

RECEIVED

MAR 07 2016

MONT. P.S. COMMISSION

DAISY SWEENEY  
CLERK DISTRICT COURT

2015 MAR -3 AM 10:40

FILED  
BY

C. Potizak

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

**MONTANA FIRST JUDICIAL DISTRICT COURT  
LEWIS AND CLARK COUNTY**

NORTHWESTERN CORPORATION,  
d/b/a NORTHWESTERN ENERGY,

Plaintiff,

v.

THE MONTANA DEPARTMENT OF  
PUBLIC SERVICE REGULATION,  
MONTANA PUBLIC SERVICE  
COMMISSION,

Defendant.

Cause No. ADV-2015-459

**ORDER ON PETITION FOR  
JUDICIAL REVIEW**

On June 23, 2015, Petitioner Northwestern Corporation d/b/a Northwestern Energy (NWE) filed a complaint and petition for judicial review of a final agency decision of the Montana Department of Public Service Regulation, Montana Public Service Commission (PSC) denying NWE's application for approval of avoided cost tariff schedule QF-1 adjustment. Sarah Norcott, Al

1 Brogan, and John Alke represent NWE. Jason T. Brown represents Respondent  
2 PSC. Michael J. Uda represents Intervenors Hydrodynamics, Inc., and Montana  
3 Marginal Energy, Inc. (Hydrodynamics). The petition is fully briefed. The Court  
4 heard oral argument on January 7, 2016. Upon review of the record and in  
5 consideration of the parties' arguments, the Court affirms the PSC's decision.

### 6 **FACTUAL AND PROCEDURAL BACKGROUND**

7 In 1978, Congress enacted the Public Utility Regulatory Policies Act  
8 (PURPA) and directed the Federal Energy Regulatory Commission (FERC) to  
9 adopt rules to implement it. PURPA's goals are to promote energy conservation,  
10 encourage the development of cogeneration and small power production  
11 facilities, and reduce domestic demand for traditional fossil fuels. *Am. Paper*  
12 *Inst. v. Am. Elec. Power Serv. Corp.*, 461 U.S. 402, 404, 103 S. Ct. 1921, 1924  
13 (1983). PURPA requires utilities to purchase energy from generating facilities  
14 known as qualifying facilities (QFs). Under Montana Code Annotated § 69-3-  
15 601(3), QFs are facilities that have a power production capacity no greater than  
16 80 megawatts and are owned by persons not primarily engaged in the generation  
17 or sale of electricity other than electric power from small production facilities.

18 Because the rates utilities pay QFs impact consumers, the rates must  
19 be just and reasonable to consumers but must not discriminate against QFs. 16  
20 U.S.C. § 824a-3(b); *Am. Paper Inst.*, 461 U.S. at 404-05, 103 S. Ct. at 1924.  
21 Pursuant to regulations adopted by FERC, QF rates are set at a utility's full  
22 avoided cost. Full avoided cost is "the incremental costs to an electric utility of  
23 electric energy or capacity or both which, but for the purchase from the  
24 qualifying facility or qualifying facilities, such utility would generate itself or  
25 purchase from another source." 18 C.F.R. 292.101(b)(6). In other words, a

1 utility like NWE must purchase energy and capacity from QFs at the same price  
2 NWE would have to pay if it otherwise purchased or generated the energy or  
3 capacity on its own.

4 Pursuant to Montana’s “mini-PURPA,” codified at Montana Code  
5 Annotated § 69-3-601, *et seq.*, the PSC is charged with determining a utility’s  
6 avoided cost and setting appropriate QF rates. The PSC is a state agency that  
7 conducts both quasi-legislative and quasi-judicial functions. *State Bar v. Krivec*,  
8 193 Mont. 477, 484, 632 P.2d 707, 711 (1981). Among its quasi-legislative  
9 duties, the PSC makes rules or sets rates and performs other acts connected with  
10 or essential to its exercise of quasi-legislative function. Mont. Code Ann. § 2-15-  
11 102(10). The PSC also interprets, applies and enforces existing rules and laws;  
12 determines rights and interests of adverse parties; evaluates and passes on facts;  
13 and performs any other acts necessary in the performance of its quasi-judicial  
14 functions. Mont. Code Ann. § 2-15-102(11). When establishing rates, Montana  
15 law allows the PSC to account for its avoided costs. Mont. Code Ann. § 69-3-  
16 604.

17 The PSC requires utilities to submit avoided cost data every other year  
18 within thirty days of submitting an integrated least cost resource plan. Admin. R.  
19 Mont. 38.5.1905. When the PSC establishes the rate a utility must purchase  
20 power from QFs, the rate must be reasonable based upon the utility’s current  
21 avoided least cost resource data. *Whitehall Wind, LLC v. Mont. PSC*, 2010 MT  
22 2, ¶ 21, 355 Mont. 15, 223 P.3d 907.

23 On December 23, 2013, NWE filed its 2013 Electricity Supply  
24 Resource Procurement Plan (2013 Plan). The 2013 Plan identified three energy  
25 procurement options. Option one was based upon NWE’s current portfolio at the

1 time NWE filed the 2013 Plan. Option two was based upon NWE's current  
2 portfolio with a combined cycle combustion turbine (turbine) coming online in  
3 2018. Under option two, NWE used the "blended market-combined cycle gas  
4 plant methodology" to calculate its avoided cost. This methodology calculates  
5 avoided cost by blending projected near-term market prices and the expected  
6 costs of owning and operating a turbine once it comes online. The PSC  
7 previously allowed NWE to use this method on two prior occasions. Option  
8 three was based upon NWE's current portfolio plus the cost to acquire PPL  
9 Montana's hydroelectric facilities. Option three did not include costs to NWE to  
10 acquire a turbine in addition to its cost to purchase the hydroelectric facilities.  
11 The 2013 Plan identified option three as the preferred option and option two as  
12 the most likely alternative if the sale of the hydroelectric facilities failed.<sup>1</sup>

13           On January 22, 2014, NWE applied for an interim rate adjustment to  
14 its Schedule QF-1 rates, Schedule WI-1 rates, and Schedule CR-1 rates.<sup>2</sup> In the  
15 application, NWE used data from the 2013 Plan to calculate its avoided costs.  
16 NWE assumed the PSC would approve the hydroelectric facilities acquisition.  
17 NWE also assumed it would acquire a turbine at some point in the future. Again,  
18 NWE used the blended market-combined cycle gas plant methodology to  
19 calculate avoided costs. NWE also hired Ascend Analytics, LLC (Ascend), to  
20 determine the ideal date for a turbine to go online. Ascend determined the  
21 turbine should become commercially operational in 2033. Thus, NWE calculated  
22 its proposed QF-1 rates assuming it would purchase the hydroelectric facilities  
23 and acquire a turbine in 2033. NWE's current rates, which the PSC set on

24 <sup>1</sup> In a separate case, the PSC approved the sale of the hydroelectric facilities. NWE completed transfer of the  
25 facilities while the current case was pending before the PSC.

<sup>2</sup> Only the Schedule QF-1 rates are at issue in this petition for judicial review.

1 December 5, 2012 are \$53.14 per megawatt-hour (MWh) for off-peak power and  
2 \$92.73 per MWh for on-peak power. NWE's proposed adjusted rates are \$35.35  
3 per MWh for off- peak and \$89.28 per MWh for on-peak power. Under the  
4 adjusted rates, NWE would pay QFs between \$3.45 and \$17.79 less per MWh for  
5 power.

6 On February 7, 2014, the PSC issued a notice of application and  
7 intervention deadline in NWE's application. The PSC allowed several interested  
8 parties, including Hydrodynamics, to intervene in the contested case. In its  
9 petition to intervene, Hydrodynamics indicates it "will generally oppose the  
10 inputs into the methodology employed by NWE in this docket in calculating  
11 avoided cost, particularly NWE's methodology for forecasting long-term natural  
12 gas prices." Over the next six months, the parties exchanged several data  
13 requests in preparation for a public hearing on November 6, 2014. On  
14 July 30, 2014, the PSC issued a notice of additional issue: "Whether it is  
15 appropriate to require future updates to the QF-1 Tariff based on updated  
16 forecasts."

17 The PSC held a hearing on November 6 and 7, 2014. NWE's  
18 witnesses provided the only testimony relevant to the issues on appeal. However,  
19 Hydrodynamics appeared at the hearing and cross-examined NWE's witnesses on  
20 the issue of avoided costs and the QF rate. PSC staff attorneys and  
21 commissioners also cross-examined NWE's witnesses.

22 On April 7, 2015, PSC staff issued a memo recommending the PSC  
23 either deny NWE's request to modify the QF-1 rates or modify the proposed rates  
24 using adjusted inputs. The staff memo identified two major problems with  
25 NWE's application: (1) NWE's failure to show the proposed procurement

1 portfolio (adding a turbine in 2033 after acquiring the hydroelectric facilities)  
2 was the least cost resource procurement strategy after NWE failed to conduct a  
3 comprehensive resource planning analysis; and (2) PSC staff identified a possible  
4 flaw in the blended market-combined cycle gas plant methodology:

5 [M]oving the acquisition of a [turbine] 18 years into the future – 2033  
6 – highlights a possible flaw in the method, at least when it is  
7 combined with [NWE’s] proposed rate table. The possible flaw  
8 involves classifying purely market-based avoided costs into energy  
9 and capacity cost components. [NWE] did not demonstrate the  
10 reasonableness of deducting a capacity cost from a purely market-  
11 based avoided cost calculation in order to determine rates for wind  
12 projects. . . .

13 This potential flaw has existed since the method was adopted in  
14 Order 7108e. Historically, however, because the acquisition of a  
15 [turbine] was more imminent, the effect was much smaller, about 3  
16 percent, and could have been considered a reasonable trade-off for a  
17 simpler cost calculation. When the [turbine] is moved out to 2033,  
18 market prices dominate the avoided cost calculation and the effect of  
19 the energy-capacity cost separation becomes significant.

20 Admin. Rec. 62, at 4-5 (April 7, 2015).

21 On May 4, 2015, the PSC issued Order 7338b denying NWE’s request  
22 to modify the QF-1 rates. In its findings of fact, the PSC addressed the same  
23 issues raised in the staff memo. The PSC concluded “[d]ue to [NWE’s] failure to  
24 provide adequate avoided cost information, however, it has not met its burden of  
25 proof in this proceeding.”

26 NWE argues the PSC violated its right to procedural due process and  
27 its right to be heard when it relied upon a staff memo to deny NWE’s application  
28 without first providing NWE an opportunity to address or rebut the document.  
29 NWE further argues the PSC’s order is arbitrary and capricious because it

1 ignores the uncontested evidence in the record that current QF-1 rates are too  
2 high and in violation of PURPA.

### 3 STANDARD OF REVIEW

4 A district court's review of an administrative agency's order is  
5 governed by the Montana Administrative Procedure Act (MAPA). The standard  
6 of review for an agency decision is set forth in Montana Code Annotated § 2-4-  
7 704(2), which provides:

8 (2) The court may not substitute its judgment for that of the  
9 agency as to the weight of the evidence on questions of fact. The  
10 court may affirm the decision of the agency or remand the case for  
11 further proceedings. The court may reverse or modify the decision if  
12 substantial rights of the appellant have been prejudiced because:

13 (a) the administrative findings, inferences, conclusions, or  
14 decisions are:

15 (i) in violation of constitutional or statutory provisions;

16 (ii) in excess of the statutory authority of the agency;

17 (iii) made upon unlawful procedure;

18 (iv) affected by other error of law;

19 (v) clearly erroneous in view of the reliable, probative, and  
20 substantial evidence on the whole record;

21 (vi) arbitrary or capricious or characterized by abuse of discretion  
22 or clearly unwarranted exercise of discretion; or

23 (b) findings of fact, upon issues essential to the decision, were  
24 not made although requested.  
25

Montana courts use a three-part test to determine if a finding is clearly  
erroneous. *Weitz v. Mont. Dep't of Natural Res. & Conserv.*, 284 Mont. 130,  
133, 943 P.2d 990, 992 (1997). First, the court must review the record to see if  
the findings are supported by substantial evidence. Second, if the findings are  
supported by substantial evidence, the court must determine whether the agency  
misapprehended the effect of the evidence. Third, even if substantial evidence

1 exists and the effect of the evidence has not been misapprehended, a court can  
2 still determine a finding is clearly erroneous when, although there is evidence to  
3 support it, a review of the record leaves the court with the definite and firm  
4 conviction a mistake has been committed. *State Personnel Div. v. Child Support*  
5 *Investigators*, 2002 MT 46, ¶ 19, 308 Mont. 365, 43 P.3d 305 (citing *Weitz*, 284  
6 Mont. at 133-34, 943 P.2d at 992). Conclusions of law are reviewed to determine  
7 if the agency's interpretation of the law is correct. *Steer, Inc. v. Dep't of*  
8 *Revenue*, 245 Mont. 470, 474, 803 P.2d 601, 603 (1990).

## 9 DISCUSSION

### 10 Procedural Due Process and the Right to be Heard

11 NWE argues the PSC violated its procedural due process rights and its  
12 right to be heard when it denied NWE's application based on issues raised in a  
13 staff memo after the public hearing concluded, without first offering NWE the  
14 opportunity to address those issues.

15 The Fourteenth Amendment to the United States Constitution and  
16 Article II, § 17, of the Montana Constitution protect an individual's right to due  
17 process. Although the requirements of procedural due process are flexible and  
18 may be adapted to meet the demands of a specific situation, an individual must be  
19 given notice and opportunity for a hearing appropriate to the nature of the case.  
20 *Montanans for Justice v. State*, 2006 MT 277, ¶ 30, 334 Mont. 237, 146 P.3d  
21 759.

22 A party's right to notice in a contested case is codified under MAPA  
23 at Montana Code Annotated § 2-4-601. The party must have an opportunity for a  
24 hearing after notice of the following: (1) the time, place and nature of the  
25 hearing; (2) the legal authority or jurisdiction under which the hearing will be

1 held; (3) the particular sections of statutes and rules involved; and (4) a short  
2 plain statement of the matters asserted. Mont. Code Ann. § 2-4-601(2). Under  
3 MAPA, parties also have a statutory right to an opportunity to respond and  
4 present evidence on all issues involved. Mont. Code Ann. § 2-4-612(1). A party  
5 has the right to cross-examine the author of any document prepared by or on  
6 behalf of or for the use by an agency and offered in evidence. Mont. Code Ann.  
7 § 2-4-612(5)

8 A petitioner bears the burden to produce sufficient evidence to support  
9 all elements of his claim. *Mont. Env'tl. Info. Ctr. v. Mont. Dept. of Env'tl. Quality*,  
10 2005 MT 96, ¶ 14, 326 Mont. 502, 112 P.3d 964. As part of its application, a  
11 utility must provide the PSC its most recent least cost resource data. Admin. R.  
12 Mont. 38.5.1905(1); *Whitehall Wind*, ¶ 21. The PSC must use this data when  
13 setting QF rates. *Id.*

14 NWE had sufficient notice of the issues in this case: the PSC  
15 informed NWE of the time, place and nature of the hearing; provided legal  
16 authority involved, including the particular statutes and rules; and issued a short,  
17 plain statement of the matters asserted. The methodological flaw, identified by  
18 PSC staff in its April 7, 2015 memo, stems from the unreliability of using long-  
19 term market based forecasts assuming a turbine would not come online until  
20 2033. The PSC first raised this issue in data requests on April 2, 2014. Admin.  
21 Rec. 9, at 2, PSC-003(d) and (e); at 4, PSC-007 (Apr. 2, 2014). NWE also had  
22 sufficient opportunity to address this issue in its responses to data requests and at  
23 the November 6, 2014 hearing. Admin. Rec. 15, PSC-4-5; PSC10-11  
24 (May 2, 2014); Pub. Hrg. Transcr. 127:19-129:1; 158:20-159:7 (Nov. 6, 2014).

25 ////

1           Although the PSC did not address this issue in great detail, nor did the  
2 parties fiercely contest the issue, NWE nonetheless had sufficient notice to  
3 satisfy procedural due process and its right to be heard. Moreover, the PSC staff  
4 memo presented no new evidence to the commission, but merely reviewed the  
5 record and highlighted the lack of evidence which NWE presented. Accordingly,  
6 NWE had no right to cross-examine the authors of the memo under Montana  
7 Code Annotated § 2-4-612(5).

8           NWE asserts neither party raised the issue regarding NWE's failure to  
9 conduct a comprehensive resource planning analysis — a matter first identified in  
10 the PSC staff memo. Even so, the PSC did not violate NWE's due process rights  
11 or right to be heard when considering this issue when it denied NWE's  
12 application. NWE assumed, without providing supporting evidence, that  
13 acquiring a turbine after acquiring the hydroelectric facilities would be the least  
14 cost procurement strategy. The 2013 Plan identified option three as the preferred  
15 option. Option three does not assume NWE will acquire a turbine at any point  
16 after it purchased the hydroelectric facilities. Therefore, NWE substantially  
17 deviated from the 2013 Plan.

18           Due to the nature of its application, NWE's duty to provide least cost  
19 resource procurement data was at issue from the beginning of the application  
20 process. As petitioner, NWE bears the burden of producing sufficient evidence  
21 to support its claim. The PSC can only determine NWE's avoided costs by using  
22 current least cost resource data. NWE failed to provide this information in its  
23 application. Without it, the PSC could not approve the NWE's request for an  
24 interim rate adjustment.

25       ////

1 **Substantial Evidence**

2 NWE further argues the PSC’s decision was arbitrary and capricious  
3 because it was not founded on substantial evidence. NWE contends its proposed  
4 interim rates, which assume NWE will acquire a turbine in 2033, were lower than  
5 NWE’s current QF rates, even without conducting a comprehensive resource  
6 plan. As such, NWE’s proposed procurement strategy is a lower cost resource  
7 strategy than the previous plan identifies. NWE further argues PSC staff  
8 improperly acted as advocates in the case. The PSC contends it was reasonable  
9 to deny NWE’s application because NWE’s avoided cost calculations were  
10 flawed. Moreover, PSC staff properly reviewed the record and provided  
11 experienced guidance.

12 Proceedings before the PSC are investigative in nature. Admin. R.  
13 Mont. 38.2.302. In a contested case proceeding, the agency’s “experience,  
14 technical competence, and specialized knowledge may be utilized in the  
15 evaluation of evidence.” Mont. Code Ann. § 2-4-612(7). Although the petitioner  
16 is the primary source of information in a contested case, the PSC is free to weigh  
17 the petitioner’s information against “any information to the contrary presented by  
18 other agencies or its own staff.” *In re Mont. Power Co.*, 180 Mont. 385, 400, 590  
19 P.2d 1140, 1149 (1979). An agency’s decision is arbitrary and capricious if its  
20 decision appears to be “random, unreasonable or seemingly unmotivated, based  
21 on the existing record.” *Silva v. City of Columbia Falls*, 258 Mont. 329, 335, 852  
22 P.2d 671, 675 (1993). However, when performing a quasi-judicial function, the  
23 PSC must exercise its judgment and discretion. Mont. Code Ann. § 2-15-  
24 102(11); *Williamson v. Mont. PSC*, 2012 MT 32, ¶ 39, 364 Mont. 128, 272 P.3d  
25 71.

1 PSC staff did not improperly act as advocates in this case. The PSC is  
2 required to investigate a party's claim and determine if substantial evidence  
3 supports the party's position. The PSC satisfied this requirement when PSC staff  
4 cross-examined NWE's witnesses during the public hearing, reviewed the record,  
5 including all relevant information, and drafted the staff memo recommending the  
6 PSC deny NWE's application.

7 Finally, the PSC was not arbitrary or capricious when denying NWE's  
8 interim rate application. As PSC staff identified, NWE's avoided cost calculation  
9 relied on a flawed methodology. NWE bore the burden to prove the accuracy of  
10 its proposed adjusted rates. The PSC staff memo reviewed the evidence in the  
11 record and determined NWE did not meet this burden. The PSC is entitled to  
12 utilize its experience and specialized knowledge in a contested case.

13 Accordingly, the record shows substantial evidence, or rather a lack of  
14 substantial evidence in support of NWE's application. In short, the record  
15 supports the PSC's decision to deny the application. Because NWE calculated  
16 proposed rates using a flawed methodology, the PSC acted reasonably by  
17 denying NWE's application outright, rather than modifying the rates by inserting  
18 adjusted figures using the flawed methodology.

### 19 CONCLUSION

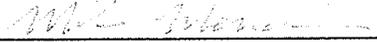
20 Upon thorough review of the record, this Court is satisfied NWE had  
21 sufficient notice of issues on which the PSC relied when denying NWE's  
22 application for interim rate adjustment. The PSC did not violate NWE's right to  
23 due process and right to be heard. Moreover, the PSC did not act arbitrarily and  
24 capriciously by denying NWE's interim rate adjustment application.

25 ////

1 Based on the foregoing,

2 **IT IS HEREBY ORDERED** that the petition for judicial review is  
3 DENIED, and the PSC's order denying NWE's interim rate adjustment  
4 application is AFFIRMED.

5 DATED this 3 day of March 2016.

6  
7   
8 **MIKE MENAHAN**  
9 District Court Judge

10 pc: Sarah Norcott/John Alke/Al Brogan, NorthWestern Energy, 208 North  
11 Montana Avenue, Suite 205, Helena MT 49501  
12 Jason T. Brown, Montana Public Service Commission, 1701 Prospect  
13 Avenue, Helena MT 59601  
14 Michael J. Uda, Uda Law Firm, 7 West Sixth Avenue, Power Block West,  
15 Suite 4H, Helena MT 59601

16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
MM/t/nwe v psc ord pet j review.doc