BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application of	)	
PacifiCorp for an Increase in its Rates	)	Docket No. 01-035-01
And Charges	)	

DIRECT TESTIMONY AND EXHIBITS OF
JAMES F. (RICK) GILLIAM

ON BEHALF OF THE
LAND AND WATER FUND OF THE ROCKIES

JULY 15, 2001

I. Introduction and Summary

Q. Please state your name and business address.

A. My name is James F. (Rick) Gilliam. My business address is 2260 Baseline Road, Suite 200, Boulder, Colorado 80302.

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

A. I am Co-Director of the Energy Project at the Land and Water Fund of the Rockies ("LAW Fund"). My responsibilities include the review and analysis of existing and the development of new statutes, regulations, policies, practices, and procedures that may affect the development and promotion of electric resources less harmful to the environment than traditional utility resources.

Q. Please describe your experience in utility regulatory matters.

A. My experience with utility regulatory matters ranges from the perspective of regulator (six years at the Federal Energy Regulatory Commission) to the regulated investor-owned utility (twelve years at Public Service Company of Colorado, now Xcel Energy), and for the last nearly seven years with a regional non-profit environmental law and policy center. All told, I have been involved in electric utility regulatory matters for well over twenty years. A summary of my background and experience is attached as Appendix A.

Q. Have you previously testified before the Utah Public Service Commission ("Commission")?

A. Yes, I testified on behalf of the LAW Fund in PacifiCorp's ("Company") last rate case in Docket No. 99-035-010.

Q. Before what other utility regulatory commissions have you testified?

A. I have testified in proceedings before the Colorado Public Utilities Commission, the Arizona Corporation Commission, the Wyoming Public Service Commission and the Federal Energy Regulatory Commission. I have also submitted testimony in proceedings before the New Mexico Public Service Commission and the Nevada Public Service Commission; however, these matters were resolved by settlement prior to hearing.

Q. On whose behalf are you testifying in this proceeding?

A. I am representing the LAW Fund. The LAW Fund is a non-profit environmental law and policy center that works with key stakeholders in the electric utility industry to promote clean energy technologies -- such as energy efficiency and renewable resources -- through interventions in regulatory and other proceedings, and collaborative efforts. In addition, the LAW Fund works to promote policies, practices, and mechanisms that contribute to improvements in air quality. We operate in six western states including Utah, Arizona, Colorado, New Mexico, Nevada and Wyoming.

The LAW Fund has a Utah office and Utah members. In addition, two members of our board of directors are from Utah. The LAW Fund has been actively involved in proceedings before the Utah Public Service Commission for over six years, primarily working on energy efficiency, resource planning and financial incentive issues. In the past, the LAW Fund has represented other public interest groups with a combined total of over 10,000 members in the state. Recently, the LAW Fund also participated on the Commission's Energy Efficiency Advisory Group, established in Docket No. 99-035-010.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to discuss and make recommendations to this Commission regarding a mechanism for the recovery of the Company's expenditures for demand-side resource ("DSR") programs.

Q. Please summarize your conclusions.

A. I recommend that a tariff rider be adopted as the cost recovery vehicle for the Company's expenditures on DSR programs. A tariff rider would help eliminate the regulatory disincentives the Company current faces in investing in DSR and is therefore preferable to other cost recovery mechanisms, such as direct expensing of DSR expenditures and deferred accounting.

Q. Do you have a recommendation as to the initial cost level to be recovered through a tariff rider?

A. Yes. The level of funding in the tariff rider should reflect those DSR expenditures currently in rates along with at least the increased funding levels recommended by Utah Energy Office ("UEO") witness David Nichols.

II. Discussion of DSR Cost Recovery Mechanisms

Q: How does the Company currently recover its DSR expenditures?

A: Currently, the Company treats DSR program expenditures as current period expenses on its books. As such, the Company only recovers the costs of DSR programs up to the level of costs recognized during the last rate proceeding. In addition, DSR expenditures are only reflected in future revenue requirements if they are recorded during a rate case test year.

Q. Does the Company's current method of expensing DSR expenditures create any disincentives to the pursuit of cost-effective DSR?

A. Yes. This current expensing method creates regulatory disincentives for the Company to invest in cost-effective DSR. Traditional recovery of utility expenses through base rates fixes cost levels at a test year level - sometimes with pro forma adjustments. Once the cost level is established and approved by the Commission, the incentive for the utility is to minimize expenditures between rate cases. With other types of expenditures, this method helps to safeguard ratepayers. However, in the case of expenditures for utility programs such as DSR that can reduce overall costs, this incentive can work to the detriment of the utility's ratepayers.

Q. Can you provide an example of how this may happen?

A. Yes. The present case provides a good example of this disincentive. UEO witness David Nichols has proposed additional cost-effective DSR programs in the Company's service territory whose program costs are in excess of the levels of DSR program expenditures reflected in the test year. Nichols explains that the recommended programs, if implemented, are estimated to provide net benefits to all of the Company's ratepayers through reduced electricity supply costs.[1] Thus, in this case, ratepayers would be better off if the Company incurred the costs of the DSR programs that Nichols has proposed. While this is a desirable outcome, the current cost recovery method only allows for recovery of costs up to the very small amount included in base rates, thus discouraging increased DSR investment.

Q. Why doesn't the Company have the proper incentive under the current method of DSR recovery if the electricity supply cost reductions resulting from the DSR program exceed its expenditure level?

A. Typically, DSR programs involve an initial cost to the utility over a limited period of time, and the demand and energy savings resulting from the program continue for many years. Thus, it would be quite unusual for a DSR program to be so effective in reducing electricity use that the utility experienced greater electricity

[1] See Direct Testimony of David Nichols in the first phase of this proceeding, pages 5 and 6.

supply cost savings in the same period in which the DSR expenditures were made. If indeed this were the case, then the utility is simply presented two cost options and should choose the lower.

In the more probable situation of the electricity supply cost savings being spread over a longer period of time, utilities tend to become reluctant to make the investment without assured cost recovery.

Q. How do you propose to overcome this current disincentive to the pursuit of cost-effective DSR?

A. I recommend that the Commission establish a separate tariff rider cost recovery mechanism specifically for DSR expenditures. A tariff rider would help eliminate the regulatory disincentives to investing in DSR and provide a closer matching of revenues and expenses than the current expensing method. Unlike the current expensing method, the Company only recovers its costs from the tariff rider account if it actually incurs those costs on Commission-approved DSR programs. If the Company does not implement a Commission-approved DSR program and therefore does not incur program costs, its revenues are reduced accordingly. As a result, the incentive for the company to minimize costs by cutting back on DSR programs is reduced.

Q. Please explain how a tariff rider would operate.

A. A tariff rider is essentially a rate mechanism that separates out, separately tracks, and recovers the revenue requirement associated with DSR programs. In addition, the associated savings in purchased power costs from the DSR programs could be credited back to the tariff rider account to offset program costs.

Q. How would the amount to be recovered through the tariff rider be established?

A. The level of the tariff rider could be established in one of two ways. In this proceeding, UEO witness Nichols has proposed a specific set of DSR programs and an estimate of program implementation costs. If the Commission authorizes these programs, the revenue requirement could be set equal to DSR expenditures currently in rates plus the costs for these additional DSR programs. The tariff rider account would be trued up on a periodic basis, typically once a year, with any positive or negative balances carrying over to the following year.

Alternatively, an estimate can be made of DSR expenditures and savings over a multi-year period, reduced to a percentage of utility revenues. This method would tend to smooth the stair-step of program by program implementation, and reduce administrative costs associated with tariff rider revisions. Annual reviews would be informational, with true-up occurring at the end of the multi-year period.

Q. What method do you recommend?

A. I propose that the tariff rider be established based upon the DSR programs recommended by UEO witness Nichols, as approved by this Commission, and reviewed and trued-up annually.

Q. Would DSR programs be subject to prudence review if a tariff rider is used?

A. Yes, DSR programs would still be subject to prudence review. At the time DSR programs are proposed, the Commission would evaluate the program design and funding levels. This initial step is analogous to acquiring a certificate of need to build a power plant. The Commission approves the need and desirability of the project, thus insulating the Company from any further prudence challenges to these elements. As in the case of a power plant (or any other expense, for that matter), implementation of the approved course of action is still subject to after-the-fact prudence review. I anticipate that most if not all DSR programs will include a review and evaluation process.

Q. What other funding mechanisms did you consider for the Company's DSR expenditures?

A. I also considered deferred accounting.

Q. Please explain deferred accounting and why you recommend a tariff rider instead.

A. Deferred accounting allows the Company to accrue expenditures incurred during a non-test year in a deferral account until the next rate case. If deemed prudent during the next rate case, the expenditures plus interest are then amortized over a specified period of time and collected through general rates. Some jurisdictions use deferred accounting for specific expense items such as fuel and purchased power costs. Another common use of deferred accounting is for major projects such as new power plants. The capital asset costs and associated capital overhead costs (sometimes called AFUDC - allowance for funds used during construction) are accrued in a deferred account to be recovered at the time the new plant goes into service.

Q. Does deferred accounting resolve the regulatory disincentive you described above?

A. No. Deferred accounting only partly remedies the incentive for the Company to minimize DSR expenditures. With deferred accounting, the Company at least has the opportunity in a future proceeding to recover current DSR expenditures in excess of those currently authorized in rates, and it is therefore preferable to the current expensing method. However, absent regulatory assurance up-front that it will be allowed to recover the costs of implementing DSR programs, the Company may be reluctant to incur those costs due to the risk that those costs may subsequently be disallowed.

Q. Why might that occur?

A. Consider, for example, a scenario in which the Company introduces new DSR programs each year for the next four years. Each program has a one year life and annual expenditures are an estimated $30 million. Further, let's assume that the next rate case is in three years. Deferred accounting would provide that no current DSR cost recovery takes place. Thus, at the time of the next rate case, the Company is now faced with recovering $90 million of accrued DSR expenditures, plus accrued interest, in addition to increasing base rates by $30 million to account for the higher annual spending level. While the individual DSR expenditures are cost-effective and justifiable, the sheer magnitude that can result from saving up these costs for future recovery is likely to subject them to intense scrutiny and possibly inappropriate political pressure.

Q. You mentioned that deferred accounting is typically used for major projects such as new power plants. If supply-side resources and DSR are to be treated comparably, should the same funding mechanism be used for both?

A. No, in order for supply-side resources and DSR to be treated comparably, a funding mechanism should be established that is appropriate to the type of resource being acquired. DSR is different from supply-side resources in two important respects, which justify different accounting treatments.

First, supply side resources tend to take several years from Commission approval to the point of providing service to customers. For these assets, deferred accounting is appropriate under the logic that costs should not be included in rates prior to the time that the plant is actually producing electricity. Conversely, DSR tends to be acquired in much smaller increments and, if it is to be effective, at reasonably stable funding levels from year-to-year. In many cases, the savings resulting from the DSR investment occur almost immediately upon implementation. Thus the expenditure and the desired result are closely tied temporally. A tariff rider is therefore appropriate because it tracks the incremental nature of DSR acquisition and promotes funding stability, more closely matching revenue with cost incurrence.

Second, supply-side resources are backed up by physical assets or contract rights that have a market value independent of Commission approval. In contrast, the Company can recoup its DSR expenditures only if the Commission specifically authorizes recovery. To the extent that DSR programs are approved by the Commission, but recovery of the program costs is dependent on future Commission action, the costs will be deemed “regulatory assets” and carried on the Company's balance sheet with a corresponding liability. This is generally not looked upon favorably by the financial community.

Under deferred accounting, the Company faces a disincentive to invest in DSR because it may be reluctant to carry regulatory assets on its books for extended periods of time, with the attendant risk of less than full recovery at the time of the next rate case. The tariff rider’s current recovery of these costs obviates this problem.

Q. How does a tariff rider promote stability of funding for DSR and why is it important?

A. A tariff rider promotes stability of funding by seeking Commission authorization up-front for DSR expenditures over a period of several years. For example, UEO witness Nichols has requested Commission approval of expenditures for his proposed DSR programs beginning in 2001 through 2006. The current approach to resource planning through production modeling tends to lead to swings in the modeled need for DSR. Because the vendors that supply and install DSR are generally small, such swings can lead to a gyrating market that is very difficult for small companies to balance over time. This tends to drive small firms from fluctuating markets to those where opportunity for steady growth is available. Moreover, it tends to drive up the costs of DSR programs. While national energy service companies can step in, if necessary, to fill the void, the State of Utah would miss out on the opportunity to establish a locally owned and operated energy services industry.

Q. Does a tariff rider have any other benefits over deferred accounting?

A. Yes, a tariff rider more readily permits the self-direction of DSR funds by large customers, should the Commission decide to authorize such a program. It is not my intention to recommend a self-directed program, but rather to explain how such a program may be implemented using a tariff rider. Under a self-directed program, certain large customers would have the option of spending money on DSR at their own facilities in lieu of paying some or all of their share of the costs for the Company's DSR programs. A tariff rider would readily permit the tracking of self-directed expenditures and authorizing credits for those expenditures. While it may be possible to implement a self-directed program using deferred accounting, it would be administratively burdensome.

Q. Are you aware of any other jurisdictions that utilize a tariff rider for the recovery of DSR costs?

A. Yes. The Colorado Public Utilities Commission approved a Demand-side Management Cost Adjustment Clause (DSMCA) in November 1990. While some of the factors have changed over the years, most notably the financial incentive mechanism, the DSMCA remains in effect today as the means for Xcel Energy to recover its demand side expenditures from customers in its Colorado jurisdiction.

Q: What do you recommend the Commission do in this proceeding?

A. I recommend the Commission require the Company to file a tariff rider with this Commission that would recover DSR expenditures, reflect purchased power reductions as a cost offset, and provide for an annual review and true-up of revenue and costs.

Q. Does that conclude your testimony?

A. Yes, it does.

Appendix A

James F. (Rick) Gilliam
Senior Technical Advisor
Land and Water Fund of the Rockies

Professional Employment

Dec 1994 to Present:	Co-Director and Senior Technical Advisor, Land and Water Fund of the Rockies Energy Project, Boulder, Colorado. Develop new business models to expand the use of renewable resources and energy efficiency technologies. Advocate for effective, workable state-based clean energy public policies through state and federal regulatory proceedings, regional air quality bodies, municipal agencies, and other electric energy stakeholder and interest groups. In addition, promote air quality related values, such as emission control of fossil fuel fired plants. (see www.lawfund.org)
Jan 1983 to Dec 1994	Director of Revenue Requirements, Public Service Company of Colorado, Denver, Colorado. Primary responsibility for development of formal rate-related filings for this investor-owned utility for three utility services with two state and one federal regulatory body. As part of this work, developed and responded to a variety of proposed mechanisms to encourage the use of energy efficiency technologies.
Dec 1976 to Dec 1982	Technical Witness (Engineer), Federal Energy Regulatory Commission, Washington, D.C. Testified as expert witness on behalf of the FERC in wholesale rate filings on technical, accounting, and economic issues.

Education

August 1998	Masters, Environmental Policy and Management University of Denver Denver, Colorado
December 1975	Bachelor of Science, Electrical Engineering Rensselaer Polytechnic Institute Troy, New York

Relevant Publications

(contributor), “How the West Can Win: A Blueprint for a Clean & Affordable Energy Future,” 1996.

Blank, Gilliam, and Wellinghof, “Breaking Up Is Not So Hard To Do: A Disaggregation Proposal,” The Electricity Journal, May 1996.

James F. (Rick) Gilliam
Summary of Testimonies

Representing the Land and Water Fund of the Rockies

- Public Service Company of Colorado Docket No.00A-008E: DSM & Wind Resources in the Integrated Resource Plan
- PacifiCorp Rate Case (Utah) Docket No. 99-035-10: System Benefit Charge Proposal
- Arizona Restructuring Rulemaking Docket No. 99-205: Renewable Portfolio Standard
- Public Service Company of Colorado Docket No. 98A-511E: Air Quality Improvement Rider
- Arizona Restructuring Rulemaking Docket No. 94-165: Stranded Cost Proceeding
- Nevada Power Company Docket No. 94-7001 (Refiled): Integrated Resource Plan Proceeding
- Southwestern Public Service (New Mexico) Case No. 2678: Merger Proceeding
- Public Service Company of Colorado Docket No. 95A-531EG: Merger Proceeding

Representing Public Service Company of Colorado

- PSCo Rate Revenue Requirements Proceeding Docket No. 93S-001EG
- PSCo Demand-side Management & Decoupling Proceeding Docket No. 91A-480EG
- PSCo Incentive Regulation Investigation Docket No. 93I-199EG
- PSCo Rate Proceeding Docket No. 91S-091EG
- PSCo Fort St. Vrain Supplemental Settlement Agreement Docket No. 91A-281E
- Various PSCo FERC rate proceedings, and subsidiary rate proceedings

Representing the Staff of the Federal Energy Regulatory Commission

- Connecticut Light & Power Company, Docket ER 82-301
- Kentucky Utilities Company, Docket ER 81-341
- Philadelphia Electric Company, Docket ER 80-557, et al.
- Minnesota Power & Light Company, Docket ER 80-5
- Boston Edison Company, Docket ER 79-216, et al.
- Connecticut Light & Power Company, Docket ER 78-517
- South Carolina Electric & Gas Company, Docket ER 78-283
- Minnesota Power & Light Company, Docket ER 78-245
- New England Power Company, Docket ER 78-78
- New England Power Company, Docket ER 77-97