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BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

IN THE MATTER OF THE APPLICATION OF US MAGNESIUM LLC FOR DETERMINATION OF LONG-TERM ECONOMIC DEVELOPMENT RATES AND CONDITIONS OF INTERRUPTIBLE SERVICE	Docket No. 03-035-19
PACIFICORP, dba UTAH POWER & LIGHT CO. vs. US MAGNESIUM LLC	Docket No. 04-035-20

PREFILED REBUTTAL TESTIMONY OF LEE R. BROWN

US Magnesium LLC hereby submits the Prefiled Rebuttal Testimony of Lee R. Brown in each of Dockets 03-035-19 and 04-035-20.

DATED this 5th day of November, 2004.

Gary A. Dodge,
Attorneys for US Magnesium LLC

PREFILED REBUTTAL TESTIMONY

Of

LEE R. BROWN

On behalf of US Magnesium LLC

IN THE MATTER OF THE APPLICATION OF US MAGNESIUM LLC FOR
DETERMINATION OF LONG-TERM ECONOMIC DEVELOPMENT
RATES AND CONDITIONS OF INTERRUPTIBLE SERVICE

Docket No. 03-035-19

PACIFICORP, dba UTAH POWER & LIGHT CO. vs. US MAGNESIUM LLC

Docket No. 04-035-20

November 5, 2004

1 **Q. Please state your name and position.**

2 A. I am Lee R. Brown, Vice President of US Magnesium LLC.
3

4 **Q. What is the purpose of your rebuttal testimony?**

5 A. The Purpose of my rebuttal testimony is to respond to testimony filed by
6 PacifiCorp, the Division of Public Utilities, and the Committee of Consumer
7 Services. I believe the testimony filed by PacifiCorp, the DPU and the CCS
8 overlooks some very important facts.

9 **Q. What important facts are being overlooked by the other parties?**

10 A. The facts in chronological order are as follows:

11 ○ **1998** - The USM interruptible electric service agreement which expired less than
12 three years ago was both a special incentive and interruptible service agreement
13 which was approved by the Commission on January 12, 1998 in Docket No. 97-
14 035-08 and covered the period from January 1,1997 thru December 31, 2001. The
15 Commission order (page 1) states in part:

16 "UP&L asserts that the amended agreement provides for a contribution to
17 UP&L's fixed costs and is in the public interest. . . . [T]he division wants
18 to insure that the contract makes a contribution to fixed costs which
19 otherwise would be borne by regular tariff customers. The Division's
20 analysis concludes that the contract prices are greater than projected
21 incremental energy prices and thus make a contribution to fixed costs over
22 the term of the contract."
23

24 The Division recommended approval of the amendment. The Commission's
25 Order (page 2) also stated:

26 The Agreement submitted for approval in this docket is hereby approved
27 as being in the public interest and establishing just and reasonable rates
28 with the following conditions:

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- A. To the extent that avoided costs of UP&L are different than the avoided costs submitted in support of the Agreement, **the Commission may modify the rates, prospectively, to make a reasonable contribution to costs. . . .**

- B. **This contract is serving an interruptible load therefore revenues are not required to cover full costs, but must cover incremental costs and make a contribution to fixed costs. . . .**

Thus, while the Commission’s Order specifically authorized rate adjustments if necessary to cover costs, the electric service agreement remained in full force throughout its term and no effort was made by anyone to reopen the contract or change prices prior to the termination of the agreement on December 31, 2001. No allegation was made that the agreement did not cover incremental costs and make a reasonable contribution to fixed costs. In fact, the rates in this agreement were very similar to the rates given to Monsanto and other special contract customers during the same time frame.

- o **1999** – The Commission issued a Report and Order on March 4, 1999, in Docket No. 97-035-01, a rate case that also dealt with issues raised by various parties in light of the proposed merger of PacifiCorp and Scottish Power. The Commission specifically addressed some of the concerns raised by interruptible and special contract customers who had intervened in the case and expressed concern that Scottish Power intended to eliminate their agreements. In a section of the report entitled “Non-Tariffed Contracts” on Pages 109-112, the Commission wrote:

A study of economic incentive, or non-tariff, contract issues and

1 guidelines was initially performed by an Economic Incentive Contract
2 Task Force established by the Commission in its January 8, 1992 Order in
3 Docket No. 90-035-06, approving a stipulation of the parties. The Task
4 Force submitted a report to the Commission in December 1992, which
5 states that **“the purpose for economic incentive contracts is to increase**
6 **the contributions to utility fixed costs, thereby reducing costs to be**
7 **borne by tariff customers.”** This has been termed the tariff customer
8 benefit standard.

9

10 In the Order approving the [Magcorp] amendment , issued January
11 12,1998 in Docket No. 97-035-08, we requested that interested parties
12 recommend criteria for regulatory evaluation of future non-tariff electric
13 service contracts. Parties present these comments and recommendations in
14 the present Docket.

15
16 The Division recommends adoption of the Task Force guidelines. It
17 suggests that **incremental cost could be defined as** the most recent
18 Commission-approved avoided cost, **average variable cost**, or marginal
19 cost, and contribution to fixed costs could be defined as 10 percent of
20 revenues or a fixed sum such as \$1 million over the life of a contract. The
21 Company also recommends adoption of the Task Force guidelines, but
22 argues that definitions of incremental cost and contribution to fixed costs
23 are unnecessary....

24

25 We conclude that the task force desired by the Company and the Division,
26 which we herein establish, should reexamine the previous Task Force
27 guidelines and definitions for regulatory treatment of special incentive
28 contracts, with particular emphasis on how risk should be shared between
29 the Company and its customers....

30
31 The task force created by the Commission’s order issued its Report on

32 December 17,1999. On page one of her testimony in this case, Andrea Coon of

33 the Division refers to this report as follows: “In previous reports, Division

34 personnel have suggested that for special contracts terms no longer than five

35 years are appropriate, with five years being the longest acceptable term. The

36 Division believes that this is still a good policy to follow.” In addition to the

37 “policy” referred to by Ms. Coon, the Division report also made a number of

1 other recommendations which are equally good policy (pages 2-3):

2 2. RATEMAKING TREATMENT

3 The current rate-making treatment is appropriate under current allocation
4 methodologies, given the review conducted herein. If at some future time
5 the PSC adopts a mechanism where the costs of departing customers are
6 assigned to shareholders rather than other customers, then an alternative
7 approach such as that recommended by Mr. Sterzinger should be re-
8 evaluated.

9

10 DECISION CRITERIA

11 4. Contract prices cover all incremental capacity and energy costs,
12 including incremental cost of generation, transmission and distribution as
13 appropriate and make a contribution to fixed costs.

14

15 DEFINITIONS:

16 10. Incremental Capacity and Energy: For now, PacifiCorp will file with
17 the contact information on two ways of calculating Incremental Costs:

18 11. Make a contribution to fixed Costs: Cover at least 5% of fixed costs
19 and/or make a significant contribution to the state and local economy
20 through increased employment or tax base.

21

22 DISCUSSION

23 1. Criteria

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25 A Special economic Incentive Contract (SEIC) at a price that covers all
26 incremental cost and makes a contribution to fixed costs is better for other
27 customers than having the customer leave the system.

28

29 The second key criteria is that the SEIC must cover all incremental
30 capacity and energy costs and make a contribution to fixed costs.

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32

33 ○ **2002** - Despite the long history and clear recommendations of the taskforce on the

34 proper means for determining rates for interruptible customers, in 2002 USM

35 found itself having to defend against attempts by PacifiCorp, CCS, and the DPU

36 to set interruptible rates for USM based on a methodology used for allocating

37 costs to firm tariff customers. USM argued in that case, as it does now, that the

1 firm cost allocation methodology simply does not produce reasonable results
2 when applied to interruptible contracts. It is inconsistent with over three decades
3 of practice and it fails to produce reasonable cost allocations. Most of the parties
4 recognized the severe limitations of this approach and the Commission declined to
5 adopt it. Instead, it created yet-another task force to determine a better means for
6 setting rates for interruptible customers.

- 7
- 8 ○ **2004** – After holding meetings over a two-year period and reviewing countless
9 studies and analyses, the Division submitted its report. Most of the task force
10 participants continued to acknowledge that a cost of service approach for
11 interruptible customers may not be appropriate and may not properly capture the
12 value of interruptibility. Nevertheless, many of them continued to rely upon an
13 admittedly-flawed approach, presumably because the parties could never agree on
14 a different approach. After two years of study, the Division was left to conclude:
15 “In sum, numerous approaches for quantifying the interruptibility value provided
16 by USM have been explored, but no approach has been identified as definitive.”
17 [Memorandum from Division of Public Utilities to Public Service Commission
18 dated August 31, 2004, docket 01-035-38, page 13].

19 **Q. What lessons do you glean from these facts?**

20 A. The failure of the parties to agree on a better approach to setting interruptible rates is
21 hardly a reason to resort to a flawed analysis, even if it is simple. Rather, the parties
22 should have resorted to the time-tested approach used over the past three decades –

1 determine the average variable costs (recall that the Division conceded in 1999 that
2 “incremental” costs in this context can mean “average variable” costs), and then
3 determine a reasonable contribution to fixed costs. While my consultant has
4 attempted his best to adjust and work within the framework of the other parties, in the
5 end none of the approaches used by the other parties captures the real value of
6 interruptibility or produces reasonable results.

7 **Q. What is your reaction to the rate levels and terms of interruptibility**
8 **proposed by the other parties?**

9 A. I believe that a great injustice is being perpetrated on USM. Moreover, I believe
10 that the DPU’s position ignores its statutory objectives as specified in Utah Code
11 Section 54-4a-6:

12 In the performance of the duties, powers, and responsibilities committed to
13 it by law, the Division of Public Utilities shall act in the public interest in
14 order to provide the Public Service Commission with objective and
15 comprehensive information, evidence, and recommendations consistent
16 with the following objectives:

17

18 (4) For purposes of guiding the activities of the Division of Public
19 Utilities, the phrase “just , reasonable, and adequate’ encompasses,
20 but is not limited to the following criteria:

21

22 (c) protect the long-range interest of consumers in obtaining
23 continued quality and adequate levels of service at the
24 lowest cost consistent with the other provisions of
25 Subsection (4).

26 (d) **provide for fair apportionment of the total cost** of
27 service among customer categories and individual
28 customers and **prevent undue discrimination** in rate
29 relationships;

30 (e) **promote stability in rate levels for customers**

31
32 In this docket, the DPU has essentially rejected earlier DPU task force

1 recommendations and an evaluation approach that has been in force for several
2 decades in favor of an admittedly flawed cost of service approach. Because of the
3 recognized problems with this cost of service approach, the best the Division
4 could do is present rates ranging from \$19.89 to \$32.37. The Division's
5 testimony proposes a base rate of \$25.94 (minus a physical curtailment credit in
6 which USM is not interested, an unspecified system integrity deduction, and
7 proposed payments for operating reserves – which will come at significant cost to
8 US Mag and cannot properly be considered when comparing to current rates).

9
10 The Division's proposed increase in USM's base rate from \$21 to \$26 represents
11 an increase of nearly 24%. Coupled with the last increase, the DPU's proposal
12 would result in a rate increase to USM of over 44% in just 3 years. The net actual
13 electric cost increase to US Mag would be @about \$29.00/MWH. When USM's
14 cost of buy-through purchases is considered, USM's total cost for payments to
15 power from PacifiCorp will, if the Division's position is accepted, have increased
16 by about 60% in just three short years. I can't image that the DPU has supported
17 such dramatic rate increases for any other Utah customers. My understanding is
18 that rates for general tariff customers have increased only about 10% in this same
19 time period. The proposed rate increases cannot possibly be consistent with the
20 DPU's mandates to provide "fair apportionment of costs," to prevent "undue
21 discrimination," or to promote "stability in rate levels for customers."

22 **Q. What do you propose for US Mag's rates and terms of interruptibility?**

1 A. –I propose that the ~~base~~-rate be set at \$21/MWH for ten years, with an annual
2 escalator based on increases in PacifiCorp’s energy costs after 2005 (similar to
3 other special contracts). –Alternatively, if only a 5 year -agreement is
4 ~~allowed~~approved, it should contain no escalation factor other than that inherent in
5 ~~to~~ the market exposure of the peak shaving months. Interruptibility and other
6 terms of service should be as proposed by Mr. Swenson. This rate will result in
7 additional cost to US Mag and additional benefit to PacifiCorp of about US Mag
8 ~~should provide 100 hours of operating reserves to PacifiCorp, as suggested by the~~
9 ~~parties, with a value set at \$3/MWH~~ for reserves that will be provided. This type
10 ~~of agreement will result in a gross price to US Mag of @ \$27.00/MWH and a net~~
11 ~~price of \$24.00/MWh. This is an increase of over 33% in 36 months and beyond~~
12 ~~the burden shared by any other rate payer class. It is more than just, reasonable,~~
13 ~~and certainly in the public interest.~~

14 **Q. Do you have any concluding comments?**

15 A. Despite two years of study, the taskforce has yet to determine the best means of
16 determining values for interruptible products. USM believes that the Commission
17 should continue to use the tried and true methodology of the past - average
18 variable cost coverage plus a reasonable contribution to fixed costs. My proposal
19 will yield a yearly contribution to fixed costs of about nearly \$86 million – which
20 is clearly reasonable. USM has already taken and accepted more than its fair
21 share of rate increases. It cannot reasonably be subjected to greater rate increases
22 as suggested by PacifiCorp, CCS, and DPU.

1 **Q. Does that conclude your rebuttal testimony?**

2 **A. Yes it does.**

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served by email or US Mail,

postage prepaid, this 5th day of ~~November~~October, 2004, on the following:

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