FIEGEN: You and I might but other than that.

CHAIRMAN NELSON: With that, we will defer and we are adjourned. Thank you.

(The hearing is concluded at 3:25 p.m.)

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 2nd day of October, 2012, and that the attached is a true and correct transcription of the proceedings so taken.

Dated at Onida, South Dakota this 9th day of October, 2012.

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

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