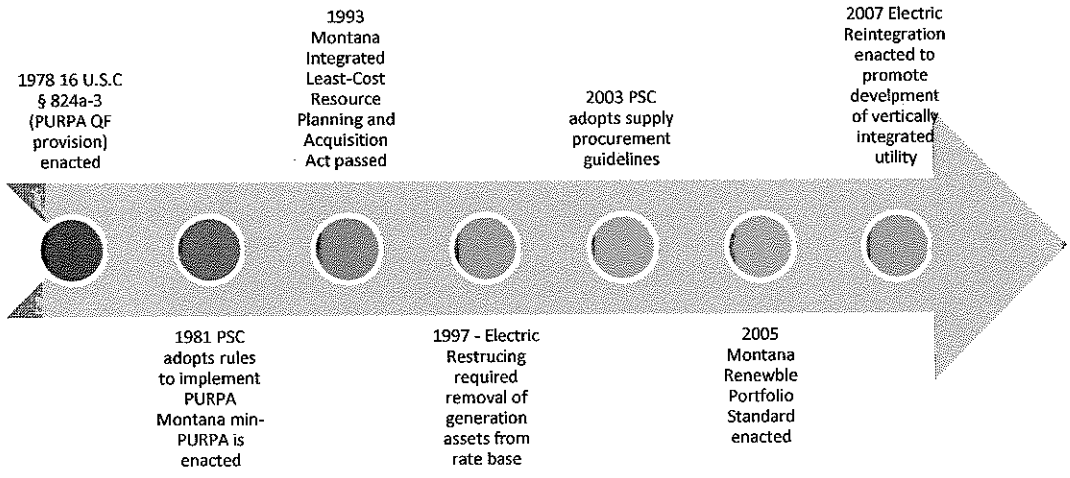
Written Comments of NorthWestern Energy

For PSC Rulemaking # 38-5-214, due Nov. 25, 2011

On October 27, 2011 the Montana Public Service Commission (Commission or PSC) published a proposed amendment to ARM 38.5.1902, rules pertaining to Qualifying Facilities (QFs). NorthWestern appreciates the Commission's proactive approach to QF issues, and recommends that the Commission adopt its proposed rules with one notable change. NorthWestern requests that the Commission adopt a capacity limit of 1 MW for intermittent QF resources (e.g. wind and solar) and adopt a capacity limit of 2 MW provision for non-intermittent QF resources.

This is a good time for the Commission to reevaluate its QF policies; 1) NorthWestern has no need for additional wind resources in the near-term to mid-term, 2) NorthWestern has acquired more that the 50-75 MW of wind identified in its 2009 Resource Procurement Plan, 3) the Commission's desire to stimulate wind development has been successful, and 4) NorthWestern has achieved the 50 MW installed capacity limit for wind QF resources.



The Public Utility Regulatory Policies Act (PURPA) was enacted in 1978 as part of President Carter's response to the oil embargo of 1973-74. PURPA was put in place

to encourage: 1) conservation of energy supplied by electric utilities, 2) efficiency of electric utility facilities and resources, and 3) equitable rates for electric consumers (PURPA section 101).

Section 210 of PURPA requires electric utilities with loads greater than 500,000 MWh/year to buy energy and capacity from facilities that meet the Federal Energy Regulatory Commission's requirements for ownership, size and efficiency. These facilities are known as Qualifying Facilities, or QFs. Prior to PURPA, Electric Utilities were vertically integrated and there was; no open access transmission, no wholesale electricity market and no requirement to interconnect generation. PURPA requires utilities to purchase energy from QFs based on an avoided cost pricing structure.

PURPA is a Federal mandate, but is implemented at the state level. In 1981, the Montana Legislature enacted a PURPA-related law (see § 69-3-601 et seq., Montana Code Annotated (MCA)). That law is often referred to as "Mini-PURPA". The law entitles QFs to contract for the sale of electricity to public utilities regulated by the MPSC. Also in 1981, the MPSC adopted rules that established the first avoided cost rates applicable to QFs (see Administrative Rules of Montana (ARM) 38.5.1901 et seq.).

In 1993 the Montana Integrated Least-Cost Resource Planning and Acquisition Act was enacted by the Montana Legislature, although Montana Power had formed a Least Cost Planning Advisory Committee and had been involved in integrated resource planning since 1987.

In 1997 the Montana Legislature enacted the Electric Restructuring Act, requiring Montana Power to remove its generation resources from rate base. The remaining distribution utility became the energy supplier of last resort, known as the "default supplier." In 2003, the Commission established Supply Procurement Guidelines for default supply.

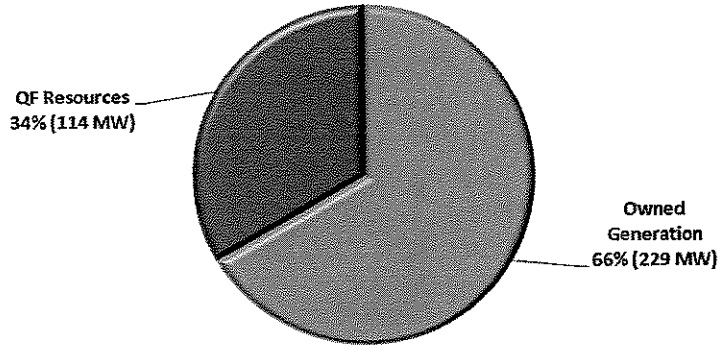
In 2005 the Montana Legislature enacted the Renewable Portfolio Standard, requiring NorthWestern to acquire renewable resources.

In 2007 the Montana legislature enacted the Electric Reintegration Act which limited customer choice, reintegrated default supply customers, and promoted the development of a vertically integrated utility.

As demonstrated above, electric supply policy in Montana has undergone many changes as it developed and all of these changes have directly affected NorthWestern. The Commission should consider electric supply policy in total and the current state of QF development as it contemplates changing its QF rules

NorthWestern and its predecessor have a long history of negotiating and administering Qualifying Facility (QF) contracts in Montana. NorthWestern's current electric resource portfolio contains 114 MW of QF resources.

Portfolio Installed Electric Generation

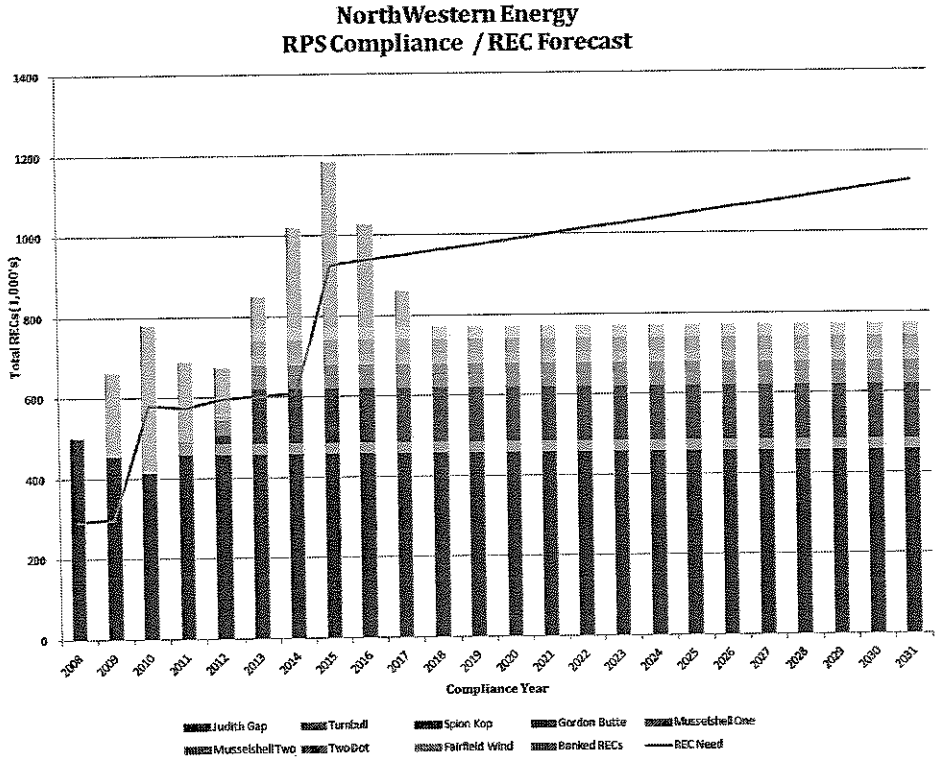


That is approximately half of the Company owned capacity NorthWestern uses to serve its energy supply customers (222 MW Colstrip Unit 4 and 7 MW of DGGS). Historically, QF projects under contract to NorthWestern have varied widely in terms of size, location, fuel type, and project type. More recently, QF development in Montana has focused on the wind power sector.

The increase in wind QF activity is due primarily to two separate Commission decisions; the first increased the QF design capacity limit, and the second created a "wind-only" tariff. In a prior rulemaking, the Commission increased the design capacity limit from 3 MW to 10 MW, allowing larger QF wind facilities to avoid the need to be chosen in a competitive process. In a later QF rate proceeding, the Commission approved the Option 3 QF-1 Tariff rate, a wind-only tariff option that eliminated variable charges to the QF for wind integration and contingency

reserves and required the conveyance the Renewable Energy Credits (RECs) to NorthWestern (Docket D2008.12.146, Order No. 6973d.

During 2011 NorthWestern entered into five (5) new long-term wind power contracts representing nearly 50 MW of nameplate capacity under terms of the QF-1 Tariff, Option 3 Rate. Including these five contracts, NorthWestern will be integrating approximately 238 MW of installed wind capacity into its energy supply portfolio, up nearly 61 percent in one year. NorthWestern forecasts that with the addition of nearly 90 MW of recently signed wind resources that it will have adequate RECs to meet RPS requirements through 2016 and into the 2017 compliance year.



The key value of wind resources is the RECs that they provide which help NorthWestern comply with RPS requirements. On October 19, 2011, the Commission removed the Option 3 Rate from the QF-1 Tariff (Docket No D2010.7.77, Order No. 7108(e)). Since the other QF-1 Tariff rate options do not require that the RECs be transferred with the power generated, new QF resources will not necessarily help NorthWestern meet its RPS obligation. Without this proposed rule change NorthWestern may be required to purchase the output of larger QF wind resources without receiving the benefits of the RECs.

Removal of the Option 3 Rate from the QF-1 Tariff will not put wind QF development "on hold" as some have claimed. The Commission recently approved an Option 1(c) wind only QF-1 Tariff rate of $55.71 per MWH, without RECs. Two of the five Option 3 QF contracts that NorthWestern signed in 2011 contained rates that were discounted from the published Option 3 QF-1 Tariff rate of $69.21. One of those contracts was signed at a rate of $59 per MWH including RECS and also provided for limited curtailment up to 3.5 percent (307 hours) per year (providing additional value to NWE's customers). While the Option 3 rate includes more beneficial terms to QFs than the Option 1(c) rate, the Option 1(c) rate does not include the RECs, which also provide value to a QF. The Option 1(c) rate is simply too close to the contract rates that NorthWestern has actually negotiated to give any credibility to the statement that removal of the Option 3 rate will dampen wind QF development and that amendment of ARM 38.5.1902 is not necessary to protect utility customers.

NorthWestern doesn't have a "QF Queue" anymore, but it does track of QF activity. Currently about 90 MW of QF wind has contacted NorthWestern showing an interest in obtaining a contract with about 30 MW that are very active. Other wind developers, in some instances large, sophisticated wind developers, who have not contacted NorthWestern, are also exploring their QF options. For example, Gaelectric has recently filed revised FERC Form 556 applications (QF certification) for two projects with a combined capacity of 44 MW (Kelly Hills at 18.8MW and Lonetree at 25.3MW). Clearly, there is a lot of interest in developing wind in Montana.

NorthWestern supports the Commission's proposals regarding competitive resource solicitations. The Commission currently has in place a robust set of rules regarding competitive solicitation (ARM 38.5.2001 through 38.5.2012 and 38.5.8201 through 38.5.8229). Standard offer QF-1 Tariff rates should only apply to smaller QF facilities that lack the expertise and ability to participate in competitive resource solicitations. Requiring larger QF resources to participate in competitive resource solicitations will allow NorthWestern to evaluate the total all-in cost of proposed resources, including REC costs. NorthWestern also supports the Commission's proposal to remove the all-source requirement from the rule. Removing the all-source requirement will allow NorthWestern

to issue resource solicitations tailored specifically to the products and resources for which it has identified a need. The revised installed capacity limit combined with the revised rule on competitive solicitations will benefit ratepayers by acquiring renewable resources in a least cost manner. Between competitive resource solicitations, larger QF facilities will still have access to short-term standard QF rates.

The proposals regarding competitive resource solicitations are consistent with PURPA. At the hearing on this proposed rule, representatives of QFs and potential QFs attacked NorthWestern's administration of competitive resource solicitations and asserted that a small QF had never been chosen in a competitive solicitation. The underlying tenor of the comments was that QFs have an absolute right to a profitable contract. These comments reflect a basic misunderstanding of the purpose of PURPA—to provide QFs a level playing field while preserving consumer indifference. The comments seemed to suggest the Commission should provide rules and processes that tilt the playing field for the QFs and ignore the costs to customers. NorthWestern encourages the Commission to adopt its proposals regarding competitive solicitation proposals that provide a level playing field and recognize the importance of customer indifference.

The Commission has previously expressed its desire for a diverse set of renewable resources, indicating that: "The most desirable result would be a diverse mix of new, small QF resources (*e.g.*, small hydro, biomass, cogeneration, wind)." Order No. 6501(f), ¶ 193. Since that order, NorthWestern has signed contracts with nearly 50 MW of new QF resources; all wind facilities. NorthWestern also has an interest in developing a diverse set of renewable resources. For this reason NorthWestern requests that the Commission adopt a 2 MW installed capacity limit for non-intermittent QF facilities and a 1 MW installed capacity limit for intermittent resources. The higher limit for non-intermittent resources would accommodate a more diverse set of non-intermittent QF projects and the smaller 1 MW installed capacity limit for intermittent QF resources would limit attempts to disaggregate.

NorthWestern believes that it is unlikely that wind developers would be able to develop larger single turbine projects at QF-1 standard offer rates. Larger more sophisticated wind developers may attempt to skirt the Commission's rules by disaggregating large projects into a number of sub-2 MW projects. Unless the Commission's rules specifically prohibit disaggregation, developers will actively seek disaggregation as a means to take advantage of standard offer rates. The Commission did not propose a rule to prohibit disaggregation.

Although the Commission's decision in D2010.2.18 prohibited disaggregation, NorthWestern believes that addition protections and guidance are needed. NorthWestern's proposal to reduce the design capacity limit to 1 MW will mitigate attempts to disaggregate larger wind projects.

The Federal Energy Regulatory Commission (FERC) requires that state commissions publish avoided cost rates for small QFs with a design capacity of 100kW or less and gave commissions the discretion to set the published avoided cost rate for facilities greater than 100kW. In the past, the Montana Commission has set required published QF rates for facilities with a design capacity limit of 3 MW. More recently, the Commission increased the design capacity limit to 10 MW (2007 MAR, 2140 (December 20, 2007. In discussing a proposed increase in design capacity limit in a prior Order, the Commission noted; "This threshold appears reasonable given thresholds and orders adopted in other states (*e.g.*, Oregon, Idaho) and admitted into evidence in this proceeding, and FERC's recent rules implementing the 2005 Energy Policy Act." Order No. 6501(f) ¶ 193. NorthWestern notes that Idaho recently reduced their applicable standard offer QF tariff from a design capacity limit of 10 MW to 100kW for intermittent resources, the lowest allowed by FERC. This action in Idaho was largely due to the sizable quantity of new wind projects already signed by Idaho Power. NorthWestern is in a similar situation with wind QFs.

Again, NorthWestern would like to thank the Commission for being proactive in its approach to QFs and NorthWestern recommends that the Commission approve its proposed rule with one notable exception; NorthWestern recommends that the 2 MW design capacity limit should be reduced to 1 MW for intermittent resources.