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

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IN THE MATTER OF the NorthWestern Energy's Application for Approval of Avoided Cost Tariff for New Qualifying Facilities	) REGULATORY DIVISION)) DOCKET NO. D2012.1.3) ORDER NO. 7199e

DISSENTING OPINION OF COMMISSIONER TRAVIS KAVULLA

The Commission's action in this Order granting a Motion for Stay is highly unfortunate. It has rejected a well-reasoned staff opinion that the motion for a stay should be denied, and in its place has issued an Order that ignores this Docket's evidentiary record and is inconsistent with good public policy.

The Commission's Order is in error for a number of reasons, from the adoption of an incorrect standard of review to a trusting consideration of unevidenced declarations that do not prove the matters asserted. Worryingly, in its public deliberation on this matter, the Commission appeared moved less by the facts relevant to this matter than by extraneous arguments that were resolved in Order 7199d and not challenged in judicial review, and by biases that have inappropriately colored this Docket and clouded the matter which is really pertinent: Small independent generators' access to a market from which the incumbent monopoly, NorthWestern Energy (NorthWestern), seeks to exclude them.

Finally, the Commission has dealt with parties in this proceeding unevenly, in a way that gives the Commission an appearance of favoritism toward the utility we regulate, affording NorthWestern extreme latitude on a procedural basis, even while treating intervening parties before the PSC in an inequitable manner.

Procedural Flaws and the Inequitable Treatment of Parties

It is notable that the Montana Consumer Counsel, the constitutionally established advocate for ratepayers in this state, has not entered an appearance before the Commission or

filed briefing to address this matter. The reason is simple: No party actually contends that the energy rate that Qualifying Facilities (QFs) are paid is unreasonable. There is no harm to consumers in denying the stay.

In the system of QF regulation, payments to these small independent generators are based on the costs NorthWestern itself would incur to acquire its "avoided resource." In the last two QF dockets the Commission has considered, the avoided resource is a combination of market purchases in the first few years and, in later years, a combined-cycle natural-gas fired generator, which for wind QFs has its value as a capacity resource removed in order to reflect wind assets' inability to be dispatched like a combined-cycle generator. As a simple test of whether the QF rate is an equitable price, it should be noted that it is similar—indeed, slightly less than—the estimated levelized cost of NorthWestern's own, new Spion Kop wind farm.[2]

While the Consumer Counsel has not advocated any outcome in this motion, NorthWestern Energy has—and has done so purportedly not for itself and its interests, but as a matter of duty and self-sacrifice for the sake of the consumers it serves. The permissibility of this advocacy is questionable. When a witness called by intervenor Hydrodynamics took the stand, he was summarily dismissed when he stated he was appearing on behalf of another QF developer who was not a party. Hrg. Transcr. 205:1–213:7 (Mar. 8, 2013). While there are good arguments for a more lenient approach to permitting testimony in an administrative proceeding, the approach that was taken at hearing was one where a party in this Docket cannot use its status to represent the claims of others. Yet that is *exactly* what NorthWestern has done in dressing its advocacy up with the veil of consumers, who are properly and only represented by the Montana Consumer Counsel. In fact, when asked straightforwardly what actual harm would come to NorthWestern itself—the actual party in the matter—the company's only witness could not articulate any. *Id.* at 127:3-13.

NorthWestern's advocacy, if permitted, should be viewed with extreme skepticism. It should be obvious why the utility's representations on supposed behalf of the consumer should not be given weight in the Commission's decision-making process: The company benefits at the expense of the ratepayer, and *vice versa*. While luck and good regulation may occasionally draw

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[2] The levelized cost of Spion Kop is estimated to be slightly more than $50 per megawatt-hour, depending on its capacity factor. Commn. Order 7159l, Docket D2011.5.41, ¶ 121 (Feb. 15, 2012). A typical wind farm, with output during peak and off-peaks hours similar to another wind asset on NorthWestern's system and paying the Zone 3 integration charge under the WI-1 tariff, would be paid $48.34 per megawatt-hour. *See* Commn. Ord. 7199d, Docket D2012.1.3, p. 34 (Nov. 20, 2012) (Kavulla, Commr., Concurring).

them into intersection, this is frequently not the case, and it is certainly not the case here. Allowing NorthWestern standing to bring a claim on behalf of consumers is not only an action of self-delusion, it is in direct contradiction of the Commission's practice in this same Docket.

The more likely motivation for NorthWestern's motion—and for the utility's extreme allergy to all things QF—is simple and idiomatic of monopolism: NorthWestern, which is the exclusive purchaser of electric power that goes to supply hundreds of thousands of Montanans, has a vested interest in ensuring that the power it purchases is bought from itself, as a generator owner, to the exclusion of independently owned generators. NorthWestern raised none of the concerns they now find convenient about wind integration in the Commission's Docket for pre-approval of the Spion Kop wind farm, which concluded just last year, because NorthWestern was to own it. Now that "they've got theirs," NorthWestern wants to close the door quickly to others. It is classic anti-competitive, monopolistic behavior, and the Commission should not countenance it. This proceeding represents a lamentable move by the utility to co-opt the power of government and use it to subvert competition which federal and state laws variously require and encourage.

Preservation of the Status Quo, as a Test to Grant a Stay, is Fallacious in this Matter

The standard of review on which the stay hinges is that the status quo will be preserved pending litigation. This logic is flawed. NorthWestern's portfolio is in constant flux. It will almost certainly add resources, and lose resources as contracts expire, during the pendency of the litigation. Throughout that time, a wide variety of resources will be allowed a place at the table—just not certain small QFs. The stay only applies to certain independent generators, and not the universe of other resources that will instead fill NorthWestern's resource portfolio, some of them highly similar to QFs, but on which the utility, seeking profit, may purchase, rate-base, and thereby earn a return.

The stay also does not apply to certain QF rate options.[3] In other words, certain fuel sources and certain contract arrangements are being arbitrarily preferred over others. This hodgepodge smacks of making qualitative distinctions that are the crux of ratemaking and

[3] NorthWestern's Motion requests only a stay of rate Option 1(c), which offers a long-term rate to wind QFs based on the avoided resource described above. Bizarrely, wind QFs could still take a contract that pays them a market rate, even though they would perpetuate the supposed wind integration problem that NorthWestern identified. The decision to subject one set of wind QFs but not another to the stay is further indicative of the arbitrary nature of the stay.

establishing QF tariffs—not of the simple matter, as the Order purports to have it, of a stay. The status quo, in other words, will change, whether or not the stay had been granted.

The Commission should have adopted a test that measures harm to the movant. In doing so, it would have found NorthWestern's claims in this matter lacking in two ways. First, NorthWestern lacks standing in the matter because the harms it claims it will suffer, if real, do not actually accrue to NorthWestern, as discussed above. Second, the substantive claims of harm, that the utility will be oversupplied with energy and that it lacks capacity to integrate wind QFs, are in fact illusory and contradicted by strong evidence.

The Specter of Excess Energy Supply

NorthWestern's first claim of harm is that additional QF contracts will leave its customers oversupplied with energy during certain hours, forcing excess supply to be dumped onto the open market at a loss. By the evidence available to the Commission, this claim is false and, even if oversupply were an issue, it is an unremarkable prospect being dressed up as a calamity.

NorthWestern, in attempting to prove its claim, compares its installed generating capacity of owned and contracted generating facilities with its low-demand hours of load, in a supposed demonstration of oversupply. This is a facile comparison that is being offered to dupe a trusting Commission. Virtually every utility that is not restructured or deregulated (i.e., whose generation is not separate from its retail arm) owns more megawatts of nameplate capacity than it needs to supply loads during low-demand hours. Utilities build to supply their peak demand—which means the existence of generators that often never run but during peak hours (certain generators during mild winters or summers, the peak seasons for utilities, will not run at all during a year). A meaningful comparison, as both NorthWestern and intervenor witnesses admitted under cross-examination, would be a comparison of non-avoidable contract deliveries and non-dispatchable owned or contracted generation overlaid against hourly loads; the analysis would also have to integrate the marginal cost of the "last" unit of generation online considered alongside the sale price of the generation being dumped onto the market because it was in excess of load. *Id.* at 79:4–81:24, 188:21–190:12. This analysis would have allowed the Commission to reach an actual judgment about whether oversupply was a real phenomenon and, if it was, whether it was uneconomic. As it stands, NorthWestern's witness Joe Stimatz supposes that in

10 percent of hours NorthWestern is long on power, but he is unable to say whether that is merely the result of a scheduling error (scheduling too much generation for too little load) or whether it is an economical oversupply (he even concedes that NorthWestern usually makes a profit when selling to energy markets). *Id.* at 103:3–105:25.

In another ongoing Docket, the Commission is exploring this very issue. *See* Docket D2012.5.49. There, in a response to a data request submitted, coincidentally, the very day of the hearing on this Motion for Stay, NorthWestern's witness in that proceeding, who works in the same department as Mr. Stimatz, produced an analysis that suggests non-dispatchable energy resources almost never exceed system loads.[4] In low-load hours, during the nighttime when NorthWestern customers need less power, only in *four* hours of the period from 2011-2012 did NorthWestern's unavoidable take-and-pay contracts (such as PPL's contract with NorthWestern) and non-dispatchable resources (like Judith Gap wind farm) yield more energy than the system load that needed to be supplied. There are, meanwhile, 8,760 hours in a typical year (8,784 hours in that year, since it was a leap year). In other words, the system was oversupplied only 0.04% of the time. *See* NorthWestern's Response to PSC-080, Docket D2012.5.49 (Mar. 8, 2013). The prospect that this four-hundredths of a percent might increase by any considerable amount is, similarly, unjustified; in most hours, the same data shows, the system can absorb a generous amount of energy from non-dispatchable resources while dispatching down other purchases or generating assets. This is commonplace utility practice that NorthWestern, for the sake of making its point, is ignoring.

The reality is that NorthWestern's own 2011 Electricity Supply Resource Procurement Plan (2011 Plan) demonstrates a considerable need for energy resources. QFs that are contracted today, Mr. Stimatz conceded, would not likely come online until 2014. Transcr. 98:11-24. That is when NorthWestern's contract with PPL expires and, when it does, the system will require on an annual basis nearly 200 average megawatts of energy during heavy load hours and nearly 100 average megawatts of energy in light load hours, numbers which increase in subsequent years. *See* 2011 Plan, Docket N2011.12.96, p. 69 (Dec. 15, 2011). There is, in other words, room in the portfolio for a substantial number of QFs.

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[4] The Commission may re-open the evidentiary record if, in the Commission's judgment, it is required to be done in the public interest or because conditions of fact have changed. Admin. R. Mont. 38.2.4805(4) (2013). In my view, the fact that the information submitted in a different docket on the same day as this hearing's consideration of substantially the same issue is troubling, and worthy of the Commission's having taken such an action.

The real question is: Will NorthWestern hold itself, when it goes to purchase or build an asset, to the same standards of evaluating the needs of its portfolio? In my view, it is unlikely. Let us hope the Commission remembers and questions NorthWestern on its argument that installed capacity can be compared against system loads to determine whether a system is adequately supplied when the Commission next considers this kind of matter.

Wind Integration Capacity

The other argument that NorthWestern marshals in support of its case is the prospect that the Dave Gates Generating Station (DGGS), which provides regulation capability to integrate wind resources, is out of spare capacity to complete this function. The Wind Integration Tariff (WI-1) is what QFs must pay to integrate their product onto the grid. It is based on DGGS's operating costs, and if DGGS lacks capacity the WI-1 will not be a genuine reflection of the cost of integrating new QFs.

This is a problem, if it is one at all, birthed of NorthWestern's own advocacy in this Docket, where it proposed DGGS be the resource which established the wind integration rate. *See* Test. of John B. Bushnell, Docket D2012.1.3, pp. 9-10 (June 1, 2012) (admitted as Exhibit NWE-1). That recommendation of the utility was adopted, and now, in what is essentially an admission of bad faith, it is claiming DGGS is in fact out of wind-integration capacity.

Indeed, DGGS does have limited regulating reserves. This is not news, and it is precisely why the Commission, in Order 7199d in this Docket, advised NorthWestern to return to the Commission with a filing to re-establish the WI-1 Tariff if and when DGGS was at last out of capacity. Ord. 7199d ¶ 76. NorthWestern has not done this, and rather than insist upon it, and thus spur a productive conversation about the actual capabilities of DGGS and the cost of integration products on the market, the Commission has merely adopted NorthWestern's approach of throwing up its hands and declaring the matter impossible to resolve.

Interestingly, and contrary to NorthWestern's position in it motion, at hearing Mr. Stimatz admitted that DGGS actually has regulating capability available—enough to integrate up to 47 megawatts of wind capacity (about 4 or 5 new, 10-megawatt QFs).[5] *See*

[5] With the 2.4 megawatts of regulating capability remaining for wind at DGGS, and assuming that QF wind development occurred in the WI-1 tariff's Zone 3, which applies a 5.1 percent integration factor to a wind farm's nameplate capacity: 47.1 megawatts of wind capacity = 2.4 megawatts of integrating capacity / .051 integration factor. *See* Ord. 7199d ¶ 70 (Table 7).

Transcr. 37:11-14. The Commission should have taken NorthWestern's witness at his word, and, if it granted a stay at all, done so only in a limited manner.[6]

In addition to the raw fact that there is generating capacity yet available at DGGS, the facility is proving resilient in its ability to integrate new wind. The Control Performance Standard 2 scores that measure NorthWestern's ability to maintain the frequency of its balancing area while managing for sudden deviations from schedule of load and wind have been robust despite NorthWestern's addition of significant new wind assets. *See* NorthWestern Response to PSC-091, Docket D2012.5.49 (Mar. 8, 2013). There are also strong indications in that same Docket that NorthWestern could utilize its assets in a more efficient way to do more with DGGS while working within its operational limits.

As it stands, the Commission's Order means that, even though DGGS has spare generating capacity, it will go unused because of this stay's impairment of economical wind development. The Commission's willingness to let an expensive asset like DGGS go under-utilized is deplorable, and harms ratepayers who pay for DGGS, whether it is fully used or not.

The Non-Germane Arguments of the Commission in Reaching its Decision

In deliberations at its public meeting on this matter, the Commission seemed to be convinced of the proposition for a stay by reasons that are not properly considered in this matter.

At least two Commissioners expressed a belief that the avoided cost was set too high, because the roughly $48 per megawatt-hour that a typical wind QF would be paid is in excess of current market costs.[7] This seemingly noteworthy point is, in fact, unremarkable. Is the claim that no resource should be acquired or built if its initial cost is above market price? If so, virtually no new energy resource ever would be acquired or built. If new resources were cheaper to acquire than market resources, then new resources ceaselessly would be built, eroding the market price.

Prices on the open market usually represent a marginal cost of production of the most-expensive unit offered on the market in a given interval, to which all other prices tend to converge. That price will not include the marginal unit's recovery of fixed costs in the hour (or

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[6] I offered a motion to amend during the Commission's work session on this matter in line with a recognition of the DGGS's remaining integration abilities. It was seconded by Commissioner Koopman, for whose consideration of the matter I am grateful, but ultimately rejected. *See* Minutes of Pub. Serv. Commn. Mtg. (Apr. 2, 2013).

[7] This payment would be slightly higher if the wind farm delivers more of its energy output on peak hours, or lower if the wind farm is located in a zone that requires a higher level of integration service, for which the QF must pay.

other time period) during which it is the marginal unit. Meanwhile, long-term contracted resources or utility-owned, "rate-based" resources recover their costs through structured payments of some kind that inevitably recover both the run cost and the fixed cost of any given asset. In the case of utility-owned assets, these costs are subject to depreciation; they decline over time. In the current QF rate-setting, the price paid in the power purchase agreement is levelized; the cost is averaged over time, based on short-term market prices and long-term fixed costs of a gas generator. Those market prices are lower and the gas-plant prices are higher; they result in an average price that is, unsurprisingly, higher than the market prices of first years, but lower than the gas-plant prices in later years. QF rates could be styled after utility-owned "depreciating" payments—although that would be disadvantageous to the ratepayer, who would have to pay more up front—or through escalating payments, pegged to inflation or another metric. But for a long-term committed asset that has a depreciating or levelized price, the first years of its price will always tend to be higher priced than current market prices, and in future years it will tend to be lower priced than market prices—assuming market prices are rising to some degree, whether in line with inflation, fuel costs, labor or some other factor. The risk of long-term prices turning out to be wrong, moreover, is a risk that utility customers must bear whether the asset in question is a utility-owned or a utility-contracted resource. The periodic higher cost of long-term contracted assets is nothing new, nothing exceptional, and is instead entirely routine.

The argument that the avoided cost is set too high if it is higher than current market prices defies the basic logic of market economics. Besides the utter wrongness of the argument, its having been inveigled into a discussion on this Motion is evidence that the Commission misunderstands what this proceeding actually concerns. No party has challenged the rates in the QF-1 Tariff as being unjust or unreasonable. That is not a matter before the District Court upon judicial review of Order 7199d. Indeed, if it were, more current evidence would in all likelihood demonstrate that, since natural gas prices have recently inclined, so too has the avoided-cost rate QFs should be paid. That is, the roughly $48 per megawatt-hour avoided cost for wind QFs is likely an underestimate of the avoided resource cost, not an overestimate. Given that reality, the Commission should be cheering QFs to take the avoided-cost rate and make a project happen, although as Mr. Pascoe testified, the economics of the rate and a QF project are very hard to

make pencil out.[8] Transcr. 164:8–165:17. In any event, reasoning that a stay is warranted because of the supposedly high avoided cost of the QF-1 tariff is a misdirection.

Another red herring surfaced during the Commission's deliberations is that the federal government's wind production tax credit (PTC) should somehow play into our decision-making on this matter. This opinion is flawed in several ways. First, and most fundamentally, the PTC has no influence on the Commission's avoided cost, which, again, is based on market purchases and the cost of a natural gas-fired generator. This issue is a spontaneous invention of the Commission that undermines the rule of law and the evidence-based nature of the Commission's proceedings. Second, even if avoided cost were at issue, and one pretended that the PTC should factor into an avoided-cost determination, the Commission has previously approved a utility-owned wind project, Spion Kop, that used the PTC to reduce its cost to NorthWestern's ratepayers, just as this state's Department of Transportation doubtless would take into account the generous interstate transportation revenues from the federal government to buy down the cost of highway projects.

The notion that NorthWestern should benefit in our calculations regarding the PTC while the effect of the PTC should be discounted for private developers building QFs is an impermissible act of discrimination under PURPA and contrary to what little competitive enterprise exists in the electric energy industry in the West. Finally, the PTC, while a distortive and poorly thought-out policy, is nonetheless a fact of life. It is, as much as the mortgage or student-loan interest deductions, a reality of economics that the federal government has created—notwithstanding the potential and real economic illogic of such policies. It would be ridiculous for the PSC to discard one such tax policy as being politically undesirable even while it accepts, in an unquestioning manner, a slew of others, from the accelerated depreciation to deferred accounting policies of the Congress and the Internal Revenue Service.

Conclusion

Montana is obtaining a poor reputation, becoming marked as inhospitable to independent development because of the persistent favoritism shown to the incumbent utility, to the ultimate disadvantage of ratepayers. This is an important public policy consideration in deciding any docket of this nature. Independents' active participation in QF proceedings is healthy because it

[8] It is not the Commission's job to make wind energy work—only to offer QFs a rate, which the utility would be paid for its own project, to allow them to compete laterally against the avoided resource.

establishes a price point that the incumbent utility must consider, and compete against, when developing its own projects. This price transparency is crucial for the Commission to do its job of questioning the utility when it comes in for pre-approval of generating assets, or for purchases of electric power under contract.

Utility generating projects and independently owned generating projects should compete on an equal footing with one another. But the Commission, in this action, seems determined to shut the door on what little independent development exists in Montana, even though the utility, who has its opponents outgunned and outmatched in every way in terms of legal resources, put on a truly miserable demonstration in support of its motion for a stay. The Commission, in its Order, has gone out of its way to protect NorthWestern Energy from competition. Ratepayers and the public interest generally will suffer because of it.

Therefore, I respectfully DISSENT,

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Travis Kavulla, Commissioner (dissenting)