

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 Qualifying
Facilities.

RENEWABLE NORTHWEST
PROJECT'S COMMENTS ON
PROPOSED RULE

Renewable Northwest Project (“RNP”) appreciates the challenge that the Public Service Commission of the State of Montana (“Commission”) faces in implementing the Public Utilities Regulatory Act of 1978 (“PURPA”) in a way that achieves its policy goals and balances the interests of diverse stakeholders. Nonetheless, because PURPA’s purchase obligation can drive utilities to diversify their portfolios when the market is able to deliver new resource types and competitive products at the utility’s avoided cost, and because a PURPA published rate can help the market respond to lawmakers’ and the public’s desire to see smaller, geographically distributed generating resources in their communities, RNP does not support moving to a 2 MW cap for PURPA published rates without a clearer understanding of how doing so will achieve specific goals of the Commission, and without an alternative plan for capturing the beneficial outcomes that a functioning PURPA regime has begun to deliver in Montana.

We hope that there is an opportunity to engage in discussion of possible alternatives to this proposal that will meet the Commission’s goals, perhaps through a negotiated rulemaking. For now, we will address just a few of the significant issues in the discussion. Before presenting our views on those issues, we will explain what we believe the proposed amendment will—and will not—accomplish. Next, we will evaluate the concern that today’s PURPA regulations may deliver too much supply (or too much supply of particular resource types) and identify some

alternatives ideas for preventing unsustainable outcomes. Finally, we will offer ideas to support the Commission's potential interest in competitive solicitation.

1. Consequences of the Proposed Amendment

a. Market consequences

The Commission's job in implementing PURPA is not to guarantee an attractive market to small and community-scale renewable energy projects. But because the Commission plays a major role in state energy policy, and because small and community-scale energy production is significant to policymakers and the public, the Commission should understand the market consequences of its proposed amendment. We expect that reducing the PURPA published rate threshold to 2 MW or lower may substantially constrict small- and community-scale wind energy development activity, unless there is an alternative directed toward this market segment (see discussion of competitive solicitation below).

There are two primary reasons why we predict that a 2 MW published rate cap will have significant market consequences. First, wind projects will not likely be able to take advantage of the published rate at 2 MW. A project size closer to 10 MW is needed to capture efficiencies and absorb fixed and balance of plant costs. Second, eliminating a realistic published rate alternative not only prevents 10 MW projects from accessing the published rate, but it may also discourage the productive negotiation that can lead to community scale projects between 10 and 20 MW. One common justification for eliminating published rates is that larger-sized projects don't need them, because their developers are sophisticated enough to negotiate a contract with the utility. Indeed, almost everyone prefers a negotiated agreement. But the absence of a realistic published rate alternative reduces the likelihood of successfully negotiated agreements. Without a certain target to shoot at—even at a lower avoided cost rate—the initial development costs to get smaller

projects off the ground may not be justified. (The project developer's expertise or sophistication is not the issue here; it is the project balance sheet.) Published rates give developers a path to start down. Importantly, published rates also give utilities an incentive to negotiate to reach the best deal for both sides—which may include a larger size, a lower price, or different terms than the usual published rate deal. Negotiated agreements only happen when both parties are motivated to be at the table, and published rates do provide motivation and set the broad outlines of expectations for a deal. For example, we believe a close examination of NorthWestern Energy's ("NWE's") recently signed Two Dot wind project deal might reveal the significance of the published rate in achieving a negotiated deal.

In short, reducing the published rate threshold to 2 MW sends a strong signal that Montana is off the map for community-scale wind development, at least where no alternative path is defined. Other mechanisms for regulating QF activity may be able to accomplish some of the Commission's same goals without cutting off development interest in this popular renewable energy sector. Small and diverse projects make a significant contribution to the power system, and the Commission should remain mindful of how its policy actions affect that market.

b. Administrative consequences

By reducing the published rate threshold to 2 MW, the Commission hopes to avoid some of the time, expense, and controversy that has surrounded the setting of published avoided cost rates. This is understandable. At the same time, a contested case will still be necessary to set a published rate, and there is no certainty that parties will not litigate the avoided cost docket—particularly when ancillary services, REC values, and other issues of broader significance are presented. (Even if reducing the published rate threshold to 2 MW resulted in an uncontested avoided cost docket, that outcome should not necessarily be viewed as a cost-saving victory for

the consumer; it is also a sign that the market has given up, thereby reducing structural pressure on the utility to keep down the costs that are used to determine avoided cost rates.) We also encourage the Commission to consider the total administrative cost-benefit consequences of continuing avoided cost dockets for projects smaller than 2 MW, while possibly adding new competitive rate-setting or solicitation processes to the Commission's workload.

2. Regulating Without Eliminating PURPA Supply

One important subtext in this and other Commission dockets is whether NWE has received or will receive too much PURPA power—and, specifically, PURPA wind. The proposal to lower the published rate cap to 2 MW guarantees that published rate wind development will stop, but does not address whether too much has actually been supplied or whether there are more flexible mechanisms for the Commission to regulate supply.

The present state of affairs reflects a good time to evaluate supply conditions, but does not demonstrate an impending emergency. In our experience, signed contracts do not equal megawatts in the ground; the Commission should always expect some attrition when estimating NWE's total supply of PURPA energy. Many of the supply concerns appear to relate to NWE's ability to integrate higher penetrations of wind energy. Good work has begun to evaluate NWE's capacity for balancing wind energy, but that conversation is nascent and apparently will be developed further in the next avoided cost docket. Where the GENIVAR study suggests that adding small wind projects has minimal effect on the need for regulation, it does not seem sensible to preempt the coming discussion and base a major change in PURPA policy on an estimate of how many more aggregate megawatts Dave Gates Generating Station can regulate—particularly without considering other market resources available for regulation. In any case,

several developers have indicated that removal of the Option 3 rate will do plenty to impede development while the Commission sorts out these issues.

Regarding supply of wind energy more generally, there has been not yet been public vetting of NWE's assertion that it does not need any more wind energy in the short- to medium-term. The 2009 Supply Plan essentially evaluated only NWE's RPS needs, and analysis in the 2011 Supply Plan is yet to be available to public stakeholders not included in the E-TAC (such as RNP, at present). PURPA provides an important market push against what may be overly conservative estimations of the role that Montana's superior wind resource can play in serving its native electricity needs.

We recognize that disaggregation is a concern when it comes to PURPA published rates, which are meant to be available only to smaller projects. In Idaho, RNP has consistently supported adoption of rules to prevent larger projects from taking advantage of published rates. But there is no indication that NWE will see supply additions on the scale seen in Idaho, where disaggregation enabled major projects to secure published rates. In Montana, the Kenfield decision has been successful in giving NWE and the Commission flexibility to weed out disaggregated projects. RNP would support addressing disaggregation in rules if the Commission or NWE does not feel that the Kenfield decision is sufficient to control misuse of published rates.

Even if the Commission believes that more aggressive action must be taken now to slow PURPA published rate supply, we would recommend a more nimble approach than amending Commission regulations to permanently reduce the published rate cap from 10 MW to 2 MW. In the short-term, it may be possible to structure a non-discriminatory, temporary PURPA contract cap that avoids the legal deficiencies of the existing tariff but still provides an outside limit to

additional supply while other alternatives are being considered. For the longer term, we encourage the Commission to consider two sets of published rates whose availability varies based on NWE's resource sufficiency/deficiency status. This mechanism is used in Oregon to modulate PURPA supply relative to the utility's needs, and could be explored for Montana.

3. Alternatives to PURPA for Competitive and Community Scale Energy

It may well be that PURPA published rates are not the ideal policy tool to accomplish an economically efficient, competitive and diverse electricity supply. We appreciate that the Commission is hesitant about the central role that PURPA published rates give it in "making the market" and we support pursuing real alternatives, including improvements to competitive solicitation.

First, though, we want to acknowledge that competitive solicitations may not ever be able to deliver the market segment that the PURPA published rate can bring. As discussed above, a published rate is particularly well suited to capturing the smaller-end projects whose potential returns do not justify incurring up-front development costs without a certain path to market. In addition, smaller projects are not likely to have the economic efficiencies to compete with larger projects in a general competitive solicitation. This is not necessarily a bad thing; RNP has long focused its efforts on larger projects, believing that they capture efficiencies and advance renewable energy penetration cost-effectively. But when lawmakers and the public have a strong interest in smaller projects, and the utility has had a difficult time hitting the project sizes and configurations that the lawmakers have asked it for, it is important to acknowledge that the Commission's PURPA policy decisions may exacerbate this divergence. To accomplish more economic efficiencies *and* deliver on these policy goals, we are intrigued by the concept of a competitive solicitation or reverse auction mechanism that explicitly seeks and then sets the best

prices for this smaller market segment. Unfortunately, we do not at this time have a ready example or conceptual framework for how this could work.

One consequence of going exclusively to a competitive solicitation model is that the utility's resource plan effectively defines the resource types that the market is invited to deliver. By contrast, a PURPA price available to all resource types can promote greater experimentation and diversity when the market can deliver alternatives at the utility's avoided cost. Greater regulatory attention to forward-looking and inclusive resource planning, and even greater direction from the Commission in evaluating resource plans, could be warranted as a companion to the shift away from PURPA that the Commission is considering.

Ultimately, competitive solicitations only achieve the goal of letting the market define the best resource choices if they are transparent and well-run. RNP has been involved in competitive solicitation policy dockets in Oregon, and notes that several elements have been considered helpful to improving the process: publishing a draft RFP for comment from stakeholders and Commission staff; Commission approval of the final RFP; participation of an independent evaluator (who reports to the Commission) in developing the RFP and the short list, and even through final negotiation where warranted; and Commission review of the short list. Effective regulation of competitive solicitation without engagement from the Commission or independent evaluator during the process is difficult. As interested parties and potential future business partners of the utility, disappointed bidders are not well positioned to convey concerns about the process. Other stakeholders do not have sufficient access or knowledge of commercial terms to opine on the success of the solicitation process. Moreover, once the winning project is packaged for pre-approval, it can be difficult to reconstruct the solicitation process. We encourage the

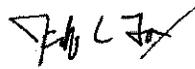
Commission to consider adding some regulatory oversight mechanisms to the competitive solicitation process.

In sum, however, we do not believe that alternative methods for introducing more effective competition are sufficiently well developed at this time to justify a major change to the Commission's PURPA policy. We respectfully suggest that the Commission further refine these alternatives—particularly ones that can combine the Commission's interest in better economic efficiency with the policy desire for small, diverse projects—before adopting a substantial change to its PURPA policy. Thank you for the opportunity to comment.

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