

Background

A stable and predictable regulatory environment is needed to attract small QF developers to Montana. This environment includes at least three elements:

1. A reasonable maximum project size
2. A standard offer rate that reflects the utility's true long-term avoided costs
3. Reasonable integration costs and certainty about integration costs

For many years, Montana's regulatory environment did not include these elements and almost no small QF development occurred. As an example, during the period that the Horseshoe Bend project was being developed, financed and constructed the maximum standard offer project size was only 3 MW and the standard offer rate available to small QFs was only \$32.75/MWh. As a result, United Materials was unable to successfully develop the Horseshoe Bend project as a Montana QF project and had to secure a QF contract with Idaho Power Company for the project to proceed.

However, over the past several years, the Commission has put the necessary elements in place that make it possible for some small QF projects to be successfully advanced. First, in early 2008 the Commission raised the maximum standard offer project size from 3 MW to 10 MW. Then, over a series of orders, the Commission increased the standard offer rate to more accurately reflect NWE's long-term avoided costs. And finally, in 2010 the Commission adopted the Option 3 rate which provided QF wind developers with certainty as to integration costs.

These Commission actions have resulted in five recent 10 MW QF contracts. However, all of these contracts are based on the Option 3 rate. With the recent Commission decision to eliminate the Option 3 rate, no new small QF contracts are likely until and unless reasonable and certain integration costs are determined.

Comments

The Commission should not adopt the proposed rule for the following reasons:

1. Transaction costs remain a significant barrier for small projects.

The staff memorandum which preceded the issuance of the proposed rule states: “In 2007, the Commission increased the Cap to 10 MW, reasoning that this increase was necessary to encourage QF power production and overcome transaction cost-based market barriers small QFs face when negotiating contracts with monopoly utilities.”

This reasoning is a valid today as it was in 2007. Many costs for small projects are inelastic and virtually the same whether the project capacity is 10 MW or 2 MW. Examples of these costs are wind data collection and analysis, environmental studies and permitting, interconnection, and construction mobilization/demobilization.

The recent contracts for new small QFs indicate that these costs can be successfully spread over a 10 MW project. But there is no evidence that these costs can be successfully borne by a 2 MW project. Absent such evidence, the Commission should not adopt the proposed rule.¹

2. The proposed rule does not provide reasonable alternatives for small projects.

The proposed rule requires QFs larger than 2 MW to be selected through a competitive solicitation. However, much work needs to be done to make competitive solicitations a viable alternative for non-utility generators in Montana, especially small QF projects.

Montana’s recent history with competitive solicitations has not been encouraging and has

¹ The staff memorandum suggests that the 2 MW maximum project size can be supported by referring to FERC’s interconnection policies. While it is certainly worthwhile to consider how others might draw the line between “large” and “small” projects, it is worth noting that FERC selected 20 MW as the dividing line between its Large and Small Generator Interconnection Procedures.

evolved with relatively little Commission oversight. In contrast, robust regulatory rules have evolved in other states that: 1) specify the frequency and content of competitive solicitations, 2) provide opportunities for comment on proposed solicitations prior to issuance, 3) require the selection of an independent party to oversee the process, etc.

It is also unclear as to whether special provisions would have to be incorporated into a competitive solicitation to encourage participation by small QFs. Even a well-developed competitive solicitation process may fail to attract small QF developers to Montana due to the cost to advance projects to the point where they are ready to participate in the solicitation process and the uncertainty about the results. A small project developer may be willing to gather and analyze wind data, complete environmental studies and secure permits, and complete the interconnection process if a standard offer contract is available. However, many small project developers will not be willing or able to complete these basic development activities if the result is only an opportunity to participate in a competitive solicitation.

The devil really is in the details when it comes to competitive solicitations and the specifics should be developed and well understood before consideration is given to adopting the proposed rule.

3. There is no compelling need to adopt the proposed rule at this time.

The recent execution by NorthWestern of five QF contracts with 10 MW wind projects may cause some concern that large numbers of new QF contracts are in the offing. However, as noted previously, all of these new contracts are based on the Option 3 rate which is no longer available. With the elimination of the Option 3 rate, no new small QF contracts with wind projects are likely until reasonable and certain integration costs are determined. Absent other action by the Commission, wind integration costs are unlikely to be addressed until NorthWestern's next avoided cost filing.

For those concerned about a possible QF "gold rush", it is worth noting that a single 10

MW wind project at a 35% capacity factor produces less than 0.5% of NWE's annual default supply energy needs (currently about 730 aMW). So, a significant number of 10 MW wind projects would have to be developed to materially impact NWE's overall default supply portfolio mix and costs.²

Similarly, the recent Genivar study completed as part of NorthWestern's Wind Integration Working Group process demonstrates that 10 MW wind projects have a very small impact on NWE's regulation requirements, especially if the projects are geographically distributed. So, again, a significant number of 10 MW wind projects would have to be developed to materially impact NWE's overall regulation needs.

Recommendation

The Commission should not adopt the proposed rule at this time for the reasons discussed above.

² The staff memorandum notes that the process for establishing avoided cost rates can be "lengthy and contentious" and may result in standard offer rates being somewhat out-of-date (either higher or lower than a utility's current avoided costs) by the time a docket is completed. However, this effect would be quite small for a 10 MW wind project. Since a 10 MW wind project would provide only 0.5% of NorthWestern's default supply energy requirements, a stand offer rate that is 10% above or below actual avoided costs would only impact NorthWestern's default supply rate by approximately 0.05%.