

121 FERC ¶ 61,204
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Sudeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

NorthWestern Corporation
Powerex Corporation

Docket Nos. ER08-71-000
ER08-72-000

ORDER ACCEPTING AGREEMENT FOR REGULATING
RESERVE SERVICES AND GRANTING REQUESTED WAIVERS

(Issued November 28, 2007)

1. On October 18, 2007, Powerex Corporation (Powerex) and NorthWestern Corporation (NorthWestern) (collectively, Applicants) submitted for filing, pursuant to section 205 of the Federal Power Act (FPA),¹ an executed agreement for Regulating Reserve Services (Agreement). Under the Agreement, Powerex will provide Regulating Reserve Services to NorthWestern, commencing January 1, 2008, for the purpose of: (i) maintaining reliability; and (ii) providing uninterrupted service under Schedule 3 (Regulation and Frequency Response) of the NorthWestern Open Access Transmission Tariff (NorthWestern OATT). In addition, NorthWestern will return Balancing Energy to Powerex and will financially settle the energy that results from the Regulating Reserve Services.
2. Powerex requests that the Commission waive the provision in section 3 of its Rate Schedule No. 1 that limits Powerex's ability to make sales of ancillary services at market-based rates to transmission providers for use in fulfilling their OATT obligations. NorthWestern requests that the Agreement be accepted and made a part of its OATT at Rate Schedule No. 250 (MT). For the reasons discussed below, we will accept the Agreement, to become effective on January 1, 2008, as requested and grant limited waiver of section 3 of Powerex's Rate Schedule No. 1.

¹16 U.S.C. § 824d (2000).

Background

3. Powerex has been granted authority by the Commission to make wholesale capacity, energy, and ancillary service sales in the United States pursuant to its market-based rate authority.² NorthWestern states that it owns and operates electric transmission facilities in the State of Montana, but owns no rate-based generation in the state. Applicants state that because NorthWestern owns no rate-based generation, NorthWestern is required to rely on contracts with third parties for the capacity and energy needed to provide the ancillary services required under its OATT and to satisfy its system reliability requirements. Applicants state that NorthWestern and its predecessor in interest, the Montana Power Company, have relied on these agreements, as approved by the Commission, since 1996.

4. Applicants state that currently, under an agreement that became effective January 1, 2005, NorthWestern's Regulating Reserve Services requirements are supplied by Idaho Power Company (Idaho Power), pursuant to a cost-based rate. These costs are passed through to NorthWestern's customers, under Schedule 3 of the NorthWestern OATT, at a rate of 14 cents per kW-month. Applicants state, however, that Idaho Power is no longer in a position to provide this service and has provided notice that it intends to terminate its agreement with NorthWestern effective December 31, 2007.

5. Applicants state that accordingly, NorthWestern issued a request for proposals (RFP) for Regulating Reserve Services, on November 30, 2006, for a minimum term of one year, commencing January 1, 2008.³ Applicants state that the RFP was sent to over 70 entities, including: (i) generators, both existing and planned, within NorthWestern's balancing authority; (ii) all transmission providers, balancing authorities and their associated generators connected to NorthWestern's Montana-based transmission system;

² See *British Columbia Power Exchange Corp.*, 80 FERC ¶ 61,343 (1997); *British Columbia Power Exchange Corp.*, Letter Order, Docket No. ER97-4024-012 (Sept. 12, 2000); *Powerex Corp.*, Docket No. ER01-48-002 (Oct. 30, 2003) (unpublished letter order); *Powerex Corp.*, Docket No. ER01-48-007 (July 26, 2007) (unpublished letter order).

³ A copy of NorthWestern's RFP is included in Applicants' filing.

(iii) the Bonneville Power Authority (BPA); (iv) the Western Area Power Administration; (v) generators on the Mid-Columbia system; (vi) various power marketers; and (vii) the remaining members of the Northwest Power Pool.

6. Applicants state that no on-system generator submitted a response to the RFP. In addition, Applicants state that only two offers, including the offer received from Powerex, were able to satisfy the technical requirements and time commitments set forth in the RFP.

7. Applicants state that over a nine-month period, they developed the operating and technical requirements under which Powerex would supply a portion of the requested Regulating Reserve Services.⁴ Applicants state that under the Agreement, Powerex will provide Regulating Reserve Services to NorthWestern from January 1, 2008 through December 31, 2008, with the energy transactions authorized thereunder settled based on the Dow Jones Mid-C Daily Firm On-Peak and Off-Peak Index (Mid-C Index). The Agreement calls for Powerex to supply 50 MW of Regulating Reserve Capacity at a price of \$9.40 per kW-month and to provide an additional 10 MW of Regulating Reserve Capacity for the period May 1, 2008 through July 15, 2008 at a fixed price of \$14.00 per kW-month.⁵ Applicants state that in order to provide NorthWestern with a delivered product, Powerex will obtain firm transmission service from British Columbia Transmission Corporation and BPA at an aggregated cost of \$5.60 per kW month. Applicants state that, as such, the delivered cost of the Regulating Reserve Capacity will be \$15.00 per kW month.

⁴ In a separate filing made in Docket Nos. ER08-56-000 and ER08-66-000, NorthWestern and Avista Corporation (Avista), seek authorizations similar to those requested here.

⁵ Regulating Reserve Capacity is a component of Regulating Reserve Services (as is Regulating Reserve Energy). Under the Agreement, at section 1.30, Regulating Reserve Capacity “means the provision of capacity and energy resources that are on-line and loaded at less than the maximum output, pursuant to [North American Electric Reliability Corporation (NERC)] and [the Western Electricity Coordinating Council (WECC)] criteria and available to respond to instantaneous changes in load.” Section 1.31 defines Regulating Reserve Energy as “the energy delivered to [NorthWestern] as part of the provision of the Regulating Reserve Services by Powerex under this Agreement.”

8. Applicants state that the Agreement also requires that NorthWestern return to Powerex a quantity of energy (Balancing Energy). Applicants explain that Regulating Reserve Service must be provided using firm transmission service between the respective balancing authority areas. Due to the fact that there is not adequate firm transmission service westbound through Montana and BPA, Applicants state that the Regulating Reserve Service may only be supplied eastbound. Applicants state that as a result, NorthWestern will typically operate the system and thus supply the Regulating Reserve Services its customers require around a “set point” of approximately half of the total Regulating Reserve Capacity. Accordingly, Applicants state that every hour Powerex will use its eastbound firm transmission service to deliver Regulating Reserve Capacity and Regulating Reserve Energy to NorthWestern, while NorthWestern will use westbound, non-firm transmission service to deliver Balancing Energy back to Powerex. Applicants anticipate that the Regulating Reserve energy and Balancing Energy will, over time, tend to net to zero and will settle at the Mid-C Index.

9. Powerex requests that the Commission grant waiver of the provisions of section 3 of its currently effective Rate Schedule No. 1 that limit Powerex’s ability to sell ancillary services at market-based rates to transmission providers purchasing such services to satisfy their OATT requirements to offer ancillary services to their customers. In the alternative, Powerex requests that the Commission accept the Agreement pursuant to FPA section 205. In addition, NorthWestern requests that the Commission accept the Agreement as part of its OATT, as Rate Schedule No. 250 (MT).

10. In support of their filing, Applicants state that it is critical for NorthWestern to obtain the Regulating Reserve Services provided for under the Agreement no later than January 1, 2008 in order to maintain system reliability.⁶ Applicants state that because NorthWestern does not own any rate-based generation resources, it must procure the

⁶ Applicants note, among other things, that the services that will be provided under the Agreement are required by NorthWestern in order to comply with the Commission-approved mandatory reliability standards set out by NERC and WECC for instantaneously balancing resources with load responsibility. Applicants assert that failure to comply with these reliability standards could adversely affect transmission customers, retail customers, NorthWestern’s balancing authority, and potentially the entire Western Interconnect.

products necessary to provide all ancillary services, and in particular, Regulating Reserve Services from third parties. Applicants add that the Agreement represents the culmination of a competitive bid RFP and arm's-length negotiations.

11. Applicants argue that under the Commission's policies and precedent, the Commission is open to authorizing requests for market-based rates by a third party supplier to a public utility that is purchasing ancillary services to satisfy its OATT requirements.⁷ Applicants further argue that in *Dynegy Power Marketing, Inc.*,⁸ the Commission granted Dynegy authorization to provide ancillary services at market-based rates under circumstances in which the transmission provider had divested its generation but retained an obligation to provide ancillary services under its OATT. Applicants assert that similar conditions are present here.

Notice of Filing and Responsive Pleadings

12. Notice of Applicants filing was published in the *Federal Register*⁹ with interventions and protests due on or before November 8, 2007. Motions to intervene were timely filed by BPA, Montgomery Great Falls Energy Partners LP (Montgomery Great Falls), the Montana Large Customer Group (LCG),¹⁰ and Central Montana Electric Power Cooperative, Inc. (Central Montana). Protests were filed by BPA, LCG, and Central Montana.

13. BPA and LCG, in their protests, acknowledge that NorthWestern must continue to provide Regulating Reserve Services to its OATT customers and that, as such, the Commission should not suspend the effective date of the Agreement beyond a nominal

⁷ Transmittal sheet at 9 (*citing Avista Corporation*, 87 FERC ¶ 61,223 at 61,883, n.12 (*Avista*), *order on reh'g*, 89 FERC ¶ 61,136 (1999)).

⁸ 118 FERC ¶ 61,094 at P 21 (2007) (*Dynegy*).

⁹ 72 Fed. Reg. 60,837 (2007).

¹⁰ LCG is an informal coalition of industrial energy customers comprised of: Ash Grove cement West, ConocoPhillips, Holcim (US) Inc., Montana Refining Company, REC Advanced Silicon Materials LLC, Smurfit-Stone Container Corporation, and Stillwater Mining Company.

suspension period. Nonetheless, BPA and LCG assert that Applicants' filing should be set for hearing. Central Montana also asserts that additional data is required to support Applicants' filing.

14. BPA argues that the pass-through rate that will be reflected in the NorthWestern OATT, as a result of the Agreement, will represent a 400 percent increase over the existing rate (\$0.54 per kW month versus \$0.14 per kW month). BPA argues that Applicants have failed to justify this increase. LCG asserts that the disparity between the Agreement rate and the existing cost-based rate is evidence that the relevant market is not competitive. Central Montana agrees, noting that the economics of the Agreement suggest market power.

15. BPA and LCG also argue that Applicants may not have entered into the Agreement prudently. For example, BPA asserts that it is unclear why the acceptable bids under the RFP were limited to a minimum of a year. BPA also asserts that it is unclear why, or to what extent, the Agreement represents the most cost effective alternative for obtaining Regulating Reserve Services. BPA and LCG further assert that Applicants' filing fails to substantiate NorthWestern's requirements. BPA notes, for example, that while the RFP requested bids for "up to plus or minus" 45 MWs of Regulating Reserve Services, this quantity of service represents a significant increase over the contract quantity currently being provided by Idaho Power. LCG adds that there is no explanation as to why NorthWestern elected not to provide a back-stop bid based on its own generation in its balancing authority area.

16. LCG and Montana Central point out that under the Commission's policies, third party suppliers of ancillary services are generally not permitted to provide these services at market-based rates if the utility at issue is purchasing these services to "satisfy its own open access transmission tariff requirements to offer ancillary services to its own customers."¹¹ LCG and Montana Central further point out that while the Commission will consider such arrangements on a case-by-case basis, under its *Avista* policy, the exception relied upon by Applicants, as set forth in *Dynegy*, is unsupportable. LCG points out that unlike the facts in *Dynegy*, there was no real competition at play in the

¹¹ LCG protest at 4, citing *Avista*, 87 FERC ¶ 61,223 at 61,883; see also Central Montana protest at 5, n. 5, citing *Market-Base Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities*, Order No. 697, 72 Fed. Reg. 39,904 (July 20, 2007), FERC Stats & Regs. ¶ 31,252 at P 1,060 (2007).

RFP process and that, as such, the filing fails to document the robustness of the RFP.¹² Specifically, LCG argues that Powerex was the only bidder who proposed to sell the ancillary services during the critical summer months from May 1, 2008 through July 15, 2008. LCG notes that the other bidder, Avista, only bid to supply a sixth of the energy and capacity desired by NorthWestern for the other months.

17. Finally, LCG and Central Montana argue that, unlike the facts in *Dynegy*, the Agreement here is not an interim contract needed only to bridge the gap caused by a delay in the implementation of an independent system operator's (ISO's) ancillary services market. LCG asserts that, here, there is no ISO contemplated for Montana. Central Montana adds that unlike the interim circumstances present in *Dynegy*, there is no reason to believe that NorthWestern and Powerex will not seek to renew the Agreement year after year.

18. On November 20, 2007, Powerex and NorthWestern submitted separate answers addressing intervenors' protests. Powerex, in its answer, challenges intervenors' characterization of the RFP bid process as not sufficiently competitive. Powerex responds that in preparing its bid, it had no information about the participation or responses that would come from its competitors. Powerex asserts that in a sealed auction, such as the one conducted by NorthWestern, prospective suppliers do not know the number of other bidders, nor do they have any access to the valuation of the product by other bidders.

19. NorthWestern reiterates in its answer that if it cannot obtain the needed Regulating Reserves, it will be prevented from complying with Commission-approved mandatory reliability standards set out by NERC and WECC regarding instantaneous balancing of resources with load responsibility, potentially adversely affecting wholesale and retail customers as well as the entire Western Interconnect. NorthWestern also notes that its failure to comply with the reliability standards also could subject it to sanctions and/or civil penalties, and that if it is obligated to provide such services, it must be provided with the tools with which to provide those services.¹³

¹² See also Central Power protest at 8 (arguing that Applicants' filing fails to provide data supporting the reasonableness of the RFP and the resulting costs).

¹³ NorthWestern Answer at 4.

20. With regard to NorthWestern's decision to limit the RFP to bids of one year or more NorthWestern states that the Commission urges utilities to obtain long-term service agreements whenever possible. NorthWestern also notes that the cost for one month of service in a recent contract for regulation service was significantly more than the monthly cost under the one-year Powerex Agreement.¹⁴

21. In response to intervenors' concerns regarding the amount of contracted capacity, NorthWestern explains that it has historically required 60 MW of Regulating Reserve Capacity to follow the moment-to-moment difference between loads and resources within its balancing authority area and to provide service under Schedule 3 of its OATT. NorthWestern states that in late 2005/early 2006, NorthWestern added a large wind project to its retail supply portfolio, and NorthWestern's retail supply unit ultimately purchased 25 MW of additional Regulating Reserve Capacity from a third party to "self supply" the Regulating Reserves needed to successfully integrate the wind generation. NorthWestern states that the RFP requested bids for up to 90 MW of Regulating Reserve Capacity – the total of the traditional needs by the transmission provider (60 MW) and the estimated additional amount for wind integration to be paid for by the retail supply unit. Thus, NorthWestern asserts that the amount of Regulating Reserves it requested is easily measured and supported.¹⁵

22. In response to LCG's question regarding NorthWestern's decision not to provide a back-stop bid based on its own generation, NorthWestern notes that LCG acknowledges that NorthWestern's assets are not rate-based and that, as such, NorthWestern was not obligated to bid. In addition, NorthWestern explains that it owns a 30 percent leasehold interest in the approximately 748 MW Colstrip Generating Unit 4, amounting to about 218 MW of actual generation capacity, all of which is sold under long-term agreements that do not terminate until 2010. In addition, NorthWestern states that the facility is a coal-fired, baseload generation facility that is ill-suited to providing Regulating Reserves as output cannot be raised or lowered to follow moment-by-moment changes in load.

¹⁴ *Id.* at 17.

¹⁵ *Id.* at 8-9.

Finally, NorthWestern states that it cannot control the output of Colstrip Unit No. 4 as it does not operate the unit. Therefore, NorthWestern states this unit could not form the basis of a backstop bid.¹⁶

23. Finally, NorthWestern also notes that until recently, it has been statutorily barred from owning any rate-based electric generation facilities, but that as of October 1, 2007, Montana rolled back its electric restructuring laws and eliminated the bar to NorthWestern's constructing its own electric generation facilities. As a result, NorthWestern is exploring whether to construct or obtain electric generation capacity that could be used to provide ancillary services, and that such possibility indicates that approval of the Agreement could be part of an interim solution until such facilities could come on-line.¹⁷

Procedural Matters

24. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure,¹⁸ the timely, unopposed motions to intervene submitted by the entities noted above serve to make them parties to this proceeding.

25. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2)(2007), prohibits an answer to a protest unless otherwise ordered by the decisional authority. We will accept Powerex and NorthWestern's answers because they have provided information that assisted us in our decision-making process.

Discussion

26. For the reasons discussed below, we accept the Agreement for filing to become effective January 1, 2008, as requested,¹⁹ and grant a limited waiver to allow Powerex to supply Regulating Reserve Services to NorthWestern during the period January 1, 2008

¹⁶ *Id* at 17-19.

¹⁷ *Id.* at 4-5.

¹⁸ 18 C.F.R. § 385.214 (2007).

¹⁹ NorthWestern Corporation, Rate Schedule FERC No. 250 (MT), Original Sheet Nos. 1-21.

through December 31, 2008 in accordance with the Agreement. We disagree with the claims raised by intervenors that the higher prices NorthWestern will pay for these ancillary services are the result of the exercise of market power by Powerex. First, we note that Powerex's only generation presence in the NorthWestern balancing authority area is its purchase of the output of the 103 MW Hardin generating plant in Montana under a long-term agreement. However, that plant is coal-fired and thus, as discussed in NorthWestern's answer regarding the use of a coal plant, not capable of providing the Regulating Reserve Service needed by NorthWestern. Since Powerex has no generation within NorthWestern's balancing authority area or any directly-interconnected first-tier market to NorthWestern that is capable of providing this service, its presence as a seller in the NorthWestern balancing authority area can only be viewed as pro-competitive.

27. Second, since the prevailing transmission flows are from east to west from the NorthWestern transmission system, and there is no evidence of binding transmission constraints for flows going from the west to the east into the NorthWestern system, it is reasonable to assume that for the provision of such a small load (50 MW) there are a variety of sellers between Powerex and NorthWestern that could have provided this service. Indeed, the Commission recently determined in another proceeding that there is approximately 2,000 MW of available economic capacity in the NorthWestern balancing authority area during most periods of the year.²⁰

28. A third reason we do not believe that Powerex has market power in the provision of ancillary services in the Northwestern market is because it does not own any generation assets in the United States, and it only controls through contract a very small market share (around 5 percent) of the uncommitted generation in the Northwestern control area.²¹ Finally, we note that there is no evidence on the record that Powerex attempted to withhold these services from the market, it is not the transmission provider in the NorthWestern balancing authority area, and there is no evidence of barriers to

²⁰ See, e.g., *PPL Montana, LLC*, 120 FERC ¶ 61,096 (2007) at n. 36.

²¹ See Powerex's Updated Market Power Analysis filing in ER01-48-007 at 6, and Attachment A at 7, showing that Powerex purchases the output of the 103 MW Hardin generating plant in Montana. This 103 MW presence would only give Powerex control over about 5 percent of the 2,000 MW of uncommitted generation in the NorthWestern market.

entry. Rather, Powerex has entered into an arms-length commitment to provide these ancillary services to NorthWestern. Thus, based on these facts we find no basis to conclude that Powerex can exert market power over prices charged in this market.

29. We also find that NorthWestern has adequately addressed intervenors' arguments. Specifically, we find that NorthWestern has supported the term and level of services contained in the Agreement and explained why it did not elect to provide a back-stop bid based on its ownership interest in Colstrip Unit No. 4. In addition, NorthWestern has provided evidence that its circumstances are temporary because it now may build or otherwise acquire generation that may alleviate its need to purchase ancillary services from third parties.²² Therefore, we accept the Agreement for filing and grant Powerex's request for waiver of section 3 of its Rate Schedule No. 1 for the term of the Agreement(January 1, 2008 through December 31, 2008).

The Commission orders:

(A) The Agreement is hereby accepted for filing, to become effective January 1, 2008, and to be made a part of NorthWestern's OATT, as Rate Schedule No. 250 (MT), as discussed in the body of this order.

(B) Limited waiver of section 3 of Powerex's Rate Schedule No. 1 is hereby granted, as discussed in the body of this order, effective January 1, 2008 through December 31, 2008.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.

²² See also *Preventing Undue Discrimination and Preference in Transmission Service*, Order No. 890, 72 Fed. Reg. 12,266 (Mar. 15, 2007), FERC Stats. & Regs. ¶ 31,241 at P 888 and P 893 (2007) (noting that it may be technically feasible for customers to self supply Regulating Reserve Services through demand side resources).