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

* * * * *

In the matter of the amendment of ARM 38.5.1902 pertaining to Cogeneration and Small Power Production	)))	COMMENTS OF THE MONTANA CONSUMER COUNSEL

The Montana Consumer Counsel ("MCC") appreciates the Commission's efforts to address the rulemaking petition of Greycliff Wind Prime, LLC, in Docket No. D2015.8.63, and more generally to address the impact of FERC's March 2014 declaratory order in *Hydrodynamics, Inc.*, 146 FERC ¶ 61,193 at PP 32-33 (2014) on the Commission's rules on the acquisition of qualifying facilities ("QFs") larger than three megawatts. The Commission, Montana's retail electricity consumers, owners and developers of qualifying facilities under the Public Utility Regulatory Policies Act ("PURPA") and utilities, in addressing the question of rule revision, need to remain mindful of ***both*** of the requirements of PURPA Section 210(b) – *i.e.*, that rates for the purchase of QF output by utilities shall (1) be just and reasonable to the electric consumers of the electric utility and in the public interest, and (2) not discriminate against qualifying cogenerators or qualifying small power producers.

The Commission rules have provided a relatively straightforward path for small QFs to sell power to the utility under a standard tariff with administratively set avoided cost rates, with an option to negotiate with the utility if there are special circumstances or if the parties believe that negotiation could be advantageous to them. For larger QFs with greater sophistication and greater resources, the route to a long-term contract has been through a competitive solicitation; in the absence of a competitive solicitation or between periodic solicitations, a QF larger than 3 MW would be eligible only for a short term

contract until the next solicitation. In the absence of regular all-source competitive solicitations, the FERC concluded that the current version of ARM 38.5.1902(5) is "inconsistent with PURPA." *Hydrodynamics, Inc.*, 146 FERC ¶ 61,193 at P 32.

The Commission has offered three variations of a possible amendment to ARM 38.5.1902(5). Each of those three versions would eliminate both the competitive solicitation requirement for QFs larger than 3 MW, and the rule's requirement that a QF that is not selected in a competitive solicitation or does not participate in one is limited to a negotiated short term contract. Version A simply strikes out the offending sentences. Version B adds language that offers large QFs the option of a negotiated long term contract. Version C includes language mandating a negotiated contract for large QFs and requiring negotiation in good faith, holding out the possibility of a summary ruling against a party found not to have negotiated in good faith.

As a threshold matter, the Commission should reject Version C. Version C does not actually resolve the problem identified in FERC's *Hydrodynamics* declaratory order. It simply shifts the focus from competitive solicitations that never materialized to "good faith negotiations" that may prove equally ephemeral. The summary disposition feature of the proposed modification is also highly problematic, as that feature effectively imposes on consumers the consequences of undesirable behavior by either the utility or the qualifying facility.

The Consumer Counsel offers the following comments and suggestions, which are generally applicable either to Version A or Version B.

A. <u>Defining the Role of Competitive Solicitations</u>

Competitive solicitations offer a superior means of determining avoided cost, and should provide consumer benefits identifying the most efficient and robust QF projects, and assisting in discovering the lowest cost options for meeting the future electric demand of electricity consumers. Consumer Counsel offered comments to this effect in the parallel inquiry being held by the Commission in Docket No. N2015.9.74 concerning

the Commission's PURPA policies generally. The most direct solution to the issue raised by the FERC's declaratory order in the *Hydrodynamics* proceeding would be to add a requirement for periodic competitive solicitations and to leave the remainder of the rule intact. However, Consumer Counsel recognizes the complexity of defining competitive solicitation processes in the context of what is really a single issue rulemaking that would dependably and efficiently meet the needs of the utility and ratepayers. A durable and useful competitive solicitation requirement would need to address, at a minimum, how a utility should deal with competitive solicitations and bidding when it does not, in fact, require additional resources. A competitive solicitation requirement would also need to address participation by the purchasing utility. If bidding by the utility is to be allowed, the Commission's ultimate rule will also need to address potential collisions between using all-source competitive solicitations and the "pre-approval" requirements of Section 69-8-421, MCA, in situations in which the utility proved to be the low bidder in a competitive solicitation.

Resolving these questions will require much thought and debate, and considerable deliberation by the Commission. The issues involved in designing a role for competitive solicitations do not appear to be amenable to resolution by means of language modifications in a simple rule change – the scope of the proposal currently before the Commission. MCC recommends that the Commission broaden the scope of its inquiry (either in this proceeding or in Docket No. N2015.9.74) to examine how best to incorporate and promote a significant role for competitive solicitations in Montana's PURPA regime.

B. Limitations of Proposed Amendments to Current ARM § 38.5.1902(5)

Versions A and B of the proposed amendments each have limitations as possible solutions to the FERC's "inconsistent with PURPA" conclusion in its *Hydrodynamics* declaratory order. Many of those limitations are relatively easy to overcome by modest revisions to the regulatory text.

First, version A appears internally inconsistent. Version A first says all QFs shall either have a written (and presumably negotiated) contract with the utility, or sell power through the standard tariff as approved by the Commission. Version A later says that QFs 3 MW or smaller may use the standard tariff. Version A is thus ambiguous as to whether QFs larger than 3 MW can use the standard tariff.

Version B tries to remove this ambiguity by allowing QFs larger than 3 MW to negotiate a rate. However, we believe the ambiguity remains because the opening sentence of 1902(5) seems to offer all QFs the options of negotiated rates or the standard tariff. If the intent is to mandate negotiations by large QFs, this should be fixed by replacing the word "may" with "shall" in the added language at the end of the first paragraph of the Commission language of version B.

A second, and much more important, shortcoming of all versions of the rule is that the current standard tariff is obsolete. The current rate was calculated before the acquisition of the PPL Montana hydroelectric facilities, authorized by Order No. 7323k in Docket No. D2013.12.85. The Commission recognized in Order No. 7338b in Docket No. D2014.1.5 at Paragraphs 18-23 that the hydro acquisition has dramatically changed the utility's need for additional resources and the resulting avoided costs that determine the price to be paid for additional QF power. Indeed, it appears highly unlikely that NorthWestern has any avoidable capacity costs for the foreseeable future.[1] The rule as currently written (and left unchanged by any of the Commission's versions of the amended rule) requires the utility to recompute avoided cost rates following submission of its least cost plan or of its procurement plan. The avoided costs currently in place are clearly obsolete and would be so even if they had been recalculated after the last least cost plan or procurement plan filings. Avoided costs and standard tariff rates must be recalculated promptly when the utility's plans change or when its resource portfolio changes. NorthWestern witness Brogan's suggestion at the November 3, 2015 hearing on

[1] *See City of Ketchikan, Alaska*, 94 FERC ¶ 61,293 at p. 62,061 (2001) (". . . [T]here is no obligation under PURPA for a utility to pay for capacity that would displace its existing capacity arrangements").

this docket, that avoided costs be recalculated immediately upon application by a large QF, might also serve to solve this issue. We suggest that the relevant sentences in 1902(5) be rewritten as follows:

> The utility shall recompute and file with the Commission its ~~the~~ short-term and long-term standard tariffed avoided cost rates within ninety days following submission of its least cost plan filing, ARM 38.5.2001 through 38.5.2012, ~~or~~ procurement plan filing, ARM 38.5.8201 through 38.5.8229, or acquisition or commitment to acquisition of resources totaling 10 MW or more since the last recalculation. New contracts filed during this ninety day period must not exceed the newly recomputed and approved rates.

Recalculating avoided costs following significant resource acquisitions provides an opportunity to reflect on when the utility will need additional capacity as well as on the value of the energy provided by QFs. If the utility does not need capacity for a period approaching 20 years then the capacity value of QFs is moot for that period and arguments over the capacity value of wind and solar QFs perhaps need not occupy the attention of the Commission, the utility, and stakeholders.

Without the changes suggested here, any of the Commission's three proposed versions could cause consumers to pay more than current avoided costs for new QF power under the current, obsolete tariff, to the detriment of ratepayers and in violation of PURPA's hold harmless provision.

C. Contract Duration and Contract Rate Levelization

As Consumer Counsel observed in its October 23 comments in Docket No. N2015.9.74, long term projections of avoided costs are highly uncertain, and converting uncertain projections into fixed rates in contracts or in standard tariffs that once approved may be exempted from Commission rate review jurisdiction for the life of the contract imposes large risk on ratepayers for the benefit of the QF developer. The very essence of PURPA is a requirement to hold ratepayers "harmless" (or perhaps more accurately,

indifferent to choices between QF resources and utility resources) by not paying QFs more than the costs avoided by the utility. Ignoring the implicit costs involved in risk shifting violates this crucial requirement of Section 201(b)(1) of PURPA: rates for purchases from QFs "shall be just and reasonable to the electric consumers of the electric utility and in the public interest."

In its October 23 comments in Docket No. N2015.9.74, Consumer Counsel urged the Commission to shorten significantly the standard PURPA contract term, from 25 years to a much more reasonable 5-7 year period. This would substantially reduce the uncertainty of the overall projections and reduce the risk being shifted to ratepayers. Consumer Counsel expects that QF developers will argue that they would not be able to finance their projects with a contract of that length. However, it is routine for commercial and industrial enterprises to finance projects with analyses and forecasts, and no guarantees, for the sale of their products; they do it by assuming the risks themselves or by paying lenders a risk premium to accept the risk. The Commission should not ask consumers and ratepayers to assume the business risks for QF developers without compensation.

We are not asking the Commission to adopt this suggestion in the current docket, as we recognize it will be controversial and will require significant examination and judgement. However, we do propose a change that would reduce some of the costs and risks imposed on ratepayers under current rules. Consumer Counsel urges the Commission to eliminate levelization of rates for large QFs. Levelization compounds the problems caused by 25 year contracts, because it shifts the projected inflated costs of the later years of the contract to current ratepayers. Economists refer to this as generational inequity. The current generation of ratepayers is penalized by paying more than the current estimated value of the power, and future ratepayers purportedly benefit by paying less than the value of the power; many of the current ratepayers will not be around to benefit, and many of the future ratepayers will not have been here in the early years to pay. Shortening the contract length will reduce the magnitude of this problem.

Eliminating levelization will take the problem off the table. QF developers may insist that without levelized rates they won't be able to finance their projects. However, levelization is unknown in competitive markets and is simply another way of shifting costs and risks from investors to captive utility ratepayers. Consumer Counsel asks the Commission to insert the following sentence into the rule, immediately following the previous suggested language change above.

A QF larger than 3 MW shall not be eligible for levelized rates.

Without this suggested change, each of the versions of the proposed amendment could require current ratepayers to subsidize QFs by paying more than the current value of power, with any possible offsetting cost reductions accruing to a different group of future ratepayers.

D. Establishment of a Legally Enforceable Obligation (LEO)

Finally, Consumer Counsel suggests that language be inserted into the proposed rule clarifying that a purchase obligation cannot be created automatically by the filing of an offer to sell power to the utility without scrutiny and approval by the Commission as to the reasonableness of the terms and conditions. Automatic creation of an LEO, as asserted in petitions to the Commission, seems highly problematic and potentially costly to consumers. We suggest the following language change be made to the proposed amendment to 1902(5);

> ~~Long term c~~Contracts for purchases and sales of energy and capacity between a utility and a qualifying facility 3 MW or less may be accomplished according to standard tariffed rates as approved by the Commission. Claims that a purchase obligation has arisen in the absence of a fully executed agreement shall be determined by the Commission. The contract or other obligation shall be based on documentation sufficient to specify:

Attached is a draft revision of Version A with the Consumer Counsel's recommended changes.

Thank you for the opportunity to submit these comments and suggestions.

Respectfully submitted November 6, 2015.

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Attachment

Montana Consumer Counsel Comments

In the matter of the amendment of ARM 38.5.1902
pertaining to Cogeneration and Small Power Production

November 6, 2015

MCC PROPOSED ALTERNATIVE TO VERSION A

(5) All purchases and sales of electric power between a utility and a qualifying facility shall be accomplished according to the terms of a written contract between the parties or in accordance with the standard tariff provisions as approved by the commission. A long-term contract for purchases and sales of energy and capacity between a utility and a qualifying facility greater than 3 MW in size ~~shall be contingent upon~~may be secured through (i) selection of the qualifying facility by a utility through an all-source competitive solicitation conducted in accordance with the provisions of ARM 38.5.2001 through 38.5.2012, (ii) negotiation between the utility and the qualifying facility, or (iii) otherwise in accordance with standard tariff provisions of the utility approved by the Commission. ~~Between competitive solicitations, purchases, and sales of energy and capacity between a utility and a qualifying facility greater than 3 MW in size shall be accomplished in accordance with negotiation of a short-term written contract.~~ The utility shall recompute and file with the Commission its ~~the~~ short-term and long-term ~~standard tariffed~~ avoided cost rates within ninety days following: (a) submission of its least cost plan filing, ARM 38.5.2001 through 38.5.2012, ~~or~~ (b) submission of a procurement plan filing, ARM 38.5.8201 through 38.5.8229, or (c) acquisition of resources totaling an aggregate of 10MW or more since the utility's most recent recalculation of its avoided costs. New contracts submitted for Commission approval during the 90-day period in which avoided costs are recalculated shall be subject to adjustment so that the rates therein provided shall not exceed the newly recomputed and approved rates. A qualifying facility with nameplate capacity exceeding 3 MW shall not be eligible for levelized rates. ~~If the qualifying facility is not selected, or does not participate, in the first available competitive solicitation, purchases and sales of energy and capacity shall continue only according to the terms of a newly negotiated short-term written contract.~~ ~~Long-term c~~Contracts for purchases and sales of energy and capacity between a utility and a qualifying facility 3 MW or less may be accomplished according to standard tariffed rates as approved by the commission. Claims that a purchase obligation has arisen in the absence of a fully executed agreement shall be determined by the Commission. The contract or other obligation shall be based on documentation sufficient to specify:

(a) the nature of the purchases and sales;

(b) the applicable rate schedule or negotiated rates for the purchases and sales;

(c) a detailed description of interconnection facilities and arrangements, and the amount and manner of payment of interconnection costs;

(d) the means for measurement of the energy or capacity purchased or sold by the utility;

(e) the method of payment by the utility for purchases, and the method of payment by the facility for utility sales;

(f) any installation and performance incentives to be provided by the utility to the qualifying facility;

(g) the services to be provided or discontinued by either party during system emergencies;

(h) the term of the contract or other obligation;

(i) applicable operating safety and reliability standards with which the qualifying facility must comply;

(j) appropriate insurance indemnity and liability provisions.

NorthWestern Corporation d/b/a NorthWestern Energy
Comments on Montana Administrative Register Notice 38-5-232
Proposed Rules Modifying Mont. Admin. R. ("ARM") 38.5.1902(5)

NorthWestern appreciates and commends the Commission for addressing the contradictory administrative provisions regarding qualifying facilities that are not eligible for standard offer rates. I will refer to these as Large QFs. The Commission is currently engaged in several QF-related dockets. Today, NorthWestern is restricting its comments to the Proposed Rules; it is not commenting on the broader issues raised in the PURPA Implementation Inquiry docket or in any project specific QF docket. NorthWestern believes that if the Commission makes any modification to the current rule, it should be Version B with some changes to eliminate ambiguity and make the rule clearer. NorthWestern believes that Version A could be workable and that Version C is not workable.

The Commission first adopted ARM 38.5.1902, along with the remainder of the Cogeneration & Small Power Production Rules, in 1981. At that time, the rule did not contain the competitive solicitation requirement, and there was no conflict between ARM 38.5.1902(5) and ARM 38.5.1903(2)(b). ARM 38.5.1902(5) provided in pertinent part simply, "All purchases and sales of electric power between a utility and a qualifying facility shall be accomplished according to the terms of a written contract between the parties or in accordance with the standard tariff provisions as approved by the commission." ARM 38.5.1903(2)(b) read as it does today.

In 1992, the Commission amended ARM 38.5.1902(5) to include the competitive solicitation requirement. The competitive solicitation requirement served and serves an important regulatory purpose. In the 1992 rule making, the Commission stated, "The amendments to ARM 38.5.1902 and 38.5.1905 are necessary to conform them to the Commission's proposed rules establishing policy guidelines on integrated least cost resource planning for electric utilities in Montana." The 1992 amendments adopted the competitive solicitation requirement without modifying ARM 38.5.1902(2)(b), thus creating the apparent conflict between them. The Commission should address the conflict but do so in a manner that does not put the QF rules in conflict with the Electric Procurement Guidelines in Subchapter 82. It would be unfortunate if the Commission were to eliminate one rule conflict while creating another.

The Commission should remember that it adopted the competitive solicitation requirement at a time that in many ways is similar to today. The Montana Power Company was a vertically integrated utility with a full portfolio. NorthWestern is becoming a vertically integrated utility and has a portfolio that is full for light-load hours and only needs specific types of resources. MPC was subject to new resource planning guidelines. NorthWestern is subject to an extensive procurement guideline regime. MPC had had several larger QFs come online in the years immediately preceding the adoption of the competitive solicitation. NorthWestern has had several large QFs come online since 2012 and expects to have substantial additional QFs achieve commercial operation in the next few years. The policy reasons that supported the competitive solicitation requirement in 1992 are still present.

The Commission is responsible for implementing PURPA in Montana. It has wide latitude to do that. NorthWestern is concerned that the reason for or the reasonable necessity of the proposed

amendment suggests that the Commission is abdicating its responsibility to implement PURPA to the Federal Energy Regulatory Commission and is acquiescing to regulatory overreach by a federal agency. The Commission cites only to FERC's so-called Declaratory Order in the Hydrodynamics matter. The Commission knows and has acknowledged that the Declaratory Order does not have the force of law. PURPA does not give FERC the authority to direct the actions of state regulatory commissions; it gives FERC the authority to ask a court to direct the actions of state regulatory commission. Those federal and state courts that have considered similar FERC declaratory orders have ignored them. If the Commission believes that the competitive solicitation rule should be amended or repealed to implement PURPA, then it should do so based on its determination of the reasonable necessity. The Commission should not merely rely on a statement of litigating position by FERC, especially when FERC declined to litigate.

Of the proposed Versions, NorthWestern supports Version B with editorial revisions. The proposed Version B of ARM 38.5.1902(5), in final form, provides:

> (5) All purchases and sales of electric power between a utility and a qualifying facility shall be accomplished according to the terms of a negotiated contract between the parties or in accordance with the applicable standard tariff provisions as approved by the commission. The utility shall recompute short-term and long-term avoided costs following submission of its least cost plan filing, ARM 38.5.2001 through 38.5.2012, or procurement plan filing, ARM 38.5.8201 through 38.5.8229. Long-term contracts for purchases and sales of energy and capacity between a utility and a qualifying facility 3 MW or less may be accomplished according to standard tariffed rates as approved by the commission. Long-term contracts for purchases and sales of energy and capacity between a utility and a qualifying facility larger than 3 MW may be accomplished at a rate which is a negotiated term of the contract between the utility and the qualifying facility. The contract shall specify:
>
> (a) through (7) remain the same.

This version removes the requirement for a written contract, seems to eliminate the requirement to update avoided costs for the standard offer, and implies that Large QF rates are uniform and only updated when resource procurement plans are filed. NorthWestern suggests that Version B be edited to provide as follows:

> (5) All purchases and sales of electric power between a utility and a qualifying facility that is not eligible for standard offer rates shall be accomplished according to the terms of a written contract negotiated between the parties. The utility shall compute the avoided costs for a qualifying facility that is not eligible for standard offer rates at the time the qualifying facility requests a contract. Only qualifying facilities having a nameplate capacity not greater than 3 MW are eligible for standard offer rates. All purchases and sales of electric power between a utility and a qualifying facility that is eligible for standard offer rates shall be accomplished according to the terms of a written contract between the parties or in accordance with the applicable standard tariff provisions as approved by the commission at standard offer rates. The utility shall recompute short-term and

long-term avoided costs for standard offer rates following submission of its least cost plan filing, ARM 38.5.2001 through 38.5.2012, or procurement plan filing, ARM 38.5.8201 through 38.5.8229. The contract shall specify:

(a) through (7) remain the same.

To be clear, the above language is the final language that NorthWestern recommends; it is not in legislative format. NorthWestern believes that this revised Version B contains the same substantive provisions as the original proposed Version B, but that it more clearly maintains the distinction between Large QFs and standard offer QFs. It also more clearly provides that the utility must compute its avoided cost for a Large QF at the time it begins negotiations and base the computation on what it knows at that time. NorthWestern believes that a mischievous QF could make arguments otherwise if Version B is adopted without these clarifying revisions.

NorthWestern believes that Version A could work. It eliminates the current conflict between ARM 38.5.1902(5) and ARM 38.5.1903(2)(b). However, it does not provide the specific guidance contained in Version B as proposed by NorthWestern. Therefore, there may still be some uncertainty in its implementation.

NorthWestern strongly opposes Version C. NorthWestern's experience has been that anytime it proposes terms different from those proposed by a Large QF, the Large QF asserts that NorthWestern has not negotiated in good faith. The Large QF is concerned only with its return and not with the impact on NorthWestern's customers. In reality, the only two interested parties are the QF and the customers. The federal statute that requires the Commission to allow a utility to recover costs paid to QFs protects NorthWestern. If the Commission were to accept an assertion that either party failed to negotiate in good faith and issued a summary ruling, the Commission may violate PURPA by ordering a contract rate that is not equal to the costs that a utility could avoid by purchasing from the QF. Furthermore, this provision invites litigation. Whether or not a party negotiates in good faith is a legally complex issue when applied to any specific set of facts. NorthWestern believes that any party dissatisfied with a summary ruling from the Commission on the good faith issue would pursue judicial review. This type of legal action would hinder the development of cost-effective QFs. Finally, determination of good faith negotiations may be a judicial power that is barred to the Commission. Rather than introducing this type of uncertainty and potential source of extended litigation, the Commission should reject Version C.

I am available for questions.

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

In the matter of the amendment of ARM 38.5.1902 pertaining to Cogeneration and Small Power Production	Comments of Greycliff Wind Prime, LLC

GREYCLIFF WIND PRIME, LLC'S REPLY COMMENTS IN SUPPORT OF PETITION TO AMEND OR REPEAL A.R.M. § 38.5.1902(5)

I. INTRODUCTION.

Petitioner Greycliff Wind Prime, LLC (hereinafter "Greycliff"), acting by and through counsel, hereby files these reply comments in support of Greycliff's petition with the Montana Public Service Commission ("Commission") to request that the Commission amend or repeal A.R.M. § 38.5.1902(5) pursuant to M.C.A. § 2-4-315, and A.R.M. § 1.3.308. After listening to the oral comments from the Montana Consumer Counsel ("MCC") and NorthWestern Corporation d/b/a NorthWestern Energy ("NWE"), Greycliff felt compelled to respond to certain issues raised by both MCC and NWE.

II. REPLY TO ORAL COMMENTS OF MCC

A. There is No Separate "Just and Reasonable" Standard Under PURPA; Rather it is Incorporated in FERC's Regulations as Part of the "Full Avoided Cost" Rule

MCC's comments regarding the need for the Commission to consider the "just and reasonable" as a standard independent of the calculation of avoided cost, is inconsistent with FERC's regulations implementing the Public Utility Regulatory Policies Act of 1978, 16 U.S.C. §824-a3 *et seq*. This issue was resolved long ago by the United States Supreme Court in *Am. Paper Inst. v. American Elec. Power Serv. Corp*, 461 U.S. 402 (1983). In that case, a group of electric utilities appealed FERC's regulations adopting the "full avoided cost" rule to the United States Court of Appeals for the District of Columbia. The Appellate court there found that FERC erred in not considering something less than the full avoided cost rule adopted by FERC. The Supreme Court reversed, finding that the full avoided cost rule was not arbitrary and capricious, and that FERC had fully considered the three criteria of Section 210(b) of PURPA": that the rates for purchase by utilities be "non-discriminatory," "just and reasonable," and in the "public interest." The Court explained:

> FERC's explanation of its reasons for promulgating the full-avoided-cost rule must be examined in light of the criteria set forth in § 210(b) of PURPA, 16 U. S. C. § 824a-3(b) (1976 ed., Supp. V), which provides that the purchase rate established by the Commission must be "just and reasonable to the electric consumers of the electric utility and in the public interest" and must not discriminate against qualifying facilities. Since the full-avoided-cost rule plainly satisfies the nondiscrimination requirement, we need only consider whether FERC adequately explained why the rule is "just and reasonable to the electric consumers of the electric utility and in the public interest."
>
> We cannot accept respondents' suggestion, Brief for Respondent Electric Utilities 9, and n. 4, that the "just and reasonable" language in § 210(b) was intended to require that the purchase rate be set "at the lowest possible reasonable rate consistent with the maintenance of adequate service in the public interest."

Id. at 414-15 (footnotes omitted).

The Supreme Court further explained that in adopting the full avoided cost rule, FERC was required to consider whether the *rule* as adopted would be just and reasonable to electric

utility consumers. The Court concluded that FERC had not failed to consider whether the full avoided cost rule was "just and reasonable" to consumers:

> The Commission did not ignore the interest of electric utility consumers "in receiving electric energy at equitable rates." H. R. Conf. Rep. No. 95-1750, *supra, at 97*. 9 The Commission recognized that the full-avoided-cost rule would not directly provide any rate savings to electric utility consumers, but deemed it more important that the rule could "provide a significant incentive for a higher growth rate" of cogeneration and small power production, and that "these ratepayers and the nation as a whole will benefit from the decreased reliance on scarce fossil fuels, such as oil and gas, and the more efficient use of energy." 10 *45 Fed. Reg.* 12222 (1980). As the Commission explained, a purchase rate established at a fixed percentage of avoided cost would discourage production of electric energy by qualifying facilities whose marginal costs exceeded the rate that a purchasing utility would be required to pay under this approach, whereas those same facilities would retain an incentive to produce energy under the full-avoided-cost rule so long as their marginal costs did not exceed the full avoided cost of the purchasing utility. *Id.,* at 12222-12223.

Id. at 415-16.

In short, the very standard for argued for by the MCC, that there should be a second and different consideration of the "justness" and "reasonableness" of rates paid to a QF is a violation of PURPA and FERC's regulations. In addition, as noted by the Supreme Court, Congress did not intend for QFs to be subject to the sort of state rate regulation normally applied to utility rates, hence a separate determination of "justness" and "reasonableness" was never intended to be applied to QF rates:

> The legislative history confirms, moreover, that Congress did not intend to impose traditional ratemaking concepts on sales by qualifying facilities to utilities. The Conference Report states in pertinent part:
>
> > "It is not the intention of the conferees that cogenerators and small power producers become subject . . . to the type of examination that is traditionally given to electric utility rate applications to determine what is the just and reasonable rate that they should receive for their electric power. The conferees recognize that cogenerators and small power producers are different from electric

> utilities, not being guaranteed a rate of return on their activities generally or on the activities vis a vis the sale of power to the utility and whose risk in proceeding forward in the cogeneration or small power production enterprise is not guaranteed to be recoverable.
>
> "[Cogeneration] is to be encouraged under this section and therefore the examination of the level of rates which should apply to the purchase by the utility of the cogenerator's or small power producer's power should not be burdened by the same examination as are utility rate applications, but rather in a less burdensome manner. The establishment of utility type regulation over them would act as a significant disincentive to firms interested in cogeneration and small power production." H. R. Conf. Rep. No. 95-1750, pp. 97-98 (1978).

Id. at 414.

Thus, the MCC is plainly wrong on its plea for separate consideration of the "justness" and "reasonableness" standard normally applied to utilities. This argument has been settled for more than 32 years. The full avoided cost rule adopted by FERC incorporates the "justness" and "reasonableness" standard, and over opposition from the utility industry, the Supreme Court found that FERC had struck a reasonable balance between the statutory criteria set forth in Section 210(b) of PURPA. In addition, subjecting QF rates to the sort of individual rate adjudication applied to utilities was also not the intent of Congress.

B. MCC's Comments Addressing Competitive Solicitations Are Thoughtful but do not need to be Addressed in this Proceeding

MCC's position at hearing that the rules for competitive solicitation need to be carefully considered is well-taken. However, MCC's comments are probably better directed to the Commission's investigation of PURPA-related matters in N2015.9.74. It is true that many considerations regarding NWE's use of competitive solicitations should be reviewed, including the type of solicitation, the interaction with the Least Cost Plan rules, the risk of self-dealing, and

the like, these are not issues directly raised by Greycliff's petition nor do they need to be addressed herein. Instead, the narrow question presented by the Commission's proposed rulemaking is whether to amend or repeal A.R.M. § 38.5.1902(5) to clarify that in between competitive solicitations, or if no such competitive solicitations are held, the utility has an obligation to negotiate with potential QFs. If the scope of the proceeding is broadened to include all issues associated with potential revision of NWE's use of competitive solicitations, the proceeding could last well beyond the time line permitted for consideration of these issues.

C. MCC Does not Appear to Understand the Risks Posed by QFs, Either Now Or in the Future

For whatever reason, MCC does not appear to understand the risks posed by QFs as opposed to utility investment. As Greycliff mentioned at the hearing, if a QF fails to perform there are multiple negative consequences: breach of contract, termination of contract, liquidated damages provisions, bonding or letter of credit consequences, and a host of potential other consequences. With natural gas rates at historic lows, and with those gas rates being the main driver in the current QF-1 model (along with the spark spread) in electricity prices, the Commission should encourage as many QFs as possible under the current low rates to lock in long term savings for ratepayers. There is every probability that in the next few years, as coal plants are either mothballed or taken off line in response to the United States Environmental Protection Agency's Clean Power Plan, the cost of emitting carbon is going to be a new, and potentially costly driver in influencing an upward spike in electricity prices. If the Commission believes that the Clean Power Plan will have an upward influence on electricity rates for consumers, locking in QF contracts at current avoided cost rates is a hedge against inflation and future energy prices.

Given the relative size of the QFs as compared to NWE's other investments in plant, none of which will qualify to offset future carbon emissions, having a host of long-term renewables in NWE's portfolio is a sound investment strategy for both NWE and the Commission. In this light, placing multiple impediments in the path of developing QFs, as MCC suggests is not only a poor strategy but would seem ill-advised. For example, the concept that the Commission should reduce the income stream to QFs in the early years of QF contracts by eliminating levelized payments will not protect ratepayers. MCC seems to believe that having an escalated payment path with higher payments due in the later years of the agreement will protect ratepayers. MCC fails to recognize two realities of renewable energy project development: (1) the vast majority of all income due to generation by renewable energy projects in the early years of those projects will go to production tax credit or investment tax credit investors, typically for the first ten years of the project; (2) The traditional investors in the project do not typically get paid much if anything until after the tax equity investors and debt service obligations are paid. This means that if rates are set lower in the early years, the QF may not be able to perform economically and this may create an incentive for those QFs to breach their agreements rather than perform. If QFs walk away from their obligations then at a time when energy prices do start to rise, NWE's portfolio will be at risk of having to acquire generation in a rising market and this will expose ratepayers to that risk. If as one suspects, the avoided cost over the life of the project is set at the utility's incremental cost of acquiring energy and capacity, then the QF will be paid less in the later years of the contract, just at the point where the utility needs lower priced power as a hedge against higher prices for energy and capacity.

The same holds true for MCC's suggestion to shorten QF contracts from 25 years to five to seven years. Shortening contracts, in MCC's view, will reduce the risk to electric consumers that longer term contracts pose. Again, in this market, the MCC is misperceiving the situation. First, utilities do not finance their projects over a five to seven year term. The reason is that debt service will be very high, and again, will drive up the cost of electricity for the utilities' customers. Second, as noted above, pushing much of short-term debt service and tax equity repayment obligation into a few short years not only creates a substantial risk that a QF will not be able to perform, leaving a hole in the utility's portfolio at a time of potentially rising energy prices, but it would also shorten the utility's planning horizon such that it may be seeking contracts to replace that power in that rising market. Third, banks also evaluate the risk of investment and long-term revenue streams over the life of a project and typically will not loan to renewable energy developers on a five or seven year contract unless there is a corresponding increase in up front capital contributions and a much higher debt service obligation over the term. The MCC's proposal is thus just another way to kill renewable energy development at a time when the Clean Power Plan may well simultaneously require the addition of significant new renewable generation and, at the same time, may be a significant cost driver in electricity rates. Thus, adopting MCC's anti-QF proposals would hurt rather than help electric utility ratepayers. .

Nor will a shift to utility-owned generation and away from fixed long-term power purchase agreements with third party developers produce lower rates for utility customers. When the Commission makes a decision to approve a utility's investment in plant, and the utility places that plant in rate base, the utility is allowed to earn a reasonable rate of return on that investment. If the plant experiences difficulties, underperforms, or needs expensive repairs, the utility is allowed to recover those costs as well. The risks posed by a QF are that it will not

perform on its power purchase agreement with the utility and the utility due to its obligation to serve its customers will have to find power to replace the QF power. If the QF fails to perform, there are a variety of contractual provisions that govern failure to perform, and if the QF does not earn a reasonable return on its investment it has to live with the consequences. Whether intentional or not, the MCC's anti-QF position is not a good bargain for electric ratepayers as it shifts the risks of power generation from the QF developers to electric utility customers who are obligated to pay for underperforming or non-performing utility owned generation assets. Thus, MCC's positions are simply poor public policy, particularly with market prices for electricity now historically low, and a looming policy change which could both require substantial new investment in renewable generation and an increased cost of electricity as coal plants are retired and taken off line.

Thus, MCC's "generational equity" argument is precisely backwards. Signing up new long-term QFs now is a hedge against likely higher future energy prices, and thus customers in the future will benefit from locking up these contracts now. If the Commission put in place the MCC's suggestions they could be potentially ruinous to future ratepayers. The Commission should decline to address these important issues in this limited rulemaking which should really be limited to the question of whether NWE has an obligation to negotiate with QFs.

III. REPLY TO ORAL COMMENTS OF NWE

A. NWE'S Position on the Rule and its Obligation to Negotiate is, at best, Opaque.

NWE's position on whether it has an obligation to negotiate with QFs, even in the absence of all source competitive solicitations, is opaque. There are a number of ways in which

a competitive solicitation model, particularly an "all source" competitive solicitation model, could satisfy the requirements of PURPA. However, at a minimum, one would presume if such solicitations are not held, that there must be a path by which a QF can form a legally enforceable obligation under 18 C.F.R. § 292.304(d), and the Federal Energy Regulatory Commission ("FERC"), interpreting its own rules implementing PURPA, has noted the Commission is out of compliance with its regulations. *Hydrodynamics, et al*, 146 FERC ¶ 61,193, PP 30-33. NWE opposed the Commission amending or repealing the rule and opposed the Hydrodynamics petition at FERC and argued that it had no obligation to negotiate and that A.R.M. § 38.5.1902(5) and now, perhaps, seems to acknowledge that it has some obligation to negotiate. However, as the Commission has heard over the past week, what precisely NWE believes about its obligation to negotiate is difficult to ascertain.

B. FERC's *Ketchikan* Decision Does not Stand for the Proposition that a Utility Need not Acquire QF Generation if it has sufficient Capacity to serve its Load and Ketchikan Has Nothing to do with the issue before this Commission

NWE argued at hearing that FERC's *Ketchikan* decision has some application to the narrow question of whether A.R.M. § 38.5.1902(5) should be amended or repealed, and what the amended or repealed rule should look like. In fact, it is unclear to Greycliff how NWE thinks the *Ketchikan* decision applies to this proceeding. *Ketchikan*, 94 F.E.R.C. ¶ 61,293. *Ketchikan* involved the issue of whether a QF could receive a capacity payment (as opposed to an energy payment) if a non-jurisdictional utility had no need for additional capacity, and whether the utility was entitled to a limited waiver of PURPA's purchase obligation. FERC held:

> In implementing section 210 of PURPA, the Commission made clear that an avoided cost rate need not include capacity costs (as distinct from energy costs) where a QF does not "permit the purchasing utility to avoid the need to

construct a generating unit, to build a smaller, less expensive plant, or to reduce firm power purchases from another utility." Order No. 69, FERC Stats. & Regs., Regs. Preambles 1977-1981 P30,128 at 30,865. The Commission commented:

> A qualifying facility may seek to have a utility purchase more energy or capacity than the utility requires to meet its total system load. In such a case, while the utility is legally obligated to purchase any energy or capacity provided by a qualifying facility, the purchase rate should only include payment for energy or capacity which the utility can use to meet its total system load.

Order No. 69, FERC Stats. & Regs., Regs. Preambles 1977-1981 P30,128 at 30,870 (emphasis added). Accordingly, an avoided cost rate need not include capacity unless the QF purchase will permit the purchasing utility to avoid building or buying future capacity. Thus, while utilities may have an obligation under PURPA to purchase from a QF, that obligation does not require a utility to pay for capacity that it does not need. KEC, however, admits that it seeks to displace capacity from the Four Dam Pool Initial Project. KEC also has demanded that it be paid a rate based on avoided capacity costs. In short, KEC seeks payment for capacity from KEC's proposed project, regardless of whether KEC's capacity is needed. This is not required by PURPA or our regulations.

KEC also asks that the state court and this Commission not consider the fact that if it displaces sales from the Four Dam Pool Initial Project, per unit rates to all five utilities which participate in that project will go up, due to the lost load, which, in turn, will result in higher per unit rates for consumers.

Because KEC seeks rights beyond what PURPA provides, we will grant Petitioners' requests for limited waiver of the purchase obligation, to the extent that KEC is seeking to require utilities to purchase and pay for capacity that is not needed. *The waiver does not change KEC's PURPA rights. It will still have the right to sell to Ketchikan, but only to the extent that any sale of capacity to Ketchikan by KEC will not displace sales to Ketchikan of capacity under the Four Dam Pool Initial Project PSA.* 17 (KEC and Petitioners are urged to come to a non-litigated consensual agreement for any sale of electric energy)

Id. at pp. *62061-62 (footnotes omitted, emphasis added).

Under the apparent theory that if one makes a living with a hammer that everything is a nail, NWE also argued that FERC's *Ketchikan* decision supported the Commission's decision to limit NWE's obligation to purchase energy and capacity from QFs to 50 total installed MWs in FERC's *Hydrodynamics* decision. FERC disagreed, stating:

> NorthWestern argues that the 50 MW installed capacity limit is supported by the Commission's decision in *Ketchikan*, which stated that "an avoided cost rate need not include capacity unless the QF purchase will permit the purchasing utility to avoid building or buying future capacity." In *Ketchikan*, however, the Commission explained that avoided cost rates need not include the cost for capacity in the event that the utility's demand (or need) for capacity is zero. That is, when the demand for capacity is zero, the cost for capacity may also be zero. Applying *Ketchikan* to the case at hand, the installed capacity limit should represent the point at which NorthWestern's demand for capacity equals zero. However, neither the Montana Commission nor NorthWestern has established that a 50 MW installed capacity limit has any clear relationship to NorthWestern's actual demand for capacity, therefore the *Ketchikan* rationale does not apply. For the foregoing reasons, we find that the 50 MW installed capacity limit is inconsistent with PURPA's goal of promoting QF development and fails to implement the Commission's regulations requiring an electric utility to purchase any capacity which is made available from a QF, and at a rate that, at the QF's option, is a forecasted avoided cost rate.

Hydrodynamics, 146 FERC ¶ 61,193, P. 35.

Ketchikan thus stands for the proposition, as has always been the case, that if a utility has no need for capacity and that need for zero capacity is demonstrated, a QF is not paid for providing capacity. How this applies to the context of whether the Commission should amend or repeal a rule that FERC has similarly found inconsistent with its implementing regulations is unclear. Perhaps NWE's point is that amending or repealing the rule and requiring negotiations will result in too many QFs seeking to sell energy and capacity? If this is indeed NWE's argument: (1) it exceeds the scope of this rulemaking for the Commission to address the question of what is or is not, "too many" QFs; (2) it necessarily begs the question as to what NWE's actual capacity needs are at present; (3) it fails to acknowledge that as QFs are added, and NWE's system contains sufficient generating capacity to meet its load obligations, the capacity payment will fall until it reaches zero. Why Ketchikan otherwise has anything to do with NWE's obligation to negotiate or the various options to amend or repeal A.R.M. § 38.5.1902(5).

The Commission should decline NWE's invitation to consider, even obliquely, this extraneous and irrelevant issue.

C. The Fifth Circuit Court Decisions in *Power Resource Group* and *Exelon* Have Nothing to do with Montana.

The Fifth Circuit Court of Appeal's decisions in *Power Resource Group* and *Exelon* arose out of anti-QF regulations adopted by the Texas Public Utility Commission. Those regulations were ultimately reviewed by the Fifth Circuit Court of Appeals which has jurisdiction over, among other states, Texas. The federal circuit court which has jurisdiction over Montana is the Ninth Circuit Court of Appeals, and one would surmise there are differences between the two circuits.

Regardless, the questions in Power Resource Group and Exelon have nothing to do with the issues in this proceeding: in the absence of all source competitive solicitations mandated by A.R.M. § 38.5.1902(5) does NWE have an obligation to negotiate with QFs? This is the narrow question presented by Greycliff's petition, and it is not resolved by an application to the Fifth Circuit Court of Appeal's decision. The entity that has weighed in is FERC, and it has made it clear that the regulation in its current form, to the extent it does not permit a negotiation as an alternative method to create an entitlement to a long-term forecast avoided cost rate, is inconsistent with FERC's implementing regulations. NWE has, at points, seemingly invited the Commission to ignore FERC's decision in *Hydrodynamics.* The Commission should disregard NWE's invitation to error.

D. Why Option C is Superior and will not lead to the "Parade of Horribles" Argued for by NWE.

Both MCC and NWE are critical of proposed Option C. Without lumping their arguments together, it is important to note that the administration of the "bad faith" negotiation

component of Option C is not the administrative nightmare or invitation to error that NWE in particular supposes.

NWE's argument is, essentially, that more disputes rather than fewer will arise and that if NWE does not negotiate or negotiates less than fully, it will be open to a potential argument that it has acted in less than good faith. As a rejoinder, Greycliff would note that the provision applies equally, and that QFs, unlike NWE, must pay for the costs of their own attorneys and experts, whereas NWE may seek cost recovery from ratepayers for expert and legal services rendered on NWE's behalf. This asymmetry creates a substantial disincentive for a QF to undertake legal actions except in the most extreme or egregious of circumstances. The way in which a typical QF-utility proceeds is with the QF approaching the utility and requesting negotiation or a rate or a contract. The utility may then reply in any number of non-bad faith ways: (1) it can agree to a meeting to discuss the proposed rate or contract; (2) it can provide information to the QF about its capacity and energy needs and proposals to acquire new resources or new power sales contracts, (3) it can decide to hold a teleconference by which to discuss these matters; or (4) it can trade contract proposals, draft contracts, etc. All of these things are commonly done elsewhere in the industry, and NWE seems to have no trouble doing these things when it negotiates its own agreements regarding acquisitions of generation, or when it has negotiated with Community Renewable Energy Project bidders.

Any of these steps would likely result in a finding of "no bad faith" by the Commission, and would deter any satellite litigation or continual challenges to NWE's approach to negotiation. What would not forestall challenges is where, as has occurred in the past, a QF approaches the utility and seeks negotiations over a contract and the utility says it is not negotiating or has no need for resources or simply does not respond at all to QF inquiries.

Keeping in mind that the standard under Proposal C is that both the QF and the utility must negotiate, the only way that a QF can obtain the information it needs to make a determination whether: (1) its project is viable economically; (2) NWE has the need for energy and capacity; or (3) the current state of NWE's avoided costs, is by discussing these matters with NWE.

The goal of the rule is to encourage negotiation in an open and fair manner, rather than allowing NWE to claim, as it did with Greycliff, that telling Greycliff it cannot enter into a contract with Greycliff because NWE is precluded by rule from negotiating – or really, any other of a myriad number of ways that a utility may argue prevents, forestalls, impedes or interferes with its ability to negotiate.

What NWE is really saying, at bottom (at least it would appear to cynical eyes), is that

NWE wishes to retain the ability to simply say "no negotiations" and have there be no consequence to that position. If NWE knows that a finding of bad faith in negotiation may result in a finding that the QF's proposed contract terms and conditions will be adopted by the Commission, then it will have a substantial motivation not to adopt that posture. Again, as argued by NWE and MCC elsewhere, there is no basis for assuming a QF will frivolously make such a filing seeking a finding of bad faith. Doing so lightly may, in turn, result in summary disposition against the QF, most of whom can ill afford to pay legal and expert fees on frivolous allegations. Nor does it presume that if the QF's proposal is far-fetched, inconsistent with NWE's avoided costs, or that the proposed contract terms or conditions are unreasonable, the Commission must rubber stamp the proposal. Option C merely provides the Commission with the power to do so rather than the obligation should it find that NWE should have acted in good faith during negotiations, thus eliminating the need for a full contested case proceeding over the contract terms, conditions, or the proposed rate. This is a more efficient and streamlined process

than currently exists, where the QF approaches NWE for a contract, either does not hear back in a timely way, or is told that NWE will not negotiate or enter into an agreement, thus prompting the need for a petition before the Commission. FERC's goal, as stated in both *Grouse Creek Wind Park* and *Hydrodynamics*, was to encourage amicable contract formation. The best way to ensure amicable contract formation is to make sure that both parties have an incentive to do so.

To claim, as NWE does, that Option C will result in an increase in litigation, seems far-fetched. Not only do QFs typically have limited budgets for legal fees and must pay for those fees themselves, QFs have only infrequently filed petitions with the Commission in the past. In the memory of undersigned counsel, he only recalls five over the past fifteen years: *Whitehall Wind*, *Two Dot Wind*, *Kenfield Wind Park I and II*, *Hydrodynamics*, and *Greycliff*. The other, *Greenfield*, was a petition filed by NWE. Greycliff is not attempting to minimize the costs of such proceedings, but if both parties are able to freely negotiate and are incentivized to do so, fewer of these sorts of petitions will be filed before the Commission as amicable contract formation takes place.

If NWE's point, however, is that it intends to continue to frustrate, stonewall, or otherwise not cooperate in productive negotiations with QF, its behavior (as opposed to the rule) may cause a brief spike in litigation over NWE's bad faith in negotiation. However, if both parties to the negotiations fully embrace the obligation, then the Commission's workload over QF litigation should decline rather than increased.

IV. PRAYER FOR RELIEF.

1. Greycliff respectfully requests that A.R.M. § 38.5.1902(5) be either amended or repealed as set forth herein. Greycliff believes that the glaring inconsistency between FERC's

decision in *Hydrodynamics*, declaring A.R.M. § 38.5.1902(5) inconsistent with FERC's regulations, finding it an unreasonable implementation of PURPA, and contrary to the purposes of PURPA which is to encourage the development of QFs, dictates that A.R.M. § 38.5.1902(5) be amended or repealed as set forth herein. Greycliff prefers Option C as the preferred alternative, and believes the scope of the Commission's consideration of each of the options should be limited to which is the superior option, and not drag in a series of important but ultimately tangentially related issues into this narrow proceeding.

2. Such further relief as the Commission finds just and appropriate.

RESPECTFULLY SUBMITTED this 4th day of November, 2015.

UDA LAW FIRM, PC

By: _____
Michael J. Uda
Attorney for Greycliff Wind Prime, LLC

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing has been served on this 18th day of November, 2015 upon the following by first class mail postage pre-paid:

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I hereby certify an original was e-filed, and one copy of the foregoing were hand-delivered to the following:

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