

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

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

ADDITIONAL COMMENTS OF THE MONTANA CONSUMER COUNSEL

The Montana Consumer Counsel (“MCC”) submits these additional comments in accordance with the Commission’s Notice of Commission Action, issued December 2, 2015.

I. OVERVIEW.

On September 24, 2015, the Commission issued its Notice of Inquiry and Opportunity to Comment (“Notice”) regarding a review of its implementation of the Public Utility Regulatory Policies Act of 1978 (“PURPA”) and five issues identified in Order No. 7338b.¹ On September 28, 2015, the PSC released a staff memorandum dated August 11, 2015, and requested commenting parties respond to several questions relating to the five broad issue areas identified in Order No. 7338b. On October 23, 2015, the NW Energy Coalition (“NWECC”); NorthWestern Energy (“NorthWestern”); the Montana Department of Natural Resources and Conservation’s State Water Projects Bureau (“SWPB”); Renewable Northwest (“RNW”); LEO Wind, LLC and Hydrodynamics, Inc. (“LEO/Hydro”); and WINData, LLC and Crazy Mountain Wind, LLC (“WIND/Crazy”), as well as the MCC, submitted initial comments in response to the Commission’s Notice.

¹ *In the Matter of NorthWestern Energy’s Application for Qualifying Facility Tariff Adjustment*, Order No. 7338b, Docket No. D2014.1.5, at p. 8 (2015).

In November 2015, additional comments were submitted by Boulder Hydro Limited Partnership; Cypress Creek Renewables, LLC; Everpower Wind Holdings, Inc.; Hydrodynamics, Inc.; LEO Wind, LLC; Montana Consumer Counsel; and NorthWestern Energy.

In its NCA, the Commission noted that “commenters did not identify specific policies that would alter the treatment of utility-owned resources in light of proposed changes to QFs resources. The Commission reiterated its Notice of Inquiry and directed parties to address the symmetrical treatment of QF and utility-owned resources. Specifically, for each proposal listed below, parties should explain whether and how utility-owned resources would be treated in a similar manner if the Commission were to adopt such a proposal for QFs:

- 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);
- Maintain a preference for competitive solicitations (e.g., ensure that utility-owned resources must participate in and be selected through a comparable process);
- 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);
- Approve interim integration rates (e.g., adjust revenue requirements to reflect more accurate integration cost information as it becomes available based on further study);
- Offer small QFs escalating instead of levelized rates (e.g., using escalating annual revenue requirements);

- 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); and
- 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).”

These additional comments address the areas identified by the Commission in its NCA.

II. ADDITIONAL COMMENTS.

General Observations

The MCC appreciates the interest of the Commission in treating QF resources similarly or symmetrically with utility-owned resources. MCC recognizes that non-discriminatory treatment of qualifying facilities is one of the two directives of Section 210(b) of PURPA (16 U.S.C. § 824a-3(b)) and the PURPA Rules of the Federal Energy Regulatory Commission issued pursuant to Section 210(b) (18 C.F.R. § 292.304(a)) – along with the justness and reasonableness to consumers of rates for purchases from qualifying facilities. The Commission’s effort to balance these two directives, however, must be cognizant of the essential differences between the utility and utility-owned resources, on the one hand, and QFs and QF-owned resources on the other.

Utility regulation focuses properly on balancing the interests of ratepayers and the utility and on the goal of serving customer loads at minimum cost with reasonable levels of reliability. This focus has a long history. Additional factors have been added to the mix, but the basic goals have never been changed. Environmental concerns have become important and regulation has adapted through portfolio planning requirements and tradeable certificates for pollutants, still aiming at providing service at the minimum cost given these environmental constraints. Renewable energy has become an important concern and regulation has adapted to renewable portfolio requirements and tradeable

renewable certificates, still without sacrificing the goal of providing service at minimum cost. And when PURPA was passed by Congress in 1978 it was clear that small independent power producers were to be offered a chance to sell their power to utilities at rates not to exceed the costs that would be avoided by the utility, to ensure that ratepayers would not be harmed.

Recently in Montana we have tried to make up for the mistakes of our experiment with deregulation by reassembling NorthWestern as a vertically integrated utility. The Legislature has encouraged the reintegration of the utility by eliminating choice for all but the largest customers who had already left the utility and by allowing the Commission to preapprove utility decisions to acquire resources, thus shifting the risk to ratepayers of new resource choices by the utility. NorthWestern has proceeded with reintegration, with the acquisition of the Basin plant, the utility purchase of Colstrip 4, the construction of the Dave Gates plant and Spion Kop, and the reacquisition of the hydros. One may argue with the costs that have been accepted in the process of acquiring Colstrip 4 and reacquiring the hydros, but in each case the Commission was convinced the acquisitions were in the long term interest of ratepayers with regard to cost and reliability, and important to the goal of reintegration.

Decisions made by the Commission with regard to preapproval of utility acquisitions, as with the approval of avoided cost PURPA tariffs, are forward looking. In each case the Commission must evaluate projections of future prices, economic conditions and environmental regulation as it makes its decision. The past is relevant only as it contributes to the legacy of the current utility portfolio of owned and contracted resources. Past decisions are of interest in consideration of new acquisitions or in avoided cost determinations only for lessons they might offer about mistakes to avoid or successes to try to repeat.

The Commission raises the question of equal treatment of utility-owned and QF-owned resources. Because they are different in certain basic ways, treating them equally could lead to unreasonable results. First, NorthWestern has been acquiring resources over the past few years with the aim, enabled by the Legislature and by the Commission,

of rebuilding itself as a vertically integrated utility. As one Commissioner has noted, the acquisition of the hydros was a special case; the importance of the hydro assets for Montana was elevated by their past role and by the degree of support brought to bear on approval of the purchase. There is no corresponding value in any new PURPA resource. NorthWestern is now in a position where it will not need to acquire additional capacity for a prolonged period. At this point it would make no sense to try to treat new PURPA resources similarly to the way NorthWestern, and the Commission, treated these recent acquisitions by the utility.

Second, utility-owned resources are acquired at cost. Costs are recovered on the basis of original cost minus depreciation (OC-D), based on a century or more of regulatory precedent and legal approval. The utility decisions to acquire resources are overseen by regulators with a focus on selection of the lowest long-term cost resources and acceptable levels of reliability. By contrast, the utility and its regulators have no choice over which QFs are selected, how much QF power is added, which technology is used, how reliable the QF power must be, or when QF resources are selected. Regulators have a single tool: they get to set the avoided cost rates that QFs will receive. QFs and their developers are exempted from “State laws or regulations respecting . . . [t]he rates of electric utilities, and . . . [t]he financial and organizational regulation of public utilities” (18 C.F.R. § 292.602(c)). In contrast to public utilities, QFs and their developers are largely unregulated, except for the avoided cost rate that governs how much they get paid. Avoided costs, properly set, will convey information about when the utility needs resources, what the value is of the power produced by QFs of various types net of the costs they may impose on the system. If they can produce power more cheaply, whether through competitive advantage, access to lower cost financing, or subsidies, they can make money. They can also, once they have a contract locked in, securitize their income stream and walk away, except for the need to maintain the project.

The primary challenge posed by PURPA is how to incorporate the QF mandate in a way that fits with the requirements of least cost integrated resource planning and that leaves ratepayers indifferent. This is a balancing act that Montana has been attempting to

achieve, with varying degrees of success, since the inception of PURPA in 1978. The critical consideration in determining the presence or absence of discrimination is whether entities that are similarly situated are treated differently, and whether there are substantial and appropriate justifications for any differential treatment. QFs and public utilities are fundamentally not equal in important ways, and requirements that they be treated as though they were will significantly skew the process of acquiring QF resources, and impose greater costs on ratepayers. This could also lead to more frequent legal challenges and greater resource and legal costs, to the detriment of ratepayers and the utility while benefitting primarily QF developers.

Specific Comments

A. Duration of QF Power Purchase Agreements

Utility-owned resources enter into rate base at cost and costs are recovered over the depreciable life of the resource. The utility has diminished risk and in return ratepayers have the long-term benefit of the resource over its economic life. If the resource were to be sold, ratepayers would have an equitable interest in any gain. There is no equivalent ratepayer interest in a QF beyond its contract term. QF owners have an opportunity to develop a resource with a guaranteed market and known prices for the life of the contract, after which they can seek renewal from the utility, or seek a better price from another utility. Because the ownership of the resource and the cost recovery methods differ between the two types of resources they are not treated identically. Utility resources could not be treated “in a similar fashion” to the way in which PURPA requires that QFs be treated, without a major change in the legal basis for utility ratemaking. No such legal change would be required to amend the contract length for QFs. Indeed, shortening the term of the standard QF contract approaches putting public utilities and QFs on a more equal footing, as compared to providing a QF a twenty-five year revenue stream without adjustment while subjecting a utility to periodic review of its rates and cost recovery mechanisms.

B. Competitive Solicitation

There are many unanswered questions about requiring an all-source competitive solicitation for utility and QF resources or for utility and competitive (non-QF) resources. Utility resources and QF resources stand on different footings with regard to the relationship between bids and actual costs to ratepayers. First, QFs could bid (and win, and be paid) more than their costs; utilities cannot. Second, QFs could be held to their bids, while utility resources would typically go into rate base at actual cost, not at the bid price. And third, a QF resource will be paid for actual production while utility resources will recover costs, regardless of whether or not they under produce or suffer breakdowns. The current regulatory structure for placing utility resources into rate base at cost does not easily accommodate competitively bid resources; some way would have to be found to hold the utility to its bid price or to otherwise ensure realistic bids. And some way would also have to be found for evaluating prospective costs to ratepayers.

C. Avoided Cost Methodologies Reflecting the Lower Capacity Value of Intermittent Technologies

Setting rates for energy and capacity that reflect the lower capacity value and other operating characteristics of intermittent technologies would result in similar treatment with utility owned resources. These characteristics of intermittent technologies should already be accounted for in utility resource planning for the evaluation of potential utility-owned intermittent technology resources, and should be considered routinely in planning and preapproval dockets.

As indicated by NorthWestern (NorthWestern Initial Comments at 4) – capacity values (if any) associated with variable energy resources should be calculated and included as avoided costs only to the extent that the specific resource at issue has the ability to deliver capacity with a degree of reliability comparable to that of the resource that the variable energy resource causes to be deferred or displaced. To hold otherwise would overcharge electric consumers for capacity, and that result would be inconsistent

with the requirements of Section 210(b) of PURPA that rates for QF purchases be just and reasonable to electric consumers.

D. Interim Integration Rates for Variable Energy Resources

The accurate determination of integration costs for variable energy resources has been a longstanding concern to the Commission, as most recently stated in Order No. 7338b at ¶¶ 24-26. NorthWestern states (Initial Comments at 10) that it's "2015 Plan will calculate technology-specific integration requirements and costs." MCC looks forward to reviewing those calculations and the supporting data and analyses when NorthWestern's 2015 Plan is filed. As the Commission's concerns in Order No. 7338b demonstrate, variable energy resource integration costs are most productively evaluated in the context of a data-driven analysis, rather than in the context of generalizations.

The issue of integration rates (and integration requirements) is one that applies equally to utility-owned and QF intermittent resources. There is no distinction between them in their integration needs and the costs of providing them – except that ratepayers have already been paying the costs for the Dave Gates plant that was built to provide regulation service for load and for intermittent resources regardless of ownership. Despite efforts to litigate the issue of how much regulation service NorthWestern's Balancing Authority Area actually requires several times since the Dave Gates Generating Station entered rate base, and despite the effort that went into the Genivar study and the dispute with FERC staff, this issue continues to be unresolved. A proper price signal to QF wind developers must recognize the cost of regulation. Since there is no agreement on what that is, it is not fair to any party to lock in an arbitrary value over the life of a long-term (or a shortened term) contract. Interim rates are appropriate. Evaluation of utility-owned intermittent resources must face the same issue until we know the extent, if any of additional capacity at DGGS, and the cost of regulation from the next source when more is needed.

E. Eliminating Levelized QF Rates

Traditional ratemaking practices embodied in law and precedent requires cost recovery for utility-owned resources based on original cost minus depreciation (OC-D), which results in recovery that declines over time except for the periodic needs for maintenance, repairs, or upgrades. Recovery of costs for QF resources is inherently different, as it is based upon the utility's forward-looking avoided costs rather than the original cost of the QF facility. Levelization does not change that inherent difference. What it does is move forward the projected future cost increases that are highly uncertain and are more uncertain the further in the future. Levelization is a great benefit to the QF developer, who generally has higher discount rates and hurdle rates than the utility, and places virtually all the risk associated with uncertain future cost projections on to ratepayers. Shortening the contract term significantly, from 25-30 years down to 5-7 years as suggested in MCC's original comments, would greatly reduce the risk shifting of levelization by eliminating the impact of greater uncertainty associated with cost projections beyond the 5-7 year contract life. PURPA does not require that QFs be offered levelized rates. Doing away with levelization without shortening contract length would not eliminate the risk shifting issue because of escalated rates in the later years of the contract but would postpone it and place it on a later generation of ratepayers. Both shortened contract length and elimination of levelization are necessary and appropriate to protect ratepayers.

F. CO2 Costs

At present all efforts to include CO2 costs in market price forecasts are speculative, and will remain so until the Clean Air Act rules are finalized and experience has been gained with how the state plans shake out in practice. This is exemplified by the debate over the implicit carbon value in the price paid for the hydros, which in fact is given no recognition in the current CAA rules. Portfolio planning encompasses risk evaluation with regard to expected CO2 regulatory requirements. Avoided costs based on

the utility's current portfolio and future resource plans based on the future need for additional resources reflect the utility's expectations and risk preferences with regard to CO2 regulation. An arbitrary CO2 adder to avoided costs only imposes additional cost and risk on ratepayers.

G. LEO test

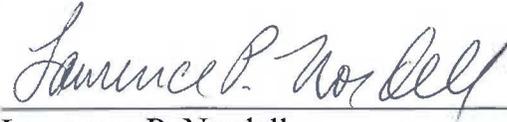
As pointed out in MCC's initial comments, the Commission should have final determination over whether an LEO has been created and whether terms are just and reasonable and consistent with the utility's current avoided cost. The Commission should equally apply just and reasonable requirements on utility preapproval applications.

CONCLUSION

In formulating its conclusions, the Commission must be guided by *both* requirements of PURPA Section 210(b), and particularly the requirement that rates for the purchase of QF output must be just and reasonable to electric consumers and consistent with the public interest. It is crucial that avoided costs be current and reflect the utility's forward looking resource needs, plans and price expectations at the time of evaluation of a QF acquisition. Only then can the Commission be certain that consumers will be indifferent and that the purchase will meet the just and reasonable standard.

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Respectfully submitted December 23, 2015.

A handwritten signature in cursive script, reading "Lawrence P. Nordell", written over a horizontal line.

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