BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application of	)	Docket No. 01-035-01
PacifiCorp for Approval of its Proposed	)	Revenue Requirement
Electric Rate Schedules and Electric	)	Rebuttal Testimony of
Service Regulations	)	George Sterzinger for the
	)	Committee of Consumer Services

16 July, 2001

Q. ARE YOU THE SAME GEORGE STERZINGER WHO TESTIFIED PREVIOUSLY IN THE COST-OF-SERVICE PORTION OF THIS CASE?
A. Yes, I am.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY IN THE REVENUE REQUIREMENT PORTION OF THIS CASE?
A. My Rebuttal Testimony addresses the recommendations of the Utah Energy Office (UEO) relating to Demand Side Management (DSM). Specifically, I respond to the recommendations of UEO witness Dr. David Nichols.

Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS.
A. My recommendations are that the Public Service Commission (Commission) withhold approval of the $35 million DSM package proposed by the UEO until: (1) the DSM measures are fully analyzed in PacifiCorp's (Company) RAMPP IRP process; and (2) a more suitable DSM cost recovery method is developed. In particular, I recommend that the Commission not approve the "sharing mechanism" proposed by UEO witness Dr. Nichols.

I have not reviewed and my recommendations do not cover the identification of specific, cost-effective DSM measures. However, I do recommend that the Company work collaboratively with other parties through the RAMPP process to develop energy conservation programs tailored to the new wholesale power realities in the West. DSM programs should be pursued for all the reasons mentioned in my prior cost-of-service testimony. In this time of price volatility, these programs may provide some protection to ratepayers. Despite the importance attached to energy conservation, it is essential that the Commission assure DSM measures are cost-effective when compared to supply-side resources. Long-run acceptance of DSM by all ratepayers requires that these investments be rigorously examined in an IRP process. The approach proposed by the UEO--particularly in view of its flawed cost recovery mechanism--fails to meet these conditions.

Q. WOULD YOU PLEASE EXPLAIN THE INCENTIVE ANALYSIS RELATED TO DSM INVESTMENTS DEVELOPED BY DR. NICHOLS?

A. In his testimony Dr. Nichols indicates that DSM programs require special cost recovery mechanisms. In order to justify these special mechanisms he explains why, in his view, they are necessary. He states: "Utilities usually treat DSM expenditures as operating expenses. Once rates are set, every reduction in operating expenses is a contribution to the utility's bottom line. This is an incentive for operating efficiency. In the special case of DSM, however, one wants the utility to expend the agreed monies, for only if the monies are spent will efficiency gains be realized. A DSM cost recovery mechanism removes the utility's incentive to spend as little as possible on DSM, because with such a mechanism unspent monies are returned to the ratepayers." (Nichols Testimony, pg.3)

Q. DO YOU AGREE THAT DSM PROGRAM COSTS SHOULD BE TREATED AS AN "EXPENDITURE"?

A. I do not, but even if it is conceded that the program costs are “expenditures” I do not agree with Dr. Nichols’ analysis of the incentives facing a utility like PacifiCorp. Dr. Nichols argues that because the DSM programs are important they require special cost recovery consideration. A utility’s decision to forgo expenditures on DSM programs in order to improve profits concerns Dr. Nichols. However, the full array of activities covered by expenditures approved as part of a utility’s cost of service are important and are periodically reviewed by utility commissions to ensure that the power delivered is safe, reliable and at a reasonable cost. For example, an amount of O&M expenditure is usually approved for line maintenance. It is true that efficiency improvements could drive down these costs and contribute to profits. But it is also true that withholding a reasonable amount of expenditures on these items could also improve profits. It is critical to the reliability and safety of service that line maintenance monies be expended on a prudent basis. Line maintenance can perhaps be done more efficiently but it cannot be ignored in order to improve the “bottom line” of the utility. Similarly, if DSM is demonstrated to be the most cost-effective and reliable resource to meet increasing retail loads, then a utility would possibly face cost disallowances if it elected to avoid those investments to improve its bottom line.

Q. BASED ON YOUR ANALYSIS OF INCENTIVES THUS FAR, WHAT RECOMMENDATION DO YOU MAKE?

A. DSM programs must be developed in a reasonable and cost-effective manner. Utilities have a positive commitment to provide least cost, safe, reliable power. In addition, the Commission has the authority to review program activities to determine after the fact how the utility has performed these functions. These are exactly the same set of incentives utilities face and commissions enforce that have governed all activities covered by cost of service. DSM programs do not require, and more importantly will not benefit from, the “special cost recovery mechanisms” recommended by Dr. Nichols.

Q. IF DSM COSTS ARE NOT TREATED AS EXPENDITURES HOW SHOULD THEY BE TREATED?

A. The recovery of the costs associated with DSM programs should coincide with the delivery of the expected benefits from the programs. Most DSM costs should be treated as an investment and the capital cost of the programs should be recovered over a period of time consistent with the delivery of benefits. Moreover, this approach to cost recovery is entirely consistent with the Commission’s policy of striving to roughly match the recovery of costs with delivered benefits to ratepayers.

Q. IF DSM COSTS ARE TREATED AS INVESTMENTS, DOES THAT CHANGE YOUR RECOMMENDATION?

A. No. Utilities routinely make investments in everything from distribution transformers to generation plant between rate cases without the need for any special cost recovery mechanism. DSM program investments are similar to these other investments and therefore do not require any special cost recovery mechanism.

Q. YOU EARLIER STATED THAT DSM PROGRAMS WILL NOT BENEFIT FROM SPECIAL COST RECOVERY MECHANISMS. PLEASE EXPLAIN WHAT YOU MEAN BY THAT STATEMENT.

A. In his testimony Dr. Nichols asserts that: "In the special case of DSM, however, one wants the utility to expend the agreed monies, for only if the monies are spent will efficiency gains be realised." (Nichols Testimony, pg. 3) This gets to the heart of the reason I think DSM will not benefit from the special cost recovery proposed. A mechanism that allows cost recovery for simply spending funds, with no requirement that the DSM measures meet cost-effective tests, penetration levels, etc., will produce programs that only spend funds. The UEO's proposed "up-front" cost recovery limits regulatory oversight and ultimately works against well-designed and executed programs in the short run and may threaten the long-term acceptance of DSM programs.

Q. WHAT MECHANISM FOR COST RECOVERY DO YOU RECOMMEND?

A. If the DSM package proposed by the UEO is adopted by the Commission, I recommend the costs be treated as investments and that PacifiCorp be afforded an opportunity for cost recovery once these DSM programs are approved as used and useful.

Q. PLEASE SUMMARIZE THE SHARING MECHANISM PROPOSED BY DR. NICHOLS.

A. Dr. Nichols proposes to "share" power cost savings between ratepayers and utilities by allowing the utility to recover so-called "lost revenues" and to give 50% of the remaining "savings" to ratepayers by reducing his proposed DSM recovery mechanism. He states: "The basic concept, as presented in my previous testimony, is that purchased power market savings, net of utility lost revenues, are credited to the DSM charge account. There are three basic steps to implementing this concept. First, the Company must track the estimated energy savings from its DSM programs. Next, the Company must estimate what it would have paid to procure the extra electricity it would have needed absent those DSM savings. Finally, the Company may calculate the sales revenues it lost due to DSM savings." (Nichols Testimony, pg. 9).

Q. PLEASE SUMMARIZE YOUR OBJECTIONS TO THIS PROPOSAL.

A. There are two major flaws in this proposal. First, avoiding an expenditure by not purchasing power does not provide the utility with additional revenue. It simply avoids a cost. The only way the utility can secure additional revenue to "share" with ratepayers is to add to expense the cost of the avoided purchased power. Adding to costs in one area in order to provide a "benefit" in another does not leave ratepayers any better off. Second, Dr. Nichols proposes to give the utility the so-called "lost revenues" which inflates the cost of the program and ultimately hinders the acceptance of DSM programs by all ratepayers.

Q. WOULD YOU DISCUSS THESE OBJECTIONS IN TERMS OF THE EXAMPLE PROVIDED BY DR. NICHOLS?

A. In his example, purchased power savings due to the kWh reduction from the DSM programs are $11 million for the year. He allows the utility to recover $4.2 million in lost revenues, which is equal to $.07 per kWh saved. The remaining “net savings” of $6.8 million is used to reduce the DSM cost recovery of $10 million. It should be obvious that there are no actual purchased power savings to net against the $10 million unless the revenue is collected in some manner from ratepayers. Dr. Nichols’ testimony contains no specific proposal for collecting these revenues. In any event, the fundamental objection remains: the net benefit Dr. Nichols would share is not a real benefit. On balance, ratepayers would not see a reduction in their total bill of the magnitude suggested by Dr. Nichols.

In addition, the $.07 per kWh in “lost revenue” granted to the Company is not in any legitimate sense lost. Dr. Nichols’ proposal fails to adequately demonstrate that the $.07 amounts to unrecovered fixed costs. He does not show that total kWh sales will fall, and he does not show that a utility’s allowed return would be threatened by DSM programs.

Q. WOULD YOU EXPLAIN WHY THE SHARING MECHANISM PROPOSED WOULD WORK AGAINST THE LONG-TERM ACCEPTANCE OF DSM PROGRAMS?

A. Long-term acceptance of DSM programs requires that they deliver savings in a cost-effective manner. Taking the example offered by Dr. Nichols to illustrate my point, allowing the recovery of “lost revenues” will, in my opinion, raise the yearly costs from $11 million to $15.2 million. That is an increase of nearly 40% in DSM program costs that will have to be paid by ratepayers with no accompanying benefit.

Q. WHAT IS YOUR RECOMMENDATION WITH RESPECT TO THE PROPOSED SHARING MECHANISM?

A. The proposed mechanism should be rejected by the Commission. It should not be used for any DSM program regardless of the other aspects of its design and implementation.

Q. DOES THIS COMPLETE YOUR TESTIMONY?

A. Yes, it does.