NorthWestern® Energy

Before The Public Service Commission
Of the State of Montana

DOCKET NO. D2016.5.39

Application for Approval of Avoided Cost Tariff Schedule QF-1

Additional Issues Testimony

November 2016

Department of Public Service Regulation
Montana Public Service Commission
Docket No. D2016.5.39
Avoided Cost Rate Filing – Schedule QF-1
NorthWestern Energy

PREFILED ADDITIONAL ISSUES TESTIMONY

OF BLEAU J. LAFAVE

ON BEHALF OF NORTHWESTERN ENERGY

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Witness Information

Q. Please state your name and business address.

A. My name is Bleau J. LaFave. My business address is 3010 West 69th Street, Sioux Falls, South Dakota 57108.

Q. By whom are you employed and in what capacity?

A. My current position at NorthWestern Energy ("NorthWestern") is Director Long Term Resources. My responsibilities include overseeing the long-term supply growth strategies for NorthWestern, including large project development and acquisitions.

Q. Please summarize your educational and employment experience.

A. I earned a Bachelor of Science degree in Mechanical Engineering from the South Dakota School of Mines and Technology in 1994. After completing my degree, I was employed by NorthWestern Public Service as a Project Engineer. Working for NorthWestern, I have held several positions, including Operations Engineer, Huron Area Engineer, Aberdeen Area Engineer, Maintenance Process Leader, Support Services Process Leader, Corporate Procurement Manager, Director of Utility Services, Director of Large Project Development, Director South Dakota/ Nebraska Supply Planning and Development, Director Long Term Resources, and Vice President of Operations for NorthWestern Services Corporation, a former subsidiary of NorthWestern Public Service Company. During this time, I served in many operations and administration functions with a focus on operations management, procurement, logistics, contracts, fleet, facilities, utility engineering, measurement, project development, supply development, planning, acquisitions, and customer service.

Q. Have you ever testified before a state regulatory commission?

A. Yes. I have testified before both the Montana Public Service Commission ("Commission") and the South Dakota Public Utilities Commission on numerous occasions concerning topics related to energy supply matters, including purchasing energy and capacity from qualifying facilities ("QFs") and the appropriate avoided cost rate for such facilities.

Purpose of Testimony

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to respond to the Commission's October 26, 2016 Notice of Additional Issues ("Notice") in this docket. The Commission identified the following two issues: 1) maximum contract length, and 2) performance standards.

Maximum Contract Length

Q. Does NorthWestern believe that the current 25-year maximum contract term in its QF-1 tariff imposes undue forecast risk upon its customers?

A. Yes it does. To estimate a levelized avoided cost for a 25-year contract, one has to somehow forecast the market price of electricity for the same 25-year period. Since the market price of any commodity is determined by supply and demand, the estimation of a levelized 25-year avoided cost requires simplifying assumptions, many of which will prove out to be wrong over time.

Current electric market index price forecasts are only available for three to five years, and natural gas market price forecasts for seven years. To estimate a 25-year levelized avoided cost, such market data is usually trended upwards by an assumed rate of inflation for the remainder of the contract period, essentially the last 20 years of the contract with the QF. In effect, it is assumed there will be no significant change in the relationship of electric supply to demand for a quarter century, and that the market price of electricity will simply increase at the assumed rate of inflation for the last 20 years of the contract.

We have already seen this regulatory model fail miserably in the past. The avoided cost rates established in Montana in the early and mid-1980s are now incredibly high, and both NorthWestern customers and shareholders are currently carrying the burden of those mistakes.

Q. Would a shorter maximum contract term be reasonable, both to NorthWestern's customers and the QF developer?

A. Yes it would. Forecast error can occur on either the high side or the low side of realized market price. If the forecasting error is on the high side, the QF developer receives an undeserved windfall. If it is on the low side, NorthWestern's customers are not paying the QF developer for the true value of the power. Under PURPA, a QF is still a QF after its initial contract expires. If the Commission were to adopt a two-year contract duration, as the Idaho Commission did for negotiated contracts for intermittent resources, the avoided costs paid to the developer would be reset every two years, and the risk of forecast error eliminated.

Q. Are you recommending that the Commission establish in this docket a two-year maximum duration for QF contracts under the standard rate?

A. No, I am not. My recommendation is for the Commission to establish a ten-year maximum duration in this docket, in recognition of Montana's statutory preference for longer term contracts.

Q. How would a ten-year maximum contract duration affect a QF developer's ability to obtain project financing?

A. It is my belief that the landscape for project financing is changing as the production tax credits are being phased out. More importantly, I do not think QF developers have a vested right to rely upon project finance. I think an important factor in this debate is the maximum size of QF to which the Commission currently allows its standard rate to apply. If these were small, less than 100-kilowatt ("kW") facilities, the Commission would not need to be particularly worried about forecasting errors, because the impacts of such errors would be small. Three-megawatt ("MW") QFs are not small, and the dollar price of a forecasting error for such facilities is significant. If the Commission reduced the entitlement to the standard rate to projects between 100 kW and 500 kW, larger QFs could bring any financing issues to the Commission under § 69-3-603, MCA, if they did not think they were receiving adequate consideration of the issue from NorthWestern.

Q. What about a hybrid arrangement in which the QF receives a fixed price in the first part of the contract, and an indexed price in the latter part of the contract?

A. If the correct indexed price was selected, that could be a methodology for reducing the risk of forecast error. However, I am not sure that is a more effective solution than simply shortening the maximum contract duration. Under the latter approach, the QF developer would still have the option of a second fixed price contract, albeit at a new price.

Q. What maximum contract lengths are available in other states?

A. NorthWestern has begun a review in response to the Commission's Notice. It is not a task we could complete in the short time allowed for the preparation of additional issues testimony. I will present the results of our review as a hearing exhibit when I testify.

Performance Standards

Q. Does NorthWestern have a position on the Commission's second question, the desirability of including performance standards in the QF-1 tariff?

A. Yes it does. NorthWestern does not believe that performance standards should be developed by the Commission and specified in the QF-1 tariff.

Q. Please explain the basis for NorthWestern's position.

A. While the development of avoided cost rates for a standard QF rate is something that is uniquely within the province of the Commission under PURPA, developing terms for a purchased power agreement is not. Utilities and independent power producers have been negotiating power purchase agreements for many years and are obviously capable of representing their own best interests in contract negotiations. Unless there is an impasse in such negotiations which requires adjudication by the Commission under § 69-3-603, MCA, there is no reason for the Commission to be involved in negotiating contract terms.

By Commission rule, standard rates are available to QFs up to 3 MW in size. A 3-MW generator is a good sized generating facility, and any performance issues associated with it will be determined by the nature of the generator (wind, solar, water, biomass), its manufacturer, and its location on NorthWestern's system. To the extent there are performance issues associated with a particular generator or location, they will be project specific and should be addressed during contract negotiations.

Q. Does this conclude your additional issues testimony?

A. Yes, it does.

CERTIFICATE OF SERVICE

I hereby certify that the original and 10 copies of NorthWestern Energy's Additional Issues Testimony in the QF-1 Avoided Cost Rate Filing, Docket No. D2016.5.39, have been hand-delivered to the Montana Public Service Commission with three copies to the Montana Consumer Counsel this date. It has also been e-filed on the Commission website, emailed to counsel of record, and sent via First Class Mail to the attached service list.

Date: November 9, 2016

Tracy Lowney Killoy

Tracy Lowney Killoy
Administrative Assistant
Regulatory Affairs

Docket Service List
Docket No. D2016.5.39

Will Rosquist
Public Service Commission
1701 Prospect Ave
Helena MT 59620-2601

Jason Brown
Montana Consumer Counsel
PO Box 201703
Helena MT 59620-1703

John Alke
NorthWestern Energy
208 N Montana Ave Suite 205
Helena MT 59601

Tracy Lowney Killoy
NorthWestern Energy
11 E Park Street
Butte MT 59701

Joe Schwartzenberger
NorthWestern Energy
11 E Park Street
Butte MT 59701

Jenny K Harbine
Earthjustice
313 East Main St.
Bozeman MT 59715

DarAnne Dunning
Luxan & Murfitt, PLLP
P O Box 1144
Helena MT 59624

Al Brogan
NorthWestern Energy
208 N Montana Ave Suite 205
Helena MT 59601

Eric Christensen
Cairncross Hempelmann
524 Second Ave, Suite 500
Seattle WA 98104

Mike J Uda
Uda Law Firm, P.C.
7 West Sixth Avenue
Power Block West, Suite 4H
Helena MT 59601

Ryan N. Meyer
ElGuindy, Meyer & Koegel, PLLP
2990 Lava Ridge Court, Suite 205
Roseville CA 95661

Ryan R. Shaffer
Meyer, Shaffer & Stepans, PLLP
305 S. Fourth St. Suite 101
Missoula MT 59801