DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

IN THE MATTER OF Inquiry by the Montana Public Service Commission into its Implementation of the Public Utility Regulatory Policies Act of 1978	))))	REGULATORY DIVISION DOCKET NO. N2015.9.74

NORTHWESTERN ENERGY'S SUPPLEMENTAL COMMENTS IN THE MATTER OF THE MONTANA PUBLIC SERVICE COMMISSION'S INVESTIGATION INTO ITS IMPLEMENTATION OF THE PUBLIC UTILITY REGULATORY POLICIES ACT OF 1978 ("PURPA")

Pursuant to the Montana Public Service Commission's ("Commission") Notice of Commission Action dated December 2, 2015, NorthWestern Energy ("NorthWestern") respectfully submits the following supplemental comments.

Utility-owned resources and Qualifying Facilities ("QFs") are different. The Commission should recognize the differences in its implementation of PURPA. Although this docket is a generic inquiry into PURPA implementation, NorthWestern is the only utility that it affects. NorthWestern is the only Commission jurisdictional utility that purchases electricity from Montana QFs. In 2014, NorthWestern purchased over 934,000 MWh from 28 QFs in Montana at an average cost of $81.99/MWh.[1] On January 1, 2015, NorthWestern had contracts with two QFs, Sleeping Giant Power, LLC and Greenfield Wind, LLC, that are not yet operational. Since January 1, 2015, NorthWestern has executed contracts with five new solar QFs. As of December 15, 2015, twenty small solar projects that would be eligible for QF standard offer rates are active in NorthWestern's interconnection queue.

Differences Between NorthWestern-owned Resources and QFs

NorthWestern acquires utility-owned resources to meet specific needs for serving its customers. Statutes and the Commission's rules impose constraints on NorthWestern's acquisition of resources. Statute requires NorthWestern to furnish reasonably adequate service at reasonable and just costs. § 69-3-201, MCA. Statute also requires NorthWestern to plan for future electricity supply needs, manage a portfolio of electricity supply resources, and procure new electricity supply resources ***when needed***. § 69-8-419, MCA (emphasis added). The

[1] NorthWestern Corporation, *FERC Form No. 1*, 326-326.2, 327-327.2, columns a, g, and m (2014/Q4).

Commission requires that NorthWestern perform a resource needs assessment before acquiring any resource, ARM 38.5.8210(1), and use industry standard procurement practices to acquire resources. ARM 38.5.8212(1). In acquiring electricity supply resources, NorthWestern must evaluate, manage, and mitigate risks associated with the inherent uncertainty of wholesale electricity markets and customer load. ARM 38.5.8219. NorthWestern must document its decision making for acquisition of electricity supply resources. ARM 38.5.8220. Before acquiring owned resources, NorthWestern must demonstrate that procurement of the resource is consistent with its obligation to provide reasonably adequate service at just and reasonable rates and in the public interest. The statutory and administrative constraints protect consumers.

None of the consumer-protective constraints and processes apply to QFs. PURPA mandates that NorthWestern purchase electricity from QFs. Developers control the timing of QFs. NorthWestern must purchase electricity from QFs when developers choose to offer a project. NorthWestern's experience has been that developers whose projects are not selected in a competitive solicitation often convert the projects to QFs. Gordon Butte Wind, Fairfield Wind, and Greenfield Wind are past examples of this practice. Currently, Greycliff Wind and Crazy Mountain Wind are seeking to employ this practice. PURPA does not permit NorthWestern to limit its electricity purchases from QFs to those that meet its specific needs. Neither the public interest nor any other planning and acquisition restrictions apply to NorthWestern's acquisition of electricity from QFs.

NorthWestern recovers the cost of its owned resources through historical cost-of-service ratemaking. Rate cases reflect changes in costs, and the amount recovered from customers changes. The Commission may reduce the return on an owned resource from that which NorthWestern expected when it made the investment, if the cost of capital goes down. Similarly, as depreciation in excess of additional investment reduces the rate base value of an owned asset, the cost to customers for the electricity from that asset goes down. If a utility dispatches an owned resource when it is not needed to serve load, the off-system sales revenue flows through to customers. On the other hand, PURPA prohibits any subsequent adjustments to NorthWestern's payments to a QF unless the parties specifically agreed to them in a power purchase agreement. When the rate a utility pays to a QF includes estimated market sales, the off-system sales revenue flows to the QF, not the utility's customers. The Commission may not adjust the rate paid to a QF due to changed circumstances.

The Commission should not seek to impose a symmetrical method of rate recovery form utility-owned resources and QF resources because the Commission cannot eliminate the fundamental differences between utility-owned resources and QFs.

Comments on the Commission's Bullet Points

The Commission requested that parties provide comments on seven specific proposals. NorthWestern offers the following supplemental comments.

Proposal – "Reduce the length of QF contracts (e.g., re-evaluate plant usefulness based on value to consumers rather than a cost-of-service based-revenue requirement)"

NorthWestern supports a reduction in the length of QF contracts. Long-term, levelized price contracts impose both market price and performance risks on NorthWestern's customers. The Commission has changed the maximum contract length several times. Prior to 1998, the maximum length of a new QF contract was 15 years. In December 1998, the Commission approved suspending the then-existing LTQF-1 tariff and the Montana Power Company's ("MPC") request to establish a new QF-1 tariff, which provided that all newly executed QF contracts would terminate no later than July 1, 2002. In 2003, the Commission extended the QF-1 tariff through June 30, 2007. In 2006, the Commission created the current QF-1 tariff and limited contract length to 15 years. In 2010, the Commission increased the maximum contract length to 25 years.

The parenthetical in the proposal is confusing. NorthWestern does not pay QFs based on the QFs' cost-of-service revenue requirements. If the Commission intends this parenthetical to suggest that the Commission would reevaluate utility-owned resources based on value to consumers, NorthWestern strenuously opposes it. After Montana's disastrous experiment with supply deregulation, the Legislature decided that it wanted NorthWestern to return to cost-of-service regulation. The parenthetical does not address PURPA implementation; it appears to address alternatives to cost-of-service regulation. The Commission did not initiate this docket to consider alternative ratemaking proposals for utility-owned resources.

Proposal – "Maintain a preference for competitive solicitations (e.g., ensure that utility-owned resources must participate in and be selected through a comparable process)"

On December 1, 2015, the Commission, by a 3-2 vote, decided to remove the competitive solicitation requirement for QFs that are not eligible for the standard offer rate. As of the filing date of these comments, the Secretary of State has not published a Notice of Adoption in the

Montana Administrative Register. NorthWestern expects that the rule change will appear in a forthcoming issue. The parenthetical does not address PURPA implementation; it addresses utility resource acquisition. ARM 38.5.8212(2) expresses a preference for the use of competitive solicitations for resource acquisition; ARM 38.5.8212(3) recognizes that competitive solicitations may not be appropriate in all circumstances. The Commission did not initiate this docket to consider utility resource acquisition.

Proposal – "Further reduce rates for energy and capacity to reflect the lower capacity value and other operating characteristics of intermittent technologies (e.g., similarly discount the value of utility-owned intermittent resources in planning and preapproval dockets)"

NorthWestern should pay rates to each QF that reflect the costs that NorthWestern will not incur by purchasing electricity from the QF. FERC has directed that rates paid to QFs should reflect (1) the capacity available during peak periods, (2) the ability of the utility to dispatch the QF, and (3) the reliability of the QF. *See* 18 C.F.R. § 292.304(e). If the Commission fully accounts for these factors in determining rates to be paid to QFs, then no further adjustment related to output characteristics should be necessary. If the Commission fails to account fully for these factors, then the resulting QF rates will not be just and reasonable. The parenthetical does not address PURPA implementation; it addresses utility resource acquisition. The Commission did not initiate this docket to consider utility resource acquisition.

Proposal – "Approve interim integration rates (e.g., adjust revenue requirements to reflect more accurate integration cost information as it becomes available based on further study)"

NorthWestern supports setting integration rates for QFs on an annual basis. NorthWestern does not support interim integration rates that continually would be subject to surcharge or refund. In 2010, the Commission approved a wind integration tariff and required that the rate be subject to annual adjustments. In 2012, the Commission eliminated the annual adjustment and required NorthWestern to provide a fixed 3-year wind integration rate and a fixed 25-year wind integration rate. As with other parentheticals, this parenthetical is confusing. NorthWestern cannot determine to which revenue requirements the parenthetical refers. However, if the Commission intends to put NorthWestern's recovery of its cost of service at risk, NorthWestern opposes the proposal.

Proposal – "Offer small QFs escalating instead of levelized rates (e.g. using escalating annual revenue requirements)"

Escalating rates for QFs would reduce the performance risk that long-term contracts impose on NorthWestern's customers. However, price-forecasting risk dwarfs performance risk. If the Commission uses the same escalation factor for rate as for price forecasts, the risk of error remains the same. Shorter contract length will reduce the risk. In either case, the justness and reasonableness of QF rates depends on the appropriateness of the escalation factor. Currently, the Commission has mandated calculation of avoided costs using the U.S. Energy Information Administration ("EIA") natural gas escalation rate. NorthWestern purchases electricity, not natural gas, from QFs. In the 2015 Annual Energy Outlook, EIA's escalation rate for electricity is about one-fifth of its escalation rate for natural gas (real compound annual growth rate of 0.63% for electricity compared to 3.07% for natural gas). NorthWestern cannot determine to which revenue requirement the Commission is referring in the parenthetical. QFs do not have a revenue requirement. Consistent with statute, administrative rules, and well-settled ratemaking principles, the Commission sets NorthWestern's revenue requirement to allow it to recover its expenses, plus a return of and a return on its investment. The Commission may not deny any utility the opportunity to recover these three components of the revenue requirement.

Proposal – "Exclude all CO2 costs from market price forecast(s) and account for all environmental attributes through RECs (e.g., exclude CO2 costs from utility planning and preapproval dockets)"

This proposal appears to be directed at utility planning and resource acquisition rather than PURPA implementation. The Commission has stated that one of the goals of its electricity supply resource planning and procurement guidelines is "to promote economic efficiency and environmental responsibility." ARM 38.5.8203(1)(b). The Commission's administrative rules require that NorthWestern pursue the objective of assembling and maintaining "a balanced, environmentally responsible portfolio of electricity supply resources." ARM 38.5.8204(1)(c). The Commission requires NorthWestern to evaluate, manage, and mitigate the price/cost uncertainty risk and the load uncertainty risk associated with environmental regulations and taxes. ARM 38.5.8219(1). NorthWestern cannot promote the Commission's goal, pursue the Commission's objective, or comply with the Commission's rules without considering all environmental risks, including CO_2 risk, in its planning process. RECs do not capture the environmental attributes of all environmentally friendly resources. NorthWestern's hydroelectric facilities are an example. These facilities dramatically reduce the carbon intensity of NorthWestern's supply portfolio. Except for expansion of these facilities for which construction commences after October 1, 2013, these facilities do not create RECs. The parenthetical does not address PURPA implementation. The Commission did not initiate this docket to consider utility planning and resource acquisition.

Proposal – "Implement a bright-line LEO test such as Texas' '90-day Rule' (e.g., require similar readiness for any utility proposal as a minimum filing requirement for preapproval filings)"

NorthWestern advocates for adoption of an LEO test similar to the 90-day Rule for QFs. NorthWestern explained its support for the 90-day Rule in its prior comments. Creation of an LEO should be a rare occurrence. QFs should not be able to assert creation of an LEO merely because they disagree with a utility's estimate of the costs that purchasing from the QF will allow the utility to avoid. QFs should not be able to assert an LEO and then abandon their projects without consequences. Requiring similar readiness for advanced approval filings would violate Montana statute. Section 69-8-421, MCA, authorizes requests for advanced approval of electricity supply resources. NorthWestern may only seek advanced approval for resources that it has not yet procured. Furthermore, advanced approval protects both NorthWestern and its customers from regulatory risk. For example, when the Commission denied MPC's request to include Colstrip Unit 3 in rates, ratings agencies downgraded MPC's debt rating. The increased cost of MPC's borrowing led to higher rates than would have occurred absent the disallowance.

Conclusion

NorthWestern appreciates that the Commission provided this opportunity to provide supplemental comments. NorthWestern encourages the Commission to recognize the substantial differences between its owned resources, other power purchase agreements, and QF power purchase agreements. The differences preclude the symmetrical treatment that the Commission suggested in its Notice of Commission Action.

CERTIFICATE OF SERVICE

I hereby certify that the original and 10 copies of NorthWestern Energy's Supplemental Comments in the Matter of the Montana Public Service Commission's Investigation into its Implementation of the Public Utility Regulatory Policies Act of 1978 ("PURPA") in Docket No. N2015.9.74 have been hand delivered to the Montana Public Service Commission with three copies to the Montana Consumer Counsel this date. It has also been e-filed on the PSC website.

Date: December 23, 2015

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