

MEMORANDUM

TO: Commissioners, Justin, D2013.12.85 work team

FROM: Will, Kate, Bob, Joel

DATE: April 3, 2014

RE: NorthWestern Hydro purchase, Docket D2013.12.85, additional issues.

Introduction

The Montana Public Service Commission (Commission) will discuss whether or not to request testimony from parties on additional issues at a work session on April 4, 2014.¹ This memo discusses several potential additional issues in two broad issue categories: resource procurement methods and due diligence review.

Resource procurement methods

Staff recommends raising an additional issue regarding whether the procurement process underlying NorthWestern Energy's (NorthWestern) proposed purchase of PPL Montana, LLC's (PPLM) hydroelectric facilities discriminates against qualifying facilities (QFs) or otherwise interferes with the Commission's proper implementation of the Federal Energy Regulatory Commission's (FERC) regulations implementing the Public Utility Regulatory Policies Act (PURPA). Although related, the recommendation to raise this additional issue is *not* prompted by FERC's March 20, 2014 Declaratory Order. The recommendation stems from the Commission's *current* approach to implementing PURPA, which intersects with Commission integrated least cost resource planning and procurement policies. Importantly, the recommendation to raise an additional issue is *not* about deciding what, if anything, the Commission should do in response to FERC's Declaratory Order. It is about ensuring that the Commission properly applies its current approach to implementing PURPA as it may relate to NorthWestern's application in this case.

¹ Generally speaking, an issue is a point of law or fact which the Commission must decide (see Martin Jacobson memo, Docket 90.7.44 (Nov. 27, 1992)). The additional issue process is intended to protect parties' due process rights by providing notice and an opportunity to confront issues the Commission determines it must decide, but which are not clearly shown in parties' prefiled direct testimony.

Federal law requires the Commission to implement FERC's rules implementing PURPA. 16 U.S.C. 824a-3(f). FERC has determined that state commissions may accomplish that implementation by issuing rules, on a case-by-case basis, or by any other means reasonably designed to give effect to FERC's rules. FERC Or. 69, 45 Fed. Reg. 12234 (Feb. 25, 1980). Currently, the Commission implements FERC's rules through a combination of rules and orders that establish rights and responsibilities for utilities and QFs, particularly Section 38.5.1902(5) of the Administrative Rules of Montana and Final Order 6444e.

Competitive solicitations are the preferred method for NorthWestern to acquire electricity supply resources. Admin. R. Mont. 38.5.8212(2). In turn, the Commission's implementation of FERC's PURPA rules necessitates strongly enforcing the preferred competitive procurement method on NorthWestern. Because the Commission requires large QFs to be chosen through a competitive solicitation in order to obtain a long-term contract with NorthWestern, *Id.* at 38.5.1902(5), acquiring resources outside of a competitive solicitation may discriminate against QFs in violation of FERC's rules. To safeguard against such discrimination, the Commission has ordered that a QF that has incurred a legally enforceable obligation (LEO) to provide energy or capacity to NorthWestern on a long-term basis may petition the Commission to set long-term contract rates if the QF alleges and shows irregularities in the competitive solicitation process or the resource procurement process that discriminate against QFs.² *In the Matter of the Petition of Whitehall Wind, LLC, for QF Rate Determination*, Docket D2002.8.100, Order 6444e (June 4, 2010); see also *Answer and Motion to Dismiss of the Montana Public Service Commission to the Petition for Declaratory Order and Petition for Enforcement Pursuant to Section 201(h) of the Public Utility Regulatory Policies Act of 1978*, Docket EL13-73-000, p. 13 (July 19, 2013). Importantly, the Commission recently informed FERC that it would be "an anomaly for a utility to procure capacity outside of a competitive solicitation, and particularly irregular to procure long-term capacity in such fashion." *Answer and Motion to Dismiss of the Montana Public Service Commission to the Petition for Declaratory Order and Petition for Enforcement*

² Montana's PURPA law may preclude even a QF claiming a LEO from petitioning the Commission for long-term contract rates. Mont. Code Ann. § 69-3-603(3)(a) (2013) states, "If a [QF] is eligible to sell electricity to a utility pursuant to a rate schedule approved by the commission, neither the [QF] nor the utility may petition the commission . . . to authorize a rate or term different from that in the rate schedule." Since large QFs are eligible for short-term rates in NorthWestern's Schedule QF-1, one could argue that the law precludes any petition whatsoever. That interpretation of the law has not been presented to the Commission.

Pursuant to Section 201(h) of the Public Utility Regulatory Policies Act of 1978, Docket EL13-73-000.

NorthWestern's proposed purchase of PPLM's hydro facilities involves a long-term commitment for a significant amount of capacity and energy and would substantially change the Company's load and resource balance. Commenting on NorthWestern's 2011 Electricity Supply Resource Procurement Plan with respect to the pending expiration of a 200 MW on-peak, 125 MW off-peak, firm energy and capacity contract with PPLM, the Commission stated:

...NWE should fully explore and analyze a broad range of options for acquiring the energy and capacity provided by the PPL contract. An all-source solicitation will almost certainly be appropriate in this situation. NWE should explore a range of contracting periods and market products, including market capacity products, through an open, transparent, and competitive solicitation process, consistent with the Commission's rules.

Written Comments Identifying Concerns Regarding NorthWestern Energy's Compliance with ARM 38.5.8201-8229, Docket N2011.12.96, p. 6 (Sept. 28, 2012). The Commission further commented that the rules allow NorthWestern to forego the preferred competitive procurement process if it can justify an alternative approach. *Id.* at p. 9. However, FERC has stated that a basic purpose of PURPA is to provide a market for electricity generated by QFs. FERC Or. 69, 45 Fed. Reg. 12234. Therefore, any alternative approach NorthWestern uses to procure resources cannot eliminate the market for QF-generated electricity provided by PURPA.

NorthWestern did not choose the Hydros or test its valuation of the Hydros through a competitive solicitation process. *Prefiled Direct Testimony of John D. Hines, p. JDH-49 (Dec. 20, 2013).* Consequently, NorthWestern's preapproval application may reflect an irregularity in the competitive solicitation process or resource procurement process that discriminates against QFs or otherwise interferes with the Commission's implementation of FERC's rules. Although the Commission has not received petitions from QFs alleging irregularities, given the large amount of energy and capacity associated with the Hydro purchase, its impact on NorthWestern's load-resource balance, and possible resource asymmetries between NorthWestern and potential QFs, it may be reasonable for the Commission to investigate whether the purchase and the underlying procurement process discriminate against QFs or otherwise interfere with the Commission's implementation of FERC's rules.

The Commission should consider requesting additional testimony from NorthWestern and intervenors on the following issues:

1. Have any QFs created LEOs for the sale of energy, capacity, or both to NorthWestern pursuant to Order 6444e? If so, which QFs have created LEOs, when were they created, how much energy, capacity, or both would the QFs provide, and what are the price and delivery terms in the LEOs?
2. Would NorthWestern's purchase of the Hydro resource outside of a competitive procurement process represent an irregularity in the competitive solicitation process or the resource procurement process that discriminates against QFs pursuant to Order 6444e?
3. If an irregularity in the competitive solicitation or resource procurement process would occur with the Hydro purchase, what actions are available to NorthWestern or the Commission to correct the irregularity or otherwise eliminate any discrimination against QFs?
4. Would approval of NorthWestern's purchase of the Hydro resource be inconsistent with the Commission's implementation of PURPA? What PURPA-related consequences could result from approving the Hydro purchase?

Due diligence review

On March 31, 2014, The Essex Partnership, the Commission's engineering consultant in this case, submitted a due diligence review "checklist" that provided Essex's assessment of the available docket information regarding the condition and status of the hydro facilities in the categories of civil engineering/FERC Part 12 inspections, electrical, mechanical, and regulatory compliance and environmental issues. On April 2, 2014, Essex submitted a memo in which the firm summarized its major findings. Essex's checklist and memo identified numerous issues as potential drivers of significant future costs that were not included in NorthWestern's future capital expenditures (CapEx) and operation and maintenance cost estimates and assumptions. Essex expressed its opinion that "... the information in the docket to date does not contain

sufficient information to confirm NWE's projections of capital or operations and maintenance (O&M) expenditures through the 20-year study period of the discounted cash flow analysis."³

As a result of the questions raised by Essex in its role as an engineering consultant to the Commission, the Commission might want to seek additional testimony from the parties regarding the structural integrity and physical condition of the individual facilities and the sufficiency of NorthWestern's due diligence effort. Essex was unable to find detailed information in the docket materials regarding some critical aspects of the hydro assets, and intervenors have addressed the issue in predominantly general terms.

The Commission also may be interested in requesting additional testimony to gain a fuller understanding of what the range of potential future CapEx costs might be and the effect of those potential costs on rates. Essex identified in its memo and checklist several issues that, if the costs to remedy them were incorporated into the CapEx projections, would increase future CapEx estimates for the next 20 years. At this point, the information in the case consists of NorthWestern's projections of future CapEx costs and an alternative CapEx scenario presented by MCC.

³ Essex Partnership memorandum to the Montana Public Service Commission, April 2, 2014, p. 1.