

BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF SOUTH DAKOTA

In the Matter of the Complaint by Oak Tree Energy LLC against NorthWestern Energy for refusing to enter into a Purchase Power Agreement	EL 11-006 <b>NorthWestern Energy's Response to Chairman Nelson's Proposal Presented at Oral Argument on April 26, 2012</b>
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## Introduction

At a Public Utilities Commission ("Commission") meeting on April 26, 2012, Chairman Nelson proposed a resolution of this matter that calculated the price to be paid to Oak Tree as the weighted average of NorthWestern Energy's ("NorthWestern") generation costs and Black & Veatch's estimated market price, plus a capacity payment. The Commission requested that the parties file comments on the proposal by 5:00 P.M. Central Daylight Time on April 30, 2012. NorthWestern submits these comments in opposition to Chairman Nelson's proposal ("Proposal").

NorthWestern appreciates the attempt to derive a creative solution to the dispute before the Commission. However, NorthWestern believes the Proposal (1) is contrary to law, (2) overstates NorthWestern's avoided costs, (3) is technically flawed, and (4) will have deleterious unintended consequences.

## Contrary to Law

NorthWestern cannot legally pay a qualifying facility ("QF") more than the incremental cost that the QF permits NorthWestern to avoid. The Proposal does not find that the recommended price to be paid is equal to NorthWestern's avoided cost. As such, the Proposal

does not comply with the statutes and the administrative regulations that require any contract price to be equal to the avoided cost.

## Overstates NorthWestern's Avoided Cost

NorthWestern recognizes that the Proposal incorporates the avoidable generation cost and the market price to determine a rate. However, the Proposal appears to be a split-the-baby approach that accepts Black & Veatch's market forecast and ignores NorthWestern's market forecast. Commission Staff recommended that "the Commission reject Oak Tree's natural gas and carbon inputs as they are excessively high, thus creating an excessively high avoided cost."

Although all Commissioners verbally endorsed the Staff's recommendations, the Proposal effectively rejects this recommendation. Incorporating the Black & Veatch estimate as the basis for the market portion of the price to be paid causes the price to exceed NorthWestern's avoided cost. NorthWestern's South Dakota consumers *will not be indifferent* to the price paid to Oak Tree as is required by PURPA. Instead, NorthWestern's ratepayers will pay nearly \$11,000,000 more under the Proposal as presented than under NorthWestern's calculation of avoided cost.<sup>1</sup> The Commission is to encourage development of QFs, but only if it can be done while maintaining customer indifference, as required by law.

## Technically Flawed

The Proposal is technically flawed in three ways. First, the proposal requires NorthWestern to pay for 3.9 MW of capacity in 2013 (20% of Oak Tree's nameplate capacity), and then to use the MISO method for calculating capacity in future years. The MISO method assigns an initial capacity based on system averages. For wind facilities built in 2012, MISO assigns 14.7% as the

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<sup>1</sup> This is the sum of the annual differences between payments made to Oak Tree under NorthWestern's estimate shown on Exhibit BJL-3 and the annual cost calculated by multiplying the Proposal rate times the expected annual output.

initial capacity value. The initial capacity value for Oak Tree in the proposal should be reduced so that it does not exceed MISO's initial capacity value for wind facilities built in 2012, or specifically, 2.8665 MW.

Second, the proposal requires the capacity payment rate to increase 2% per year for the entire life of the contract. Courts have ruled that the capacity rate may not increase beyond the point in time at which a utility acquires its next generation resource.<sup>2</sup> NorthWestern has disclosed plans to acquire two natural gas peaking resources within the next 10 years.<sup>3</sup> The capacity rate increase should cease no later than 10 years from the date of the Commission's order, the latest intended operational date of the second planned resource.

Third, the Proposal allocated 58.40% of the avoided cost to NorthWestern's generation component and 42.60% to the purchase component. These percentages total 101%, not 100%. The difference between the annual rate calculated at 42.60% and 41.60% ranges from \$0.358/MWh the first year to \$0.929/MWh the twentieth year. This small rate difference multiplied by the estimated annual production of 76,652 MWh and summed for the 20-year term would cause NorthWestern's South Dakota consumers to pay over \$1,000,000 more than intended.

## Unintended Consequences

The Proposal does not provide guidance to utilities or potential QFs as to the Commission's method for estimating the market purchase component of avoided cost.<sup>4</sup> Potential QFs that disagree with a utility's calculation of its avoided cost will be incented to prepare high

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<sup>2</sup> See the discussion related to *Armco Advanced Materials Corp. v. Pa. Pub. Util. Comm'n*, 664 A.2d 630, 637-39 (Pa. Commw. Ct. 1995), on page 11 of NorthWestern Energy's Post-Hearing Brief.

<sup>3</sup> See NorthWestern Energy's 2009 Integrated Resource Plan, page 43.

<sup>4</sup> During the April 26, 2012 oral argument, counsel for Oak Tree indicated that he was aware of several additional potential QFs that were waiting for the outcome of this proceeding. The transcript of this oral argument is not yet available.

estimates of market costs and file complaints with the Commission. The Commission, NorthWestern (and other utilities), and potential QFs will all be expending resources unnecessarily in proceedings before the Commission in defining, on a case-by-case basis, the avoided cost. This situation will be exacerbated because the Proposal does not provide guidance as to what constitutes a legally enforceable obligation in South Dakota.

## Conclusion

For the reasons stated above, NorthWestern respectfully requests that the Commission not adopt the Proposal and either (1) accept NorthWestern's calculation of its avoided costs or (2) schedule additional proceedings as recommended by Staff. If the Commission schedules additional proceedings, NorthWestern also respectfully requests that the Commission provide specific limitations as to the issues on which it desires additional evidence.

Dated at Sioux Falls, South Dakota, this 30<sup>th</sup> day of April, 2012.

Respectfully submitted,

NorthWestern Corporation d/b/a  
NorthWestern Energy



Timothy P. Olson  
3010 West 69<sup>th</sup> Street  
Sioux Falls, SD 57108  
(605) 978-2942  
Tim.Olson@northwestern.com

and

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

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