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BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application of PacifiCorp for Approval of Its Proposed Electric Service Schedules & Electric Service Regulations	DOCKET NO. 06-035-21

PREFILED SURREBUTTAL TESTIMONY OF KEVIN C. HIGGINS

[TEST PERIOD]

The UAE Intervention Group hereby submits the Prefiled Surrebuttal Testimony of Kevin C. Higgins on test period issues.

DATED this 14th day of July, 2006.

/s/ ___________________________________
Gary A. Dodge,
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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served by email this 14th day of July, 2006 to the following:

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PREFILED SURREBUTTAL TESTIMONY

Of

KEVIN C. HIGGINS

[Test Period]

On behalf of UAE Intervention Group

In the Matter of the Application of PacifiCorp for Approval of Its Proposed Electric Service Schedules & Electric Service Regulations

Docket No. 06-035-21

July 14, 2006

Introduction

Q. Please state your name and business address.

A. Kevin C. Higgins, 215 South State Street, Suite 200, Salt Lake City, Utah, 84111.

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

A. I am a Principal in the firm of Energy Strategies, LLC. Energy Strategies is a private consulting firm specializing in economic and policy analysis applicable to energy production, transportation, and consumption.

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

A. My testimony is being sponsored by the Utah Association of Energy Users Intervention Group (UAE).

Q. Are you the same Kevin C. Higgins who filed direct testimony on test period in this proceeding?

A. Yes, I am.

Q. What is the purpose of your surrebuttal testimony?

A. My surrebuttal testimony responds to certain issues raised in the rebuttal testimonies of DPU witness George R. Compton and PacifiCorp witnesses A. Richard Walje and Jeffrey K. Larsen.

Response to George R. Compton

Q. On page 6 of his rebuttal testimony, Dr. Compton expresses some puzzlement at your contention that efficiency gains are more likely to be captured by shareholders

than by ratepayers the further into the future the test period is projected. Do you wish to respond?

A. Yes. As Dr. Compton noted, in my direct testimony, I stated that I viewed the choice of test period to be relatively neutral with respect to achieving efficient management and operations *per se*. This is because once rates are set, either through a historical test period or a projected test period, a well-run utility will seek to be as efficient as possible, as all cost savings will flow to the bottom line – at least until the next general rate case.

However, I did go on to make the following statement, which was the object of Dr. Compton's rebuttal commentary:

> With a projected test period, a utility might anticipate the cost of a future activity to be a given level "x" some 12 to 20 months into the future, and build that projected cost into rates. If, during the intervening period, the utility finds a way to perform that activity more efficiently, the cost savings flow to the Company. The incentive to be efficient exists, but the benefits are not experienced in rates until they are reset pursuant to a subsequent case. For this reason, efficiency gains are more likely to be captured by shareholders than by ratepayers the further into the future the test period is projected.

In discussing this passage, Dr. Compton notes that if the efficiency improvement is not discernable until after the results of operation are revealed, say, in January of 2007, it would be too late to be reflected in rates irrespective of whether the test period was 2006 or 2007. He concludes that the choice of test year will not affect when efficiency improvements inure to the benefits of ratepayers.

I should clarify my point. In the quoted passage above, when I state that, "With a projected test period, a utility might anticipate the cost of a future activity to be a given level 'x' some 12 to 20 months into the future, and build that projected cost into rates," I am implicitly assuming that the projected cost includes cost escalation, as that is characteristic of PacifiCorp's projections in this proceeding. Consequently, the further into the future the projection goes, the greater the cost escalation. If, during the intervening period, the utility finds a way to perform that activity more efficiently, the cost savings flow to the Company, including some or all of the projected cost escalation. If a less-aggressive test period is used, the cost escalations in rates are lower in the first instance, and the benefit of the efficiency improvements inure to customers to the extent of the avoided cost escalations. This is a more precise way of making my point.

I note here that the issue of a test period's influence on the incentives to efficient utility management and operation is an issue identified by the Commission. I believe the distinction I am making – that the choice of test period is neutral with respect to efficiency incentives per se, but does affect who benefits from the efficiency gains – speaks to the Commission's concern.

Q. On page 2 of his direct testimony, Dr. Compton responds to a question that states as a premise: "Since [Mr. Higgins's] proposed test period (calendar year 2006) ends before the proposed rate increase would take effect (January 2007), would you call his proposed test period a future test period?" Do you wish to comment on the premise of this question?

A. Yes. Strictly speaking, the premise of the question is incorrect. The rate-effective period proposed by PacifiCorp in this proceeding starts in December 2006, not January 2007. In any case, the statute refers to a "future test period" as being "determined on the basis of projected data." In my direct testimony, I used the terms "future test period" and "fully-projected test period" interchangeably, consistent with my reading of the terms "future" and "projected" as used in the statute.

Response to A. Richard Walje

Q. In several places in his rebuttal testimony, Mr. Walje objects to your characterization that adoption of PacifiCorp's proposed test period would result in customers pre-paying a return on the Company's projected investment in future facilities that have not yet been completed. If the test year rate base included facilities that were scheduled to be completed, say, in August 2007, and rates went into effect December 2006, would customers in December 2006 be paying for facilities that would not be on line until August 2007?

A. Yes.

Response to Jeffrey K. Larsen

Q. On pages 6-7 of his rebuttal testimony, Mr. Larsen states that you offer a one-sided analysis of the impacts on Utah stemming from forecast errors in allocation factors. Do you wish to comment?

A. Yes. Mr. Larsen bases his criticism on the premise that if the Company over-allocates inter-jurisdictional costs to Utah, it would be due to a forecast error that overestimates Utah loads, which in turn would result in lower Utah revenues than projected. The upshot, Mr. Larsen implies, is that the consequences of the forecast error for Utah customers would be largely self-correcting: inaccurate forecasts may cause Utah to be over-allocated costs, but the same error results in an under-collection of revenues. So why worry?

I disagree with Mr. Larsen's characterization of my testimony and I disagree with the implication in his testimony that the consequences of forecast error for Utah customers would generally be self-correcting. Mr. Larsen's point has some validity if it is limited to a discussion of <u>energy</u> cost allocation. But in my direct testimony, I did *not* cite PacifiCorp's over-allocation of *energy* costs to Utah as an example of a potential problem due to forecast error. What I cited as a potential problem was over-allocation of the <u>SG</u> factor, which is a different matter. Seventy-five percent of the SG factor is determined by coincident peak demand. The consequences of over-allocating SG costs to Utah as a result of forecast error will not necessarily be offset by reduced retail sales. This is because changes in the SG factor are driven primarily by the relationship of Utah load relative to system load at the time of the monthly peaks; consequently, changes (or forecast errors) in the SG factor are not necessarily directly proportionate to changes (or forecast errors) in retail sales volumes.

In fact, in the example I cited in my direct testimony, this is precisely the case. In that example, I compared updated data for the period April 2005 through March 2006 to the forecast that PacifiCorp had made for the same period in the previous rate case. I calculated an updated SG Allocation Factor for the test period April 2005 through March 2006 of 40.1628% for Utah. I compared that result to the Company's projection of the SG Allocation Factor from the prior rate case of 41.9081%, and concluded that the prior forecast over-allocated SG costs to Utah to a significant degree. The relative magnitude of this over-allocation is 4.3 percent (i.e., 41.9081 / 40.1628).

If we examine the energy allocation factor (SE) for Utah for the same period, we find that according to the updated data it is 40.0694%[1], compared to 41.1668% that was projected in the forecast from the prior rate case. We can see that the relative magnitude of the over-allocation for energy was quite a bit smaller than the over-allocation for SG: 2.7 percent. What this tells us is that the over-allocation of SG costs to Utah as a result of forecast error was not offset by a comparable reduction in Utah energy sales.

Overstating Utah's SG factor due to forecast error remains a concern for customers, and a more aggressive future test period is more likely to get it wrong.

Q. Does this conclude your surrebuttal testimony?

A. Yes, it does.

[1] This calculation is shown in UAE Exhibit No. TP 1.3 (KCH-3), attached to my direct testimony.