



## Energy and Telecommunications Interim Committee

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### 63rd Montana Legislature

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DAWN FIELD, Secretary

August 29, 2013

**TO:** ETIC Members

**FR:** Todd Everts, Staff Attorney

**RE:** ETIC Legal Responsibilities With Respect to Reviewing the Department of Public Service Regulation (DPSR) Economic Impact Statement (EIS) Regarding the DPSR's Proposed Amendments to the Qualifying Facility Rules

The purpose of this memorandum is to outline the ETIC's legal responsibilities regarding ETIC's review of the attached DPSR EIS.

On June 26, 2013, DPSR received a letter from 15 legislators, in accordance with section 2-4-405, MCA, requesting that the DPSR prepare an EIS regarding the proposed amendments to ARM 38.5.1902 pertaining to qualifying facilities (MAR Notice No. 38-5-218).

Section 2-4-405(1), MCA, requires that if the DPSR receives a request for an EIS, the DPSR must provide a copy of that request to the ETIC. The DPSR provided that copy of the request to ETIC staff on July 1, 2013, and ETIC staff e-mailed a copy of that request to ETIC members on July 8, 2013.

Section 2-4-405(3), MCA, requires that DPSR must file the EIS with the ETIC within 3 months of the request. The DPSR filed the EIS with ETIC staff on Thursday, August 22, 2013.

Upon receipt of the EIS, the ETIC is required to make a sufficiency determination pursuant to section 2-4-405(4), MCA. That section of law sets out the following procedural committee requirements:

(4) Upon receipt of an impact statement, the committee shall determine the sufficiency of the statement. If the committee determines that the statement is insufficient, the committee may return it to the agency or other person who prepared the statement and request that corrections or amendments be made. If the committee determines that the statement is sufficient, a notice, including a summary of the statement and indicating where a copy of the statement may be obtained, must be filed with the secretary of state for publication in the register by

the agency preparing the statement or by the committee, if the statement is prepared under contract by the committee, and must be mailed to persons who have registered advance notice of the agency's rulemaking proceedings. (2-4-405(4), MCA)

In order for ETIC to make a sufficiency determination, the committee must analyze the EIS in light of the content requirements provided for in section 2-4-405(2), MCA. That section of law provides that, unless waived via the request, the EIS must include:

- (a) a description of the classes of persons who will be affected by the proposed rule, including classes that will bear the costs of the proposed rule and classes that will benefit from the proposed rule;
  - (b) a description of the probable economic impact of the proposed rule upon affected classes of persons, including but not limited to providers of services under contracts with the state and affected small businesses, and quantifying, to the extent practicable, that impact;
  - (c) the probable costs to the agency and to any other agency of the implementation and enforcement of the proposed rule and any anticipated effect on state revenue;
  - (d) an analysis comparing the costs and benefits of the proposed rule to the costs and benefits of inaction;
  - (e) an analysis that determines whether there are less costly or less intrusive methods for achieving the purpose of the proposed rule;
  - (f) an analysis of any alternative methods for achieving the purpose of the proposed rule that were seriously considered by the agency and the reasons why they were rejected in favor of the proposed rule;
  - (g) a determination as to whether the proposed rule represents an efficient allocation of public and private resources; and
  - (h) a quantification or description of the data upon which subsections (2)(a) through (2)(g) are based and an explanation of how the data was gathered.
- (2-4-405(2), MCA)

The ETIC will be making its sufficiency determination at its upcoming September meeting. If you have any questions regarding this process, do not hesitate to contact me.

**PUBLIC SERVICE COMMISSION  
STATE OF MONTANA**



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August 22, 2013

Sonja Nowakowski  
Lead Staff  
Energy & Telecommunications Interim Committee  
State Capitol  
PO Box 201704  
Helena MT 59620-1704

Dear Ms. Nowakowski:

Enclosed is a document prepared by the Montana Public Service Commission (PSC) titled "Economic Impacts of Proposed Amendments to the Montana Department of Public Service Regulation's Qualifying Facility Rules (ARM § 38.5.1902)." This economic impact statement was prepared in response to a request received by the PSC under § 2-4-405, MCA, to evaluate the impacts, costs and benefits of rule amendments that have been proposed by the PSC regarding qualifying facilities. Pursuant to § 2-4-405(3), MCA, the PSC must submit the statement to the Energy & Telecommunications Interim Committee (ETIC). Pursuant to § 2-4-405(4), MCA, the ETIC shall determine the sufficiency of the statement.

Sincerely,

A handwritten signature in blue ink that reads "Kate Whitney".

Kate Whitney  
Regulatory Division Administrator  
Montana PSC

Enclosure

# **ECONOMIC IMPACTS**

**of**

**Proposed Amendments**

**to the**

**Montana Department of Public Service Regulation's Qualifying Facility Rules**

**ARM § 38.5.1902**

Prepared by  
The Montana Public Service Commission  
August 2013



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## I. Introduction and purpose

On May 13, 2013, the Department of Public Service Regulation (Department or Commission) submitted a Notice of Public Hearing on Proposed Amendment to Administrative Rules of Montana (ARM) § 38.5.1902 to the Montana Secretary of State.<sup>1</sup> The proposed rule pertains to the Commission's implementation of federal rules and Montana statutes adopted pursuant to the Public Utility Regulatory Policies Act of 1978 (PURPA).<sup>2</sup> Specifically, the proposed rule affects qualifying cogeneration and small power production facilities (QFs) by lowering the long-term standard rate eligibility threshold from 10 megawatts (MW) to 100 kilowatts (kW). If adopted, QFs certified by the Federal Energy Regulatory Commission (FERC) that are more than 100 kW in nameplate capacity would not be eligible for long-term contracts that require a utility to buy energy and capacity at standard tariff rates periodically set by the Commission. Instead, QFs larger than 100 kW in nameplate capacity would be required to compete against each other and against other energy suppliers when a utility solicits long-term resources. A utility must still purchase energy made available by QFs larger than the standard rate threshold during periods when it is not soliciting long-term resources. Rates for such purchases can reflect either standard short-term rates or negotiated rates. QFs larger than the standard rate threshold can also request the Commission to set long-term contract rates, terms, and conditions pursuant to § 69-3-603, Montana Code Annotated (MCA) upon showing irregularities in a utility's competitive solicitation or resource procurement process that discriminate against QFs.<sup>3</sup> The proposed rule promotes two Commission objectives: it contributes to minimizing a utility's total cost of service by expanding the use of competitive bidding to procure new supply resources, and it promotes QF purchase rates that are just and reasonable to utility consumers and which do not exceed a utility's avoided cost. Both objectives are consistent with PURPA.

Section 2-4-405, MCA provides that an agency shall prepare a statement of the economic impact of the adoption, amendment, or repeal of a rule as proposed upon receipt by the agency of a written request for an economic impact statement made by at least 15 legislators. The

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<sup>1</sup> Montana Administrative Register (MAR) Notice No. 38-5-218.

<sup>2</sup> Pub. L. 95-617, 92 Stat. 3144. (1978).

<sup>3</sup> Order No. 6444e, Docket D2002.8.100, p. 13 (June 4, 2010).

Commission received a written request for an economic impact statement regarding its proposed amendment to § 38.5.1902, signed by 15 members of the Montana Legislature, on June 26, 2013. This report is the Commission's response to that request.

Section 2-4-405(2), MCA specifies requirements for an economic impact statement. Unless the request for an economic impact statement expressly waives any one or more of the following, the statement must include:

(a) a description of the classes of persons who will be affected by the proposed rule, including classes that will bear the costs of the proposed rule and classes that will benefit from the proposed rule;

(b) a description of the probable economic impact of the proposed rule upon affected classes of persons, including but not limited to providers of services under contracts with the state and affected small businesses, and quantifying, to the extent practicable, that impact;

(c) the probable costs to the agency and to any other agency of the implementation and enforcement of the proposed rule and any anticipated effect on state revenue;

(d) an analysis comparing the costs and benefits of the proposed rule to the costs and benefits of inaction;

(e) an analysis that determines whether there are less costly or less intrusive methods for achieving the purpose of the proposed rule;

(f) an analysis of any alternative methods for achieving the purpose of the proposed rule that were seriously considered by the agency and the reasons why they were rejected in favor of the proposed rule;

(g) a determination as to whether the proposed rule represents an efficient allocation of public and private resources; and

(h) a quantification or description of the data upon which subsections (2)(a) through (2)(g) are based and an explanation of how the data was gathered.

The request for an economic impact statement received by the Commission did not waive any of these requirements. This report addresses each of the requirements in § 2-4-405(2), MCA in Section III below. Section II below summarizes the history of PURPA and other federal and state energy policies that have influenced the Commission's implementation efforts over time. Section IV below summarizes the Commission's conclusions.



## II. History of PURPA and its implementation in Montana

In 1978, Congress enacted a National Energy Act consisting of five energy-related laws including PURPA. Through PURPA, Congress sought to encourage certain types of alternative power supplies as a way to improve the overall efficiency of electric power supply, reduce the use of oil and natural gas in electricity generation, and diversify the nation's sources of electric power supply.<sup>4</sup> PURPA requires electric utilities to buy energy and capacity offered by qualifying cogeneration and small power production facilities. Cogeneration facilities simultaneously produce two forms of useful energy, such as electric power and steam, using less energy than would be needed to produce the two separately. Small power production facilities use biomass, waste, or renewable resources, including wind, solar, and water, to produce electric power.

PURPA requires that the rates utilities pay cogeneration and small power production facilities for energy and capacity purchases must be just and reasonable to consumers and in the public interest, must not discriminate against cogenerators and small power producers, and must not exceed the incremental cost to the utility of alternative electric energy.<sup>5</sup> Congress tasked FERC with prescribing rules implementing PURPA. FERC issued rules in 1980, finding that rates that reflect a utility's full avoided cost satisfy PURPA's rate criteria.<sup>6</sup> FERC defined the term "avoided cost" as the incremental cost to an electric utility of electric energy or capacity or both which, but for the purchase from the QF or QFs, such utility would generate itself or purchase from another source.<sup>7</sup> FERC reserved implementation of its rules to state regulatory authorities, such as the Commission, stating that the rules afford state regulatory authorities great latitude so long as the manner of implementation is reasonably designed to achieve the requirements in the rules.<sup>8</sup>

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<sup>4</sup> *Emerging Policy Issues in PURPA Implementation: An Examination of Policy Issues Related to Federal and State Efforts to Encourage Development of Cogeneration and Small Power Production Under Title II of PURPA*. Prepared for U.S. Dept. of Energy by Pfeffer, Lindsay & Associates, Inc. (March 1986). ("DOE Study")

<sup>5</sup> 16 U.S.C. Ch. 12, Subch. II § 824a-3(b) (2012).

<sup>6</sup> Order No. 69, 45 Fed. Reg. 12,222

<sup>7</sup> 18 C.F.R. § 292.101(b)(6).

<sup>8</sup> Order No. 69, 45 Fed. Reg. 12,216, 12,230-12,231.

In 1981, the Montana Legislature enacted a PURPA-related law sometimes referred to as “mini-PURPA.”<sup>9</sup> Montana law authorizes QFs to contract for the sale of electricity to regulated public utilities. When a QF and a utility are unable to agree on contract terms, including price, and absent a Commission-approved rate schedule, the law allows either party to petition the Commission to set contract terms. The law requires the Commission to set rates based on a utility’s avoided costs over the term of the contract. The law also authorizes the Commission to adopt rules “further defining the criteria for [QFs], their cost effectiveness, and other standards.”<sup>10</sup>

The Commission has adopted, and from time-to-time revised, rules that implement FERC’s regulations and Montana law.<sup>11</sup> The Commission’s rules adopt FERC’s regulations by reference and specify obligations for QFs and utilities. During the early 1980s, the Commission conducted three comprehensive investigations into reasonable QF policies and rate-setting procedures.<sup>12</sup>

After FERC issued its regulations implementing PURPA, state regulatory authorities struggled with what FERC characterized as the “extremely difficult” task of developing methods for determining utility avoided costs and QF purchase rates.<sup>13</sup> Some of the methods state regulators used resulted in oversubscription of cogenerators and small power producers, particularly when avoided capacity costs were included in the purchase rates and when the avoided cost-based rates were levelized by significantly loading the early years of the contract period with rates that exceeded then-current avoided costs.<sup>14</sup> A 1986 Department of Energy study of the results of FERC and state efforts to implement PURPA found some evidence that

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<sup>9</sup> § 69-3-601 et seq., MCA.

<sup>10</sup> § 69-3-604(5), MCA.

<sup>11</sup> ARM §§ 38.5.1901 et seq.

<sup>12</sup> See Docket Nos. 81.2.15, 83.1.2, and 84.10.64. In Docket 84.10.64, the Commission observed that other states acquired QF power through competitive bidding. Although the Commission did not implement competitive bidding in that case, it stated that a competitive bidding process, combined with regulatory oversight, would be an efficient means of minimizing the cost of producing electricity to consumers and the economy, a result intended by PURPA. Order No. 5091c, p. 10 (March 7, 1986).

<sup>13</sup> Order No. 69. 45 Fed. Reg. 12,226.

<sup>14</sup> *Competitive Bidding for Electric Generating Capacity: Application and Implementation*. The National Regulatory Research Institute, p. 35 (November 1988). (“NRRI 88-12”)

efforts to encourage QF development in some jurisdictions had increased costs to consumers and increased oil and natural gas use, contrary to the goals of PURPA.<sup>15</sup> The study identified a number of inefficiencies in various state methods governing utility purchases from QFs, including failure to properly distinguish between sunk costs and avoidable costs, rates containing capacity payments where no measurable savings resulted from QF purchases, failure to consider QF availability and reliability in determining QF purchase rates, mandated purchases from QFs that required utilities to deviate from the most efficient mode of system dispatch and operation in order to accommodate QF purchases, and restrictions on the ability of utilities to competitively solicit needed capacity from QFs on a least cost basis.<sup>16</sup>

After these initial experiences in implementing PURPA, some states began exploring competitive bidding methods. In the context of PURPA implementation, competitive bidding offered several perceived benefits compared to rates set administratively by state regulatory authorities. First, competitive bidding methods impose QF-on-QF competition (and competition among all non-utility and utility resource options), which makes it more likely that a utility will select the least cost option for meeting future electricity demand compared to administratively determined “first-in-the-door” standard rates.<sup>17</sup> Second, bidding methods are flexible and can respond quickly to changing market conditions, whereas adjusting administratively determined rates requires extensive and prolonged regulatory processes.<sup>18</sup> Third, bidding methods allow better matching of utility capacity additions and capacity needs, compared to administratively determined rates — observed instances of QF oversubscription and excessive rates are linked to the inflexibility of administratively determined rates and the decline in a utility’s avoided costs that accompanies incremental capacity additions.<sup>19</sup> The DOE Study described above proposed a

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<sup>15</sup> DOE Study, p. 13.1

<sup>16</sup> *Ibid.*, pp. 13.2-13.3

<sup>17</sup> NRRI 88-12, p. 61.

<sup>18</sup> *Ibid.*

<sup>19</sup> Michael H. Rothkopf, Edward P. Kahn, Thomas J. Teisberg, Joseph Eto, and Jean-Michel Nataf, *Designing PURPA Power Purchase Auctions: Theory and Practice*. Energy Analysis Program, Lawrence Berkeley Laboratory, University of California. July 1987. *See also* DOE Study, p. 13.2.

form of competitive bidding for QFs in order to increase economic efficiency while still sufficiently encouraging cogeneration and small power production.<sup>20</sup>

In 1988 FERC proposed changes to its rules implementing PURPA to incorporate competitive bidding.<sup>21</sup> FERC's proposal specifically sanctioned the use of bidding as a procedure for purchasing electricity from QFs. FERC never adopted the rules proposed, but acknowledged that bidding is a viable alternative to determining avoided cost.<sup>22</sup>

The Energy Policy Act of 1992 (Act)<sup>23</sup> amended PURPA by establishing electric utility integrated resource planning standards. The Act defines integrated resource planning as a planning and selection process for new resources that evaluates the full range of alternatives, including new generating capacity, power purchases, energy conservation and efficiency, cogeneration and district heating and cooling applications, and renewable energy resources in order to provide adequate and reliable service to customers at the lowest system cost.<sup>24</sup> It requires integrated resource planning processes to account for necessary features for system operation, such as diversity, reliability, dispatchability, and other risk factors.<sup>25</sup> In addition, as FERC explained in Order No. 888, the Act also promotes greater wholesale market competition by encouraging exempt wholesale generators and authorizing FERC, under sections 211 and 212 of the Federal Power Act, to order transmitting utilities to provide wholesale transmission services.<sup>26</sup> In recognition of these goals of the Act, FERC stated that its goal is to "facilitate the development of competitively priced generation supply options, and to ensure that wholesale electric energy purchasers can reach alternative power suppliers and vice versa."<sup>27</sup>

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<sup>20</sup> DOE Study, p. 13.16

<sup>21</sup> *Regulations Governing Bidding Programs*, Docket No. RM88-5-000 (March 22, 1988). ("Bidding NOPR")

<sup>22</sup> *Regulations Governing Bidding Programs, Order Terminating Proceedings*, 64 FERC ¶ 61,345 (Sept. 29, 1993).

<sup>23</sup> Pub. L. 102-486, 106 Stat. 2276 (1992).

<sup>24</sup> 16 U.S.C. Ch. 46 § 2602(19)

<sup>25</sup> *Ibid.*

<sup>26</sup> *Promoting Wholesale Competition Through Open Access Nondiscriminatory Transmission Services by Public Utilities*, Order No. 888, 75 FERC 61,080 (April 24, 1996)

<sup>27</sup> *Ibid.*, p. 32 (citing *Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Notice of Proposed Rulemaking, 59 FR 35274 (July 11, 1994), FERC Stats. & Regs., Proposed Regulations 32,507 at 32,866 (Stranded Cost NOPR)).

In December 1992, the Commission adopted integrated least cost resource planning rules to encourage Montana's regulated electric utilities to meet their customers' needs for adequate, reliable and efficient energy services at the lowest total cost.<sup>28</sup> Similar to the Act, the Commission's rules direct electric utilities to account for diversity, reliability, resource performance, and other risk factors. The Commission's rules also encourage electric utilities to use competitive bidding for new resources to manage risk and minimize costs. The 1993 Montana Legislature enacted The Montana Integrated Least-Cost Resource Planning and Acquisition Act authorizing the Commission to require utilities to prepare and file integrated resource plans for meeting their customers' service requirements in the most cost effective manner based on evaluations of the full range of available resource alternatives.<sup>29</sup>

Concurrent with its adoption of integrated resource planning rules, the Commission amended its QF rules to include a 3 MW long-term standard rate eligibility threshold. The amended rule required QFs larger than 3 MW to compete and be selected in a utility's all-source competitive bidding process, conducted according to the Commission's integrated resource planning rules, in order to obtain a long-term contract.<sup>30</sup> The amended rule required utilities to purchase energy and capacity from QFs larger than 3 MW at standard or negotiated short-term rates during periods when the utility was not soliciting long-term resources. An all-source solicitation requests proposals from QFs, other non-utility independent power producers, publicly- and investor-owned utilities, power marketing agencies, and international suppliers, which compete against utility resources identified in the integrated resource planning process.<sup>31</sup>

In 1997 the Montana Legislature determined that the generation and sale of electricity was becoming a competitive industry and that Montana consumers should be able to choose their suppliers of electricity and related services. It enacted the Electric Utility Industry Restructuring and Customer Choice Act (Choice Act).<sup>32</sup> The Choice Act required electric utilities to functionally separate retail transmission and distribution services from electricity supply

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<sup>28</sup> ARM § 38.5.2001(1).

<sup>29</sup> § 69-3-1204, MCA

<sup>30</sup> ARM § 38.5.1902(5), referring to § 38.5.2001 et seq.

<sup>31</sup> ARM §38.5.2010(1)(e).

<sup>32</sup> Laws of Mont., Ch. 505 (1997). Codified in Title 69, Chapter 8, MCA.

services, remove electricity supply-related costs from regulated rate base, and provide consumers and electricity suppliers non-discriminatory access to retail transmission and distribution services no later than July 2002. The Choice Act prompted the Montana Power Company (MPC) in 1998 to request that the Commission suspend the Company's existing long-term standard QF rate schedule and replace it with a new rate schedule that provided standard rates only for the period before July 2002. The Commission approved MPC's proposed new QF-1 rate schedule but directed the Company to extend the availability of standard rates if in 2002 PURPA was still federal law.<sup>33</sup>

In 1999 MPC sold substantially all of its regulated generating assets.<sup>34</sup> In 2000 the Commission ordered MPC to be a default electricity supplier for retail customers that did not have access to, or did not want service from, alternative suppliers. In 2001 the Montana Legislature delayed the deadline for full retail access to competitive electricity suppliers to July 2007.

In 2002 MPC sold its electric transmission and distribution utility operations to NorthWestern Corporation, d/b/a/ NorthWestern Energy, which assumed MPC's default electricity supplier obligations. NorthWestern took on the burden of demonstrating the reasonableness of a portfolio of wholesale supply purchases assembled by MPC to meet default supply obligations beginning in July 2002. The Commission ultimately declined to approve several resources in that portfolio and criticized the utility for its failure to apply integrated resource planning principles, including open, fair, and transparent competitive solicitations.<sup>35</sup>

In 2003 the Commission adopted rules governing default supplier planning and procurement practices.<sup>36</sup> The rules were similar to the integrated resource planning rules, but were tailored to default suppliers operating in retail markets transitioning to competition — default suppliers acquired all power needed to serve consumers from wholesale power suppliers. Like the integrated resource planning requirement in the 1992 Energy Policy Act, the Commission's default supplier planning and procurement rules direct default suppliers to

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<sup>33</sup> Order No. 6124, Docket D98.8.183 (December 17, 1998).

<sup>34</sup> The Milltown Dam hydroelectric generating facility was not sold due to its proximity to a federal superfund site.

<sup>35</sup> Order No. 6382d, Docket D2001.10.144 (June 21, 2002)

<sup>36</sup> ARM § 38.5.8201 et seq.

account for diversity, reliability, dispatchability, and other risk factors.<sup>37</sup> And, like the integrated resource planning rules, the default supplier planning and procurement rules establish competitive bidding as the Commission’s preferred method for acquiring new resources.<sup>38</sup>

In 2007, the Montana Legislature enacted the Electric Utility Industry Generation Reintegration Act (Reintegration Act), which repealed much of the Choice Act, prohibited retail direct access to non-utility suppliers for customers served by default suppliers, grandfathered customers receiving electricity supply service from non-utility suppliers, and authorized utilities to acquire electricity generating assets.<sup>39</sup> In December 2007 the Commission amended its QF rules to increase the long-term standard rate eligibility threshold from 3 MW to 10 MW, finding that small QFs up to 10 MW need a simplified mechanism for obtaining long-term contracts to sell electricity and face barriers to effectively participating in competitive solicitations.<sup>40</sup> Since that rule change NorthWestern has acquired 90 MW of new wind generation capacity, 50 MW of which were acquired at long term standard QF rates and the other 40 MW through competitive bidding. The Commission has also conducted three comprehensive rate proceedings to investigate methods for determining avoided costs and setting standard QF rates for QFs up to 10 MW.<sup>41</sup> These events have caused the Commission to question whether QFs up to 10 MW should be considered “small” and whether such QFs should be procured competitively rather than at standard rates. The Commission published the proposed rule as a way to evaluate that question.

### **III. Statement of economic impacts**

In this section the Commission addresses each of the requirements in § 2-4-405(2), MCA pertaining to classes of persons affected by the proposed rule, probable economic impacts of the proposed rule on those classes of affected persons, alternatives to the proposed rule, costs and benefits of the proposed rule compared to inaction, and impacts on other agencies and state

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<sup>37</sup> ARM §§ 38.5.8210, 8213, 8219.

<sup>38</sup> ARM § 38.5.8201.

<sup>39</sup> Laws of Mont. Ch. 491 (2007).

<sup>40</sup> MAR Notice No. 38-2-198 (December 10, 2007).

<sup>41</sup> See Docket Nos. D2008.12.146, D2010.7.77, and D2012.1.3.

revenue. Many factors could directly or indirectly influence the way the proposed rule affects various classes of persons, including future utility and QF costs, consumer demand, rates of technological change, and state and federal policies affecting energy production and consumption. These factors all involve uncertainty. The Commission attempted to reasonably quantify probable economic impacts, wherever practicable.

## Assumptions

The Commission's analysis of the economic impacts of the proposed rule starts with three assumptions. First, the Commission assumes that the requirement in ARM § 38.5.1902(5) that QFs larger than some specified generating capacity compete against one another and against other supply sources is consistent with PURPA, and when effectively enforced, promotes adequate, reliable, and least-cost electricity service at just and reasonable rates for consumers, and is in the public interest. The Commission believes this is a reasonable assumption given the well-documented potential for improvements in economic efficiency from introducing competitive bidding into utility generation resource procurement.<sup>42</sup> As noted above in Section II, FERC itself has determined competitive bidding to be a viable option for implementing PURPA, and the Commission's competitive bidding framework in ARM § 38.5.1902(5) has stood for over 20 years.<sup>43</sup>

Second, the Commission assumes that Montana's regulatory framework is capable of reasonably motivating utilities to: (a) conduct competitive solicitations as part of an on-going, comprehensive, resource planning and analysis effort, (b) evaluate offers fairly and transparently, and (c) select offers that represent economically superior supply sources based on price and non-price factors. Importantly, the analysis does not assume that the regulatory framework is always implemented perfectly or that it cannot be improved, just that it is capable of producing reasonably adequate results, as required by Montana law.<sup>44</sup> The Commission believes this is a

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<sup>42</sup> For example, see the studies referenced in footnotes 4, 14, and 19, *supra*.

<sup>43</sup> Several QFs recently petitioned FERC to declare the rule inconsistent with PURPA. *Petition for Declaratory Order and Petition for Enforcement Pursuant to Section 210(h) of the Public Utility Regulatory Policies Act of 1978 by Hydrodynamics, Inc., Montana Marginal Energy, Inc., and WINData, LLC*. Docket No. EL13-73 (June 14, 2013).

<sup>44</sup> § 69-3-201, MCA. (Every public utility is required to furnish reasonably adequate service and facilities. The charge made by any public utility for any...service produced...shall be reasonable and just...).



reasonable assumption in light of existing statutory requirements and Commission rules that require just and reasonable rates and establish an expectation that utilities conduct fair and transparent competitive solicitations.<sup>45</sup> The rules are clear that a utility risks potential cost disallowances if it fails to satisfy that expectation.<sup>46</sup> As discussed in the sections below, requiring utilities to use competitive solicitations does not ensure that such solicitations will, in fact, be effectively competitive — that requires the Commission and other parties to diligently and critically supervise a utility’s entire resource acquisition process from the initial planning, to the development of solicitations and bid evaluation criteria, to the actual evaluation of offers and final resource selection. Active involvement by stakeholders in various Commission proceedings can facilitate such supervision. In addition, Commission decisions are subject to judicial review and a failure by the Commission to enforce its own rules may be remedied by the courts. The Commission is a creature of the Legislature and understands that general grants of authority may be replaced by more prescriptive statutory requirements if the Commission fails to reasonably discharge its statutory responsibilities. Commissioners are also elected officials accountable to the public for inadequate supervision and control of public utilities.

Third, the economic impact analysis assumes that Montana’s existing renewable energy standard will continue in its current form for the foreseeable future.

### **Specific economic impact statements required by § 2-4-405(2), MCA**

**Section 2-4-405(2)(a): a description of the classes of persons who will be affected by the proposed rule, including classes that will bear the costs of the proposed rule and classes that will benefit from the proposed rule.**

Developers of QFs sized between 100 kW and 10 MW of nameplate capacity will be affected by the proposed rule. Based on information on file with FERC, the Commission estimates there are currently seven potential QF projects which would be eligible for long-term contracts with a utility at Commission-determined standard tariffed rates but which would

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<sup>45</sup> § 69-8-419, MCA. ARM §§ 38.5.2010 and 38.5.8212.

<sup>46</sup> ARM §§ 38.5.2001 and 38.5.8201.

exceed the standard rate eligibility threshold if the proposed rule is adopted as proposed.<sup>47</sup> Some affected QF projects are owned by large, multi-national wind developers such as Gaelectric (Kelly Hills, Lonetree). Some appear to have previously bid in utility resource solicitations (Norris Hill, Kelly Hills). Other potentially qualifying cogeneration and small power production projects could also be affected by the proposed rule. The Commission cannot quantify the number of such projects because they have not filed at FERC for QF certification.<sup>48</sup> QF developers may bear some additional costs due to the proposed rule, as discussed more below.

Consumers of regulated electricity services will be affected by the proposed rule. The Commission expects the proposed rule to affect the cost of utility QF power purchases, the timing of utility QF power purchases, and/or the quality (e.g., reliability, availability) of utility QF power purchases. Since electric utilities recover QF power purchase costs in rates charged to consumers, the proposed rule will affect consumers' rates. Electric utilities regulated by the Commission serve about 366,000 Montana residents and businesses. As explained in more detail below, the Commission expects consumers of utility services to benefit from the proposed rule.

Electric utilities in Montana will be affected by the proposed rule to the extent it affects their total costs of service (however, ultimately this impact primarily affects consumers). The Commission does not expect the proposed rule to result in significant costs or benefits to electric utilities because they are already subject to statutory and Commission resource planning and competitive procurement policies for non-QF resource acquisitions. QFs from 100 kW to 10 MW are a fraction of the non-utility power producer market that currently offers power supply options to utilities. Therefore, the Commission does not expect the proposed rule's marginal expansion of competitive bidding for larger QFs to necessarily lead to marginal increases in rate based generation. Nothing in the proposed rule relieves utilities of their obligation to demonstrate to the Commission the prudence of their resource acquisitions and their compliance with resource planning and procurement standards, or their obligation to charge just and reasonable rates. Nor does the proposed rule relieve the Commission of its responsibility to diligently supervise all aspects of utility resource acquisition.

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<sup>47</sup> The seven QF projects are: Norris Hill Wind (9.6 MW); Kelly Hills (8.9 MW); Lonetree (8.9 MW); Crazy Mountain Wind, LLC (10 MW); Crazy Mountain Wind II, LLC (10 MW); Greenfield Wind, LLC (10 MW); and Greenfield Wind II, LLC (10 MW).

<sup>48</sup> NorthWestern is aware of 11 wind projects that have expressed interest in its standard QF rates.

Various subgroups of Montana residents and businesses may experience different *net* economic impacts from the proposed rule based on their proximity to affected QF projects or a utility's alternative source of supply. For example, if competition encouraged by the proposed rule reveals that there are lower-cost alternatives to an affected QF, residents and businesses near that affected QF's project might not realize the economic development benefits that otherwise might have been possible under administratively determined rates. The unrealized economic development benefits for that subgroup would be partially offset by reduced utility bill impacts due to the rule. On the other hand, residents and businesses located near the alternatives that displaced an affected QF project would experience benefits from the development of those projects, which might not have been possible without the rule. Under the proposed rule, the alternative resource could be either another affected QF project, a non-QF independent power producer or any other supplier, including, potentially, a utility. The Commission did not attempt to quantify subgroup level net economic impacts due to the amount of time and numerous assumptions that would be required for such an analysis.<sup>49</sup> In addition, the Commission does not believe estimates of such impacts are needed to assess the reasonableness of the proposed rule.

The proposed rule does not prevent affected QFs from developing their projects, but it does require them to compete against each other and against other sources of supply to ensure prices do not exceed a utility's avoided cost and the amount of new capacity acquired matches a utility's need for additional resources. The Commission expects that, as a result of the proposed rule, some QFs that might have been economically viable at an administratively determined standard rate will turn out to be more costly than alternatives identified in a bidding process. The Commission also expects some economically viable QFs to experience marginal economic impacts under the proposed rule, such as somewhat reduced profits or more constrained construction budgets due to competitive pressure. The Commission expects consumers to benefit from such competition as long as it is fair and effective. Depending on the economic viability of the affected QFs compared to potential alternatives identified in a bidding process,

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<sup>49</sup> Required assumptions include, but are not necessarily limited to, cost information for various QFs and utility alternatives, temporary and permanent employment impacts for various projects, state and local taxes and fees associated with the development of various projects and the potential for tax holidays or abatements, and multiplier effects.

the proposed rule's impacts on affected QFs could indirectly affect "spillover" economic activity such as local tax revenue and local purchases of goods and services, including labor.

Some opponents of the proposed rule contend that the rule would eliminate QFs in Montana and, consequently, the accompanying local economic benefits, such as landowner income, county tax revenue, and employment impacts.<sup>50</sup> As just discussed, the Commission does not expect the proposed rule to eliminate QFs. The Commission expects the proposed rule to result in more QF-on-QF competition, and competition with non-QF projects, which could reveal that some affected QFs are not economic compared to alternatives. But more to the point, in the context of PURPA implementation, the Commission believes the notion of a net loss of resource development-related economic benefits absent QF development is misplaced. The reason is PURPA's prohibition on paying QFs more than a utility's avoided cost. If QFs truly displace a utility's alternative (i.e., the utility actually avoids the costs of an alternative resource by purchasing from QFs), then economic activity accompanying QF development likely displaces economic activity that would have accompanied the utility's alternative. If a QF is not developed because it is not economic compared to alternatives, some other resource will likely be developed instead with its own accompanying local economic benefits. PURPA does not promote cogeneration and small power production facilities for economic development reasons, but only as cost effective substitutes for a utility's alternative means of supply. The purpose of the proposed rule is not to promote or obstruct local economic development, but to implement PURPA fully and effectively.

The Commission believes the relevant economic impacts of the proposed rule relate strictly to its effect on a utility's total cost of service, which directly translates into costs to consumers. PURPA requires the Commission to set QF power purchase rates that are just and reasonable to consumers.<sup>51</sup> Montana law obligates public utilities to charge just and reasonable rates for service.<sup>52</sup> The Legislature created the Commission to supervise and regulate public utilities and ensure their rates are just and reasonable.<sup>53</sup> Therefore, a Commission rule that

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<sup>50</sup> Written comments received by the Commission on the proposed rule are posted on the Commission's web site: <http://psc.mt.gov/Docs/Rules/38-5-218pro-armQFcomments.pdf>

<sup>51</sup> 16 U.S.C § 824a-3(b).

<sup>52</sup> § 69-3-201, MCA.

<sup>53</sup> §§ 69-1-102, 69-3-102, 69-3-110, MCA.

implements PURPA, such as the proposed rule, must encourage QFs while satisfying the avoided cost standard and ensuring just and reasonable rates for consumers. The Commission believes the reasonableness of the rule should be evaluated by how well it meets these standards.

**Section 2-4-405(2)(b): a description of the probable economic impact of the proposed rule upon affected classes of persons, including but not limited to providers of services under contracts with the state and affected small businesses, and quantifying, to the extent practicable, that impact.**

In the discussion above, the Commission concludes that, in the context of PURPA implementation, the relevant economic impacts of the proposed rule affect primarily two classes of persons: QF developers, which may bear some additional costs from the proposed rule, and consumers of electric utility services, which the Commission expects will benefit from the proposed rule, assuming expanded competition is fair and effective. This section describes and, where practicable, attempts to quantify the economic impacts of the proposed rule on these two classes of persons. The Commission quantifies potential economic impacts on electric utility consumers by comparing costs for QF wind generation acquired under administratively determined standard rates to costs for wind generation acquired competitively. In order to provide an apples-to-apples cost comparison, the Commission adjusts the cost of the wind generation acquired competitively to account for a difference in the amount of capacity acquired such that the cost comparisons assume the same quantity of energy production.

Currently, QFs sized between 100 kW and 10 MW may enter into power purchase agreements with a utility that reflect administratively determined standard rates set by the Commission. Such contracts contain numerous non-price terms, some of which result from negotiations with a utility. If the Commission adopts the proposed rule the primary direct cost imposed on affected QFs will be related to: preparing and submitting price offers in response to utility competitive solicitations, any additional contract negotiation-related costs, and any marginal reduction in profits due to competitive pressure attributable to the rule. The Commission lacks adequate information to precisely quantify the incremental costs affected QFs would incur to prepare and submit offers in response to utility competitive solicitations. PURPA exempts QFs from state regulation as public utilities.<sup>54</sup> Consequently, the Commission does not

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<sup>54</sup> 16 U.S.C § 824a-3(e).

have tools for gathering QF cost information. Preparing and submitting an offer in response to a utility competitive solicitation would require a QF to thoroughly understand the energy production characteristics of its generating plant, reasonably estimate construction costs, including permitting, financing, and interconnection costs, and reasonably estimate the costs of operating and maintaining its generating plant, including labor costs, component replacement costs, production tax credits, and fuel costs. Since a QF would also require such information to evaluate a potential project's economic viability at the standard rate, the Commission expects affected QFs to incur negligible incremental costs under the proposed rule. Opponents of the proposed rule did not submit comments to the Commission contending that bidding costs would be burdensome.

The proposed rule expands the use of competitive bidding to acquire larger QFs. In 2005 the Legislature enacted the Montana Renewable Power Production and Rural Economic Development Act (Renewable Act), which sets renewable resource standards for public utilities.<sup>55</sup> In meeting the renewable resource standards, public utilities must conduct competitive solicitations to procure renewable energy credits, either with or without the associated electricity.<sup>56</sup> In implementing the Renewable Act, the Commission has obtained information on the cost to electric utilities of wind projects acquired through a competitive bidding regime, which it can compare to the cost of wind projects acquired at administratively determined standard QF rates. This cost comparison, quantified below, provides some insight into the potential economic benefits of the proposed rule to consumers of regulated utility services.

NorthWestern's 2007 Electric Default Supply Resource Procurement Plan (Plan) economically evaluated numerous combinations of supply- and demand-side resources capable of meeting the Company's projected long-term service obligations in Montana.<sup>57</sup> NorthWestern concluded based on various resource cost estimates that acquiring additional wind resources would contribute to a least-cost, least-risk resource portfolio. It planned to solicit bids for wind

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<sup>55</sup> § 69-3-2001 et seq., MCA.

<sup>56</sup> § 69-3-2005(1)(a), MCA.

<sup>57</sup> *NorthWestern Energy Electric Default Supply Resource Procurement Plan*, Docket No. N2007.11.138 (December, 17, 2007).

and other renewable resources.<sup>58</sup> In December 2008, the Commission opened a docket to review NorthWestern's standard QF rates.<sup>59</sup> An association of QF developers, the Montana Small Independent Renewable Generators (MSIRG), intervened in the docket and testified that a reasonable avoided cost-based standard rate for wind QFs would be the estimated cost of wind resources in NorthWestern's 2007 Plan.<sup>60</sup> In Order No. 6973d, the Commission adopted MSIRG's proposal, set a standard rate of \$69.21/MWh (the wind cost estimate in NorthWestern's 2007 Plan) for wind QFs, and required wind QFs contracting under that rate to convey their renewable energy credits to NorthWestern. In 2011, NorthWestern executed five QF contracts at the \$69.21/MWh standard rate.<sup>61</sup> Together, the contracts represented 49.3 MW of installed wind capacity and 158,420 MWh of expected annual energy production. Over the 25 year contract period, the contracts would cost consumers approximately \$122 million in net present value.<sup>62</sup>

In August 2009, while the Commission's QF rate proceeding was still on-going, NorthWestern issued its planned solicitation for renewable energy resources. The Company solicited offers for up to 75 MW of renewable resources. In February, 2010, it narrowed the 40 offers it received down to four wind projects. It interviewed the four finalists and chose two for contract negotiations in June, 2010. Ultimately, NorthWestern did not execute contracts with either of the chosen bidders, but in February, 2011, it reached an agreement with another of the four finalists, Compass Wind, to purchase the Spion Kop wind project.<sup>63</sup> Spion Kop provides 40 MW of installed wind capacity and 138,000 MWh of expected annual energy production. Over a 25 year period, Spion Kop is estimated to cost consumers approximately \$91 million in net

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<sup>58</sup> Ibid., Volume 1, pp. 114-119.

<sup>59</sup> See Docket No. D2008.12.146.

<sup>60</sup> Order 6973d, p. 21 (May 6, 2010).

<sup>61</sup> In two of the five contracts, NorthWestern and the QFs negotiated a discount to the \$69.21/MWh rate based on other negotiated contract terms that limited NorthWestern's ability to curtail energy deliveries under certain market conditions. Those price discounts are reflected in the Commission's total cost calculation.

<sup>62</sup> The net present value calculation discounts future costs to account for the positive time preference indicated by positive interest rates. The net present value calculations described in this report use a 7% discount rate.

<sup>63</sup> *Application of NorthWestern Energy for Approval to Purchase and Operate the Spion Kop Wind Project*, Prefiled Direct Testimonies of Steven Lewis and Bleau LaFave, Docket D2011.5.41 (May 31, 2011)

present value, which equates to a nominal levelized per unit cost of energy of \$56.27/MWh.<sup>64</sup> The Commission inflated the Spion Kop costs by a factor of approximately 1.15 based on the ratio of expected energy production from the five QFs to Spion Kop's expected energy production. This adjustment increases Spion Kop's cost to approximately \$104 million in net present value ( $158,420/138,000 = 1.148$ .  $\$91 \text{ million} \times 1.148 = \$104 \text{ million}$ ), \$18 million less than the QF wind contracts.<sup>65</sup>

In 2011, NorthWestern acquired about 90 MW of installed wind generation capacity. The 40 MW acquired through competitive bidding was priced about 15% lower than the 50 MW acquired through administratively determined standard QF rates. The price difference might indicate that the estimated wind cost embedded in the standard QF rate did not reflect current market conditions or that Spion Kop achieved economies of scale that were not available to the five QF projects, each of which was about 10 MW. In any event, the administratively determined QF wind rate in 2011 exceeded the cost of wind power actually avoidable in 2011.<sup>66</sup>

In 2010, Montana-Dakota Utilities acquired the Cedar Hills Wind project, which provides about 20 MW of installed wind capacity and 63,200 MWh of expected annual energy production. Using the cost of Cedar Hills, about \$55.00/MWh, the amount of energy production expected from the five wind QFs would cost approximately \$101 million in net present value, \$21 million

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<sup>64</sup> When NorthWestern requested preapproval of the Spion Kop project it estimated a 25 year levelized per unit cost of \$53.78/MWh. The Commission observed in Order 7159I that because Spion Kop would be rate based, rates used to recover Spion Kop costs would not be adjusted annually and, therefore, rate revenue recovered from consumers would exceed \$53.78/MWh by about \$3.00/MWh, other things being equal.

<sup>65</sup> Some opponents of the proposed rule criticized aspects of the bidding and/or selection process that resulted in Spion Kop. The Commission extensively reviewed that process in a contested case proceeding, Docket D2011.5.41. The Commission determined that the process sufficiently complied with statutory and Commission requirements in Order 7159I. To the extent the solicitation process that produced Spion Kop was suboptimal, the Commission's cost comparison may be conservative.

<sup>66</sup> It might be reasonably argued that smaller, geographically diverse QF projects impose fewer wind integration costs on consumers compared to larger projects like Spion Kop. In this particular case, three of the five QF projects are located near the Judith Gap wind farm. The 2011 GENIVAR Montana Wind Integration Study found that additional wind generation near Judith Gap increases integration needs more than additional wind generation far from Judith Gap. In Docket D2012.1.3, United Materials of Great Falls, owner of the Horseshoe Bend wind project, estimated that, together, the five QFs would require 9.7 MW of integration capacity (19.6% of nameplate capacity). (See Docket D2012.1.3, data response PSC-026a) In Order 7199d, the Commission adopted a standard QF rate design with zonal wind integration charges based, in part, on United Materials' analysis. Under that zonal rate design, Spion Kop would require 2 MW of integration capacity (5.1% of nameplate capacity). The wind costs compared in this report do not include wind integration costs.



less than the QF wind projects.<sup>67</sup> Therefore, NorthWestern's administratively determined QF wind rate may also have exceeded the cost of wind power actually avoidable in 2010.

Thus, the probable economic impact of the proposed rule involves a negligible incremental cost to affected QF developers in return for improved economic efficiency and consumer protection benefits that, in some cases, may amount to tens of millions of dollars in net present value.

**Section 2-4-405(2)(c): the probable costs to the agency and to any other agency of the implementation and enforcement of the proposed rule and any anticipated effect on state revenue.**

As described in Section II, a variant of the proposed rule has been in place for over 20 years. For most of that period, the standard rate eligibility threshold was 3 MW. The Commission does not expect significant incremental agency costs to implement and enforce the proposed rule, as proposed (i.e., 100 kW), compared to agency costs to implement and enforce the rule at the 10 MW or 3 MW size thresholds. In the near-term, some larger QFs may petition the Commission pursuant to § 69-3-603, MCA in an effort to show that a utility's solicitation or resource procurement process discriminates against QFs. Such proceedings could be resource intensive for all involved due to the 180 day decision requirement in the law. However, resolution of any such petitions would likely improve the quality of competitive bidding processes over time, which may, in turn, reduce the future frequency of such petitions.

The agency most likely affected by the proposed rule, besides the Commission, is the Montana Consumer Counsel, which represents consumer interests in Commission proceedings. The Commission does not expect the Consumer Counsel to incur material incremental costs related to the Commission's implementation and enforcement of the proposed rule.

The Commission does not anticipate any significant effects on state revenue from the proposed rule. As explained above, PURPA is designed to encourage QFs that are cost effective substitutes for traditional fossil-fueled utility resources that would otherwise be used to supply consumers. To the extent the state taxes QFs, other non-utility power producers, and utilities

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<sup>67</sup> Montana-Dakota Utilities estimated the \$55.00/MWh levelized cost of its Cedar Hills wind project based on a 20-year revenue requirement in Docket D2010.8.82, data response PSC-085. In this report, the Commission simply applied the \$55.00/MWh cost to an assumed 25 year contract, which overstates somewhat the actual cost of the Cedar Hills project and makes the comparison to the cost of the five QF contracts conservative.

similarly, net impacts on state revenue should be negligible. If the state taxes QFs, other non-utility power producers, and utilities differently, or taxes various types of generating facilities differently, marginal impacts on state revenue could occur if the rule results in a different mix of suppliers or generating plants compared to the status quo. The Commission did not attempt to compare how the state taxes categories of power suppliers and types of generating facilities.

The proposed rule does not involve fees or fines that would generate state revenue.

**Section 2-4-405(2)(d): an analysis comparing the costs and benefits of the proposed rule to the costs and benefits of inaction.**

As described in Section II, in 1992 the Commission adopted an integrated resource planning framework for electric utilities, a central component of which involved competitive bidding for new supply resources. At that time, the Commission stated that achieving just and reasonable rates pursuant to § 69-3-201, MCA requires a reasonable planning process by which utilities acquire new resources.<sup>68</sup> The Commission simultaneously modified its QF rules to conform them to the new integrated resource planning rules by establishing a 3 MW standard rate eligibility threshold and requiring utilities to acquire larger QFs through competitive bidding.<sup>69</sup> A decade later, the Commission's implementation of electric utility deregulation resulted in a separate resource planning framework for default supply utilities, which similarly emphasizes competitive resource procurement.

The Commission's electric utility resource planning and acquisition standards have long favored competitive bidding because of its well-documented potential for improving economic efficiency and enhanced consumer protection.<sup>70</sup> Consumers directly benefit from cost savings that result from competitively procured power supplies. Competitive bidding more comprehensively identifies available power supply sources than bilateral negotiations or administratively determined "first-in-the-door" standard QF rates and, therefore, more accurately estimates a utility's true avoided cost at a particular point in time. Competitive bidding is more flexible than administratively determined standard QF rates because it can respond quickly to

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<sup>68</sup> MAR Notice 38-2-104 (August 27, 1992)

<sup>69</sup> Ibid.

<sup>70</sup> NRR 88-12, pp. 60-64, DOE Study, pp. 5.44, 13.16

changes in market conditions, whereas changing administratively determined standard QF rates requires extensive and prolonged contested cases to reflect new economic and technical conditions. Competitive bidding is more likely to result in a utility's selection of the least-cost option to meet future service obligations and may impose stronger incentives for cost control.<sup>71</sup> Competitive bidding provides a utility more control over when and how much additional supply capacity it acquires. Standard QF rates may lead to more than the needed quantity of additional supply at rates that exceed true avoided costs.<sup>72</sup> The risk in this regard is not symmetrical; more QF capacity is likely to develop if administratively determined rates overstate true avoided costs.

The Commission expects that as long as the incremental cost to affected QFs of preparing and submitting bids in utility solicitations does not prevent them from participating, consumers will benefit from the economic efficiency and consumer protection improvements associated with the expanded competitive bidding in the proposed rule. If bidding costs discourage affected QFs from participating, potentially cost effective QFs may go undeveloped and higher total costs for consumers could result. As discussed above, the Commission expects the incremental cost to affected QFs of preparing bids to be small and the affected QFs identified by the Commission should not be discouraged from bidding on the basis of cost. In addition, the Commission believes the proposed rule better encourages QFs to optimally size their projects and exploit economies of scale in order to minimize their bid prices.<sup>73</sup>

The Commission believes inaction would expose consumers of utility services to future instances of administratively determined QF rates that exceed a utility's actual avoided cost. For example, toward the end of 2011, the Commission terminated NorthWestern's \$69.21/MWh standard wind QF rate and set a new rate for wind QFs based on a combination of forecast near-term market electricity prices and the estimated cost of owning and operating a natural gas-fired electricity generator, which the Company included in its 2009 resource plan. NorthWestern's

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<sup>71</sup> Ibid.

<sup>72</sup> Long-term standard rates generally reflect costs for a block of needed capacity that has been specified in a utility's integrated resource plan. Each QF contract that goes beyond the utility's specified resource need is paid more than the utility's avoided cost since those QFs do not avoid any capacity costs. This is true regardless of how accurate the long-term standard rate was when it was first set.

<sup>73</sup> As discussed in footnote 66, optimally sizing a wind project to exploit economies of scale may involve trading off lower integration costs and/or greater aggregate capacity value. The Commission's resource planning rules envision that utilities will analyze such trade-offs in their resource planning processes and design their resource solicitations accordingly.

current standard wind QF rates reflect that method for estimating avoided costs and range from \$37.00 - \$47.00/MWh, depending on proximity to the Judith Gap project, without renewable energy credits.<sup>74</sup> Although the Commission believes the rates reflect a reasonable method for administratively determining avoided costs, competitive bids for new wind resources would reflect cost factors specific to that technology, which could differ from the cost estimates underlying the standard rate. In fact, Montana-Dakota Utilities recently informed the Commission that a competitive solicitation it conducted in 2013 revealed opportunities to purchase wind energy for a 25 year period for about \$30.00/MWh.<sup>75</sup> In its comments on the proposed rule, NorthWestern stated that its 2012 solicitation for Community Renewable Energy Projects yielded a 20 year wind energy offer at less than \$40.00/MWh. These wind resources presumably include renewable energy credits. Absent executed contracts, the reality of these wind prices can be questioned. The Commission's concern is that even the best administratively determined rate may not accurately reflect a utility's actual avoided cost for each type of QF, particularly if market conditions, including input prices, technological progress, and public policy factors such as production tax credits, are in flux, as they are in the wind industry.

Of course, achieving the potential economic efficiency and consumer protection benefits of competitive bidding requires an open, fair, and transparent solicitation and bid evaluation process so potential suppliers are encouraged to submit high-quality offers, and so winning bids are truly superior sources of supply. Some opponents of the proposed rule contend that NorthWestern's competitive bidding process is deficient. They assert that Commission regulation does not sufficiently counter the utility's pursuit of higher profits and its bias to own generating plants, that the bidding process should involve an independent entity to ensure winning bids represent the best deal for consumers, that NorthWestern changes bid evaluation criteria after bids are received, that solicitations are not conducted regularly, and that QFs never win. The Commission takes seriously allegations of deficiencies in the competitive bidding process and takes action when necessary to ensure the process adheres to statutory standards and

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<sup>74</sup> The Commission has determined that more geographically diverse wind development imposes fewer integration requirements. See Order 7199d, Docket D2012.1.3. NorthWestern's current standard QF tariff does not require QFs to convey renewable energy credits to NorthWestern. To acquire a QFs renewable energy credits, NorthWestern would have to pay the QF a negotiated purchase price.

<sup>75</sup> Montana-Dakota Utilities Company Informational Meeting, July 17, 2013.

its own rules.<sup>76</sup> However, QF developers are also motivated by profits and act strategically for their self-interest. The opponents' singular focus on the competitive bidding process appears to be logically inconsistent, since the same utility profit incentive is present in the standard QF rate setting process (and every other aspect of regulating a monopoly utility). The opponents do not explain why the Commission adequately counters the utility's profit incentive in that process but not in its oversight of competitive bidding. One possible reason for asymmetric oversight could be asymmetric priorities by stakeholders as reflected by their intervention and participation in standard QF rate proceedings versus proceedings where bidding procedures are reviewed. The Commission has no knowledge of how stakeholders prioritize various Commission proceedings, but observes that proceedings involving utility requests for rate recovery of resources acquired through solicitations typically generate robust stakeholder participation.

A QF of any size can petition the Commission to set long-term contract rates and conditions pursuant to § 69-3-603, MCA if it shows irregularities in the utility's solicitation or procurement process that discriminate against QFs. Additionally, a utility's compliance with competitive bidding standards is subject to contested case procedures when it seeks to recover the cost of a newly-acquired supply resource. Such cases are publicly noticed and provide opportunities for QFs and others to offer evidence of a utility's non-compliance. The solution to any deficiency in the competitive bidding process is to work to correct it, rather than to abandon it. Again, given clearly articulated Legislative and Commission policies regarding competitive bidding, this economic impact statement assumes that Montana's regulatory framework is fully capable of advancing open, fair, and transparent utility resource solicitations, and taking appropriate action to protect consumers when utilities do not meet these standards. The Commission acknowledges that, despite its best efforts to diligently enforce its resource planning and acquisition expectations, regulation is a complex process that probably does not discipline utility behavior to a theoretically ideal market standard. The Commission is open to constructive comments on ways to improve regulatory practices for supervising utility competitive bidding. However, the Commission is not convinced that modifying its assumption regarding the capability of Montana's regulatory framework, for example by assuming periodic instances of

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<sup>76</sup> In fact, in 2012 the Commission hired a consultant to assess its resource planning and procurement practices. *Final Report: Recommendations and a Draft Rule for Electric Utility Resource Planning and Procurement in Montana*, Pamela Morgan and B. Martin Howard. September 12, 2012. Also see Order 6382d.

regulatory dysfunction or capture, would lead to a preference for administratively determined standard QF rates as a check against utility self-interest. As previously discussed, it seems unlikely that administratively determined standard QF rates would be uniquely immune to regulatory dysfunction or capture such that they more effectively check utility self-interest than a competitive bidding process. But if that were the case, inaction could better ensure a more diverse utility resource portfolio which could benefit consumers.

The proposed rule sets the standard rate eligibility threshold at the minimum allowed under FERC rules. Consequently, the broadest possible range of potentially affected QFs was encouraged to comment on the proposed rule. As discussed above, the primary consideration in setting the standard rate eligibility threshold is whether QFs above the threshold would be discouraged from participating by the cost of bidding. Unfortunately, the Commission received relatively few comments on this issue, particularly from QF developers. The Consumer Counsel commented that it does not object to making small and unsophisticated QFs eligible for standard rates so long as consumers are not harmed. It recommended that the Commission adopt the 3 MW threshold that HB 188 (2013 Legislative Session) would have implemented. A secondary consideration regarding the proper threshold could be litigation cost barriers to small QFs that feel a solicitation process was discriminatory. For example, a 150 kW wind project might bid a \$47.00/MWh price for a 25-year period which, if selected, would provide about \$216,000 of total revenue on a net present value basis. However, it might cost the QF \$30,000 to prosecute a case before the Commission challenging a utility's solicitation process.<sup>77</sup> Such rate case expenses would constitute a significant portion (14%) of the QF's total potential revenue and may discourage an otherwise legitimate complaint. For a 3 MW or 10 MW project, on the other hand, similar rate case expenses would amount to about 0.6% or 0.2%, respectively, of the QF's potential revenue. The Commission will consider these issues thoroughly and may ultimately determine a threshold greater than 100 kW is appropriate.

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<sup>77</sup> In two recent cases of small water utilities, the Commission has identified rate case expenses of approximately \$30,000. See [http://psc.mt.gov/Docs/ElectronicDocuments/pdfFiles/D2009-12-156\\_7056f.pdf](http://psc.mt.gov/Docs/ElectronicDocuments/pdfFiles/D2009-12-156_7056f.pdf) and [http://psc.mt.gov/Docs/ElectronicDocuments/pdfFiles/D2008-10-123\\_6972f.pdf](http://psc.mt.gov/Docs/ElectronicDocuments/pdfFiles/D2008-10-123_6972f.pdf)

**Section 2-4-405(2)(e): an analysis that determines whether there are less costly or less intrusive methods for achieving the purpose of the proposed rule.**

The primary costs of the proposed rule affect QF developers and are related to any incremental bid preparation and contract negotiation costs and the effects of competition. As described above, the Commission does not expect QFs to incur significant incremental costs for bid preparation and contract negotiation. However, any such costs must be incurred in order to achieve the proposed rule's purpose of expanding competitive bidding. The Commission is not aware of lower cost alternative methods for achieving that purpose. Competitive bidding is extremely common in commercial transactions throughout the economy. The Commission does not believe the proposed rule's marginal expansion of competitive bidding for QF energy and capacity would be overly intrusive to the affected QFs it identified.

**Section 2-4-405(2)(f): an analysis of any alternative methods for achieving the purpose of the proposed rule that were considered by the agency and the reasons why they were rejected in favor of the proposed rule.**

The Commission believes the primary alternative to the proposed rule is the status quo, which involves administratively determining avoided costs and QF rates every few years through contested case procedures. Within that alternative, the Commission can experiment with various methods for estimating avoided costs and various rate structures in order to attempt to satisfy PURPA's various objectives, as the Commission has done over the past 30 or so years. The Commission's implementation of PURPA is a continual process of refinement. The Commission's recent experiences in administratively determining QF rates, combined with anecdotal evidence from wind resources acquired competitively and through standard QF rates since the Commission changed the standard rate eligibility threshold from 3 MW to 10 MW, have convinced it that a return to greater use of competitive bidding will better achieve PURPA's objectives. The Commission believes the status quo could lead to additional instances of QF rates that exceed utility avoided costs and higher costs to consumers.

Another alternative to the status quo would be individual contested cases to set rates for each QF above some size threshold. The Commission believes such a process would be overly burdensome for the Commission and stakeholders, particularly if avoided costs must be

determined simultaneously for multiple QFs. Such a process would also be inefficient given the well-documented potential for competitive bidding, with adequate regulatory oversight, to efficiently and effectively determine avoided costs.

**Section 2-4-405(2)(g): a determination as to whether the proposed rule represents an efficient allocation of public and private resources.**

The Commission believes the proposed rule represents an efficient and effective method for achieving the requirements in PURPA and, therefore, also represents an efficient allocation of public and private resources. Over the last decade, the QF community, NorthWestern Energy, MCC, and other interested parties have spent considerable time, effort, and expense litigating standard QF rate issues. In many ways this litigation benefited the Commission by furthering its understanding of complex resource planning and acquisition issues, such as load and wind generation variability, regulation capacity needs and allocation methods, transmission interconnection, resource capacity value, and market price forecasting methods. It is possible that the proposed rule would cause QFs and, consequently, the Commission, MCC, utilities, and others, to reallocate litigation resources from standard rates to competitive bidding procedures. To the extent such resource reallocation improves the bidding process, QFs, other non-utility suppliers, and consumers may benefit.

**Section 2-4-405(2)(h): a quantification or description of data upon which subsections (2)(a) through (2)(g) are based and an explanation of how the data was gathered.**

The Commission arrived at its estimate of seven potential QF projects that would be affected by the proposed rule by conducting a search of FERC's website for QFs located in Montana that filed a Form 556 (Certification of Qualifying Facility Status for a Small Power Production or Cogeneration Facility) between June 1, 2011, and July 8, 2013. QFs that exceeded 10 MW in size or that have already obtained long-term contracts with NorthWestern Energy were excluded from the results. Because it is possible that the Commission's online search missed some Montana QFs that filed Form 556's with the FERC in the specified date range, the quantification of potentially affected QFs is an estimate, not a definite number.



For the cost comparison provided in response to § 2-4-405(2)(b), the Commission relied on publicly available information from Docket No. D2011.5.41 (NorthWestern's Application for Approval to Purchase and Operate the Spion Kop Wind Project) and QF contract price and annual energy production information reported by NorthWestern Energy. The Commission also relied on information obtained in other Commission proceedings and reviewed regulatory research on competitive bidding, particularly as it relates to implementing PURPA. Those data sources are footnoted throughout this report.

#### **IV. Conclusion**

The proposed rule, or a variant thereof, if adopted, would expand the Commission's existing policy of implementing PURPA for larger QFs through competitive bidding methods. The Commission has long favored competitive bidding as an effective and efficient way of acquiring new electricity supply resources, including QFs. FERC has determined that competitive bidding is a viable method for achieving PURPA's objectives: greater efficiency in electric power supply, just and reasonable rates to utility consumers, nondiscriminatory treatment of QFs, and QF purchase rates that do not exceed utility avoided costs.

The proposed rule would not impose significant incremental costs on QFs. QF cost impacts would be related to preparing and submitting bids, contract negotiations, and profit constraints from competitive pressure. Although, the proposed rule should not cause a substantial *net* loss of "spillover" economic activity related to development of new electricity generating facilities dedicated to serving utility consumers in Montana, that is not an appropriate standard by which to evaluate the reasonableness of the proposed rule. The proposed rule would reduce the risk of acquiring significant, long-term QF resources at prices that exceed the cost of actual utility alternatives, which would benefit consumers and comply with PURPA. QFs larger than the standard rate eligibility threshold can petition the Commission pursuant to § 69-3-603, MCA for project-specific long-term contract rates if they show irregularities in a utility's solicitations or resource procurement process that discriminate against QFs. Standard rates are appropriate for QFs that would be discouraged from offering potentially cost effective resources because bidding and litigation costs are high relative to total project costs. The Commission will

consider the comments it received on the proposed rule to determine a reasonable standard rate eligibility threshold based primarily on whether such costs may discourage smaller QF projects.

Montana has outstanding wind energy potential.<sup>78</sup> The wind generation potential in Montana far exceeds what the state's utilities can use.<sup>79</sup> The Legislature has required that regulated electric utilities obtain a minimum of 15% of their retail sales of electricity in Montana from renewable resources by 2015. To date, wind resources have dominated the utilities' compliance strategies. Perhaps not surprisingly, recent QF development has also primarily consisted of wind resources and standard QF rate proceedings have wrestled with wind-related issues such as intermittency, integration costs, capacity values, and renewable energy credit policies. Limited space on transmission lines heading out of Montana means those attempting to develop wind projects in Montana are looking for any means possible to sell energy to Montana consumers. This situation creates a "buyer's market" for Montana consumers, and makes a market-based mechanism such as the proposed rule a particularly appropriate tool for selecting the highest quality and best priced wind resources. The Renewable Act already requires utilities to use competitive bidding. The proposed rule would make the Commission's QF rule more consistent with the Renewable Act by expanding the use competitive bidding to acquire renewable resources that also happen to be QFs. The proposed rule coordinates PURPA, state law (including the Renewable Act), and Commission integrated resource planning rules, and creates a consistent regulatory framework for acquiring the types of resources PURPA encourages, wind, solar, small hydro, and biomass, in a way that benefits consumers and the economy.

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<sup>78</sup> *Estimates of Windy Land Area and Wind Energy Potential, by State, for Areas  $\geq$  30% Capacity Factor at 80m*, National Renewable Energy Laboratory. February 4, 2010. ("NREL report")  
[http://www.windpoweringamerica.gov/windmaps/resource\\_potential.asp](http://www.windpoweringamerica.gov/windmaps/resource_potential.asp)

<sup>79</sup> The NREL report estimated Montana's wind generation potential to be 3.23 billion MWh per year. Montana regulated utility consumers used about 7.2 million MWh in 2012.