BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Request of Rocky Mountain Power for Waiver of Solicitation Process and for Approval of Significant Energy Resource Decision	**))))))))))**	**DOCKET NO. 08-035-35** **Exhibit No. DPU 1.0** **Testimony and Exhibits** **Charles E. Peterson**

FOR THE DIVISION OF PUBLIC UTILITIES
DEPARTMENT OF COMMERCE
STATE OF UTAH

Testimony of

Charles E. Peterson

June 20, 2008

PUBLIC VERSION

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Attachments:

DPU Exhibit 1.1, Resume of Charles Peterson

DPU Exhibit 1.2, Report of Bodington & Company to the Division of Public Utilities, Dated May 30, 2008

I. Introduction

Q: Please state your name, business address and title.

A: My name is Charles E. Peterson; my business address is 160 East 300 South, Salt Lake City, Utah 84114; I am a Technical Consultant in the Division of Public Utilities (Division).

Q: On whose behalf are you testifying?

A: The Division.

Q: Please summarize your educational and professional experience.

A: I attended the University of Utah and earned a B.A. in mathematics in 1978 and a Master of Statistics (M.Stat.) through the Graduate School of Business in 1980. In 1990 I earned an M.S. in economics, also from the University of Utah.

Between 1980 and 1991 I worked as an economic and financial consultant and business appraiser for several local firms or local offices of national firms. My work frequently involved litigation support consulting and I have testified as an expert witness in both federal and state courts.

In 1991, I joined the Property Tax Division of the Utah State Tax Commission. In 1992, I was promoted to manager over the Centrally Assessed Utility Valuation Section. I provided expert testimony regarding valuation, economic and cost of capital issues, both in deposition and formal hearing before the Utah State Tax Commission.

I joined the Division in January 2005 as a Utility Analyst; in May 2006 I was promoted to Technical Consultant. I have worked primarily in the energy section of the Division. In 2007, I earned the Certified Rate of Return Analyst (CRRA) certificate from the Society of Utility and Regulatory Financial Analysts (SURFA).

My current resume is attached as DPU Exhibit 1.1. I most recently testified before the Commission regarding cost of capital issues in the Rocky Mountain Power and Questar Gas general rate cases, Docket Nos. 07-035-93 and 07-057-13.

Q. What is the purpose of your testimony?

A. My purpose is to present the Division's position regarding the proposed acquisition by PacifiCorp of a natural gas-fired power plant located near Chehalis, Washington.

Q. Please briefly describe the subject power plant.

A. Many of the transaction details remain confidential and under a protective order, however the Company has stated the following:

In April 2008, PacifiCorp entered into a purchase agreement to acquire 100% of the equity interests of an entity owning a 520-MW natural gas-fired facility located in Chehalis, Washington. This anticipated acquisition is not included in the above estimated capital expenditures for the year ending December 31, 2008. The acquisition is subject to regulatory approval by the FERC, the Department of Justice/Federal Trade Commission pursuant to the Hart-Scott-Rodino Act, the Federal Communications Commission, the Utah Public Service

Commission (the "UPSC") and the Washington Energy Facilities Siting Council. In April 2008, PacifiCorp filed requests with the UPSC and the OPUC seeking a waiver of state-mandated request for proposal procurement processes to purchase a generating facility. Also in April 2008, PacifiCorp filed with the FERC its application under Section 203 of the Federal Power Act.[1]

Furthermore, in a letter dated May 9, 2008 from Rocky Mountain Power's General Counsel, Mark Moench, explained that "the name of the plant (Chehalis), the name of the parent of the owner of the plant (SUEZ Energy North America), the location of the plant (Lewis County, Washington), the fuel source…(natural gas), the rated capacity…(520 MW), the approximate operational heat rate…(near 6,700 Btu/kWh), the fact that the plant is interconnected with Bonneville Power Administration transmission system and balancing authority area, and the fact that Rocky Mountain Power intends to use the flexibility of the plant in part to support its owned and purchased wind generation capacity" is now public information.

Further information is available in the confidential documents filed by PacifiCorp.

Q. Please outline your testimony.

A. The Division has hired a consultant who visited the plant along with Division personnel and provided a report to the Division regarding the fair market value of the plant along with an evaluation of the current condition of the plant. This report is introduced and briefly discussed in my testimony. There are additional topic areas that I will discuss here: (1) the question of an acquisition adjustment and whether it should be included in rate base; (2) the net present value of the Chehalis plant and the potential effects upon ratepayers given that the

[1] PacifiCorp SEC Form 10-Q, March 31, 2008, p. 24.

plant is effectively an early replacement for a plant the Company planned to build or otherwise acquire in the 2012 time frame according to its latest IRP; and (3) whether or not the Chehalis plant would have been selected had it been included in the 2012 RFP process. Each of these topics is discussed in turn.

A fourth topic concerns the deferred accounting order requested by the Company should the acquisition fall through. Shauna Benvegnu-Springer will present the Division's position on this matter in her testimony and will discuss additional accounting topics related to an acquisition adjustment.

Q: Please describe what you and the Division have done in evaluating these issues.

A. In addition to hiring a consultant mentioned above, the Division has reviewed the documents provided by the Company in its original testimony or provided through several data requests. The Division has also held in-person and telephonic conferences with various PacifiCorp/Rocky Mountain Power representatives to verify the information provided and arrive at a better understanding of the plant purchase. The Division has also performed some sensitivity analyses related to the present value of the plant to ratepayers. The Division has reviewed particularly the data requests of Merrimack Energy relating to the 2012 RFP bid issue.

Q. What conclusions and recommendations have you and the Division reached?

A. Based upon the report from our consultant, Bodington & Company, we conclude that the purchase price is at market value and fair to all parties; we also conclude that the plant is well maintained and in nearly new condition.

Since the plant is being acquired from a third party at market value, we see no reason not to include the full purchase price in rate base. The Company has made an argument that according to FERC accounting rules, the full amount of the purchase price should be booked in plant in service accounts.

With respect to the issue that the plant is not beneficial to ratepayers at the present time, in addition to evaluating information provided by the Company, the Division also performed its own sensitivity analyses. Based upon these analyses the Division has concluded that there is a reasonable probability that over the life of the Chehalis plant the Company's ratepayers will receive a net benefit over the IRP base plan.

In addition, there is the non-quantifiable benefit that the Company gains flexibility that it otherwise won't have with respect to the choice of operating the plant or purchasing power on the wholesale market, whichever makes more economic sense. In the 2007 IRP both the Division and the Committee of Consumer Services expressed concern for the Company's reliance on wholesale market purchases instead of building or acquiring its own generating capacity. The Division primarily discussed its concern with the market purchases over the

2008 to 2012 time frame, the Committee appears to be more concerned with the post 2012 market purchases. [2] The Chehalis acquisition will mitigate this criticism.

Finally, in conjunction with data requests and questions sent by the Commission's Independent Evaluator, Merrimack Energy, the Division considered the question of whether or not the Chehalis plant would likely have been chosen had it been bid into the 2012 RFP. Based upon the available information, it appears that at a minimum, the Chehalis plant would have been a strong candidate in that RFP and is likely to have been selected.

In summary, the PacifiCorp's proposed purchase of the Chehalis plant is for a fair price, the plant is in good condition, and ratepayers will likely receive a net monetary benefit from the plant over the currently contemplated alternatives. The plant would likely have been selected in the 2012 RFP process had it been a bidder. Therefore the Division recommends that the Commission approve the purchase of the Chehalis plant as being prudent and in the public interest with the full purchase price allowed in rate base in the next general rate case, or other appropriate proceeding.

II. The Bodington & Company Report

Q. Please identify and explain the use of the consultant the Division hired in the matter.

[2] Division of Public Utilities, Memorandum dated August 31, 2007 in Docket No. 07-2035-01, see pp.12-13, 19-20, 37, 39-40, and 42. The Committee of Consumer Services, Comments dated August 31, 2007 in Docket No. 07-2035-01, see pp. 18 and 20.

A. The Division hired Bodington & Company (B&C), an investment banking company specializing in electric power plant purchases and sales, located in San Francisco, California. B&C was hired to evaluate the sales price of the Chehalis plant and the condition of the facility.

Q. Please outline B&C's activities.

A. On May 7 Jeff Bodington, principal at B&C, and Robert Cosentino, B&C's engineer, visited the Chehalis plant site. Shauna Benvegnu-Springer and I were also present at the plant visit representing the Division. Messrs. Bodington and Cosentino came prepared with interview questions and quizzed the plant's senior management for about 3.5 hours. Following the interview a plant tour was made.

B&C requested numerous documents and data, which were provided. The attached confidential DPU Exhibit 1.2 is the report prepared for the Division by B&C.

Q. What general conclusions has the Division reached based upon the B&C report?

A. The Division has concluded that the sale price of the plant is a fair, market value price. The Division has also concluded that the plant itself has been well maintained and is in near-new condition.

Q. Will B&C be providing testimony in this matter or just supplying its report to the Division?

A. B&C will not be providing direct testimony other than having its report provided through the Division. However, based upon the comments of other parties in direct testimony or the Company in its rebuttal testimony, B&C may provide rebuttal or surrebuttal testimony. In any event, B&C will be available to answer questions at the hearing on this matter.

III. The Acquisition Adjustment Question

Q. What is an Acquisition Adjustment, or premium?

A. Generally an acquisition adjustment is the amount paid by a regulated company for an asset that is in excess of the seller's book value of the asset.

Q. Is there such an excess amount in this case?

A. Yes. While the exact amount cannot be quantified at this time, it will likely be in the range of [**REDACTED]** or about 3 percent of the total selling price.

Q. Does PacifiCorp intend to place the entire amount of the purchase price, including the excess or premium over the seller's book value, into its rate base in its next rate case?

A. Yes. PacifiCorp has indicated to the Division that this is the Company's intent.

Q. Does the Division support the inclusion of the excess amount over the seller's book value in rate base? If so, please explain.

A. Yes. The Division supports this for three reasons. First, the Division's consultant, B&C has determined that the purchase price is in the range of fair market value and is being purchased from an independent third party that has operated the plant as a merchant plant. As indicated in the B&C report, the plant was valued primarily based upon its use as a high-risk merchant plant with no long-term power purchase agreements, i.e. as the seller has been operating the plant. This fact appears to create a bargain situation for PacifiCorp to purchase the plant at a price that reflects a higher risk than would be applied to plant within PacifiCorp's regulated system. Second, if PacifiCorp acquired a similar plant through an RFP process, it appears likely that the cost of such a plant would equal or exceed the price being paid for the Chehalis plant. There would be likely little controversy that the cost of a plant acquired through a successful RFP process would be included in rate base. Third, the Division believes that it is in the public interest to encourage PacifiCorp to seek out situations where it can acquire assets at favorable prices. Denying recovery of the full purchase price would be a disincentive to PacifiCorp to pursue these types of deals. Therefore, the Division concludes that it is both reasonable and in the public interest to allow the full purchase price into rate base.

Q. Has PacifiCorp offered an additional rationale for including the excess over seller's book value into rate base?

A. Yes. In an answer to a Division data request the Company indicated that it believes FERC accounting rules would permit the Company to book the entire purchase amount into plant in service accounts. Division witness Shauna Benvegnu-Springer will comment further on this point.

IV. Ratepayer Net Benefits

Q. Please explain the relationship between the proposed Chehalis purchase and the Company's latest IRP.

A. In the Company's latest IRP there was no expectation that a major thermal generation plant would be acquired between 2007 and 2012. However, such plants were contemplated in the 2011 to 2014 time frame.[3] The purchase of the Chehalis plant would replace a similar natural gas CCCT 500 MW plant that was to be built or acquired in the later time frame.

Q. Does this early purchase of a 500 MW plant mitigate a criticism leveled against the Company's 2007 IRP by the Division and, to some extent, the Committee?

A. Yes. As referenced above in the Introduction, the Division in its comments on the IRP stated:

> The Company has asserted that increasing reliance on market purchases and reduction of the planning margin to 12 percent was done for "flexibility." What is meant by this "flexibility" is that the Company potentially avoids committing to and deploying too soon technologies that subsequently go out of favor for one reason or another. While the Division recognizes that this may be one kind of flexibility, the Company forecloses an operational flexibility by reducing its ability to respond in different ways to changing economic and operational situations. For example, not building today locks the Company into market purchases in the near and intermediate future and subjects it to the vagaries of the market. Reducing the planning reserve margin likewise reduces the Company's flexibility in its response to unscheduled plant outages or unforeseen high demand.[4]

[3] PacifiCorp 2007 Integrated Resource Plan, Table 1.3, p. 8. Note that almost 900 MW of generation capacity was planned for the 2012-2014 time period to be coal resources. Now it appears most likely these resources will be natural gas or some other type of resource.
[4] DPU IRP Memorandum, p. 19-20.

Similarly the Committee recommended that the Company should "Reduce reliance on short term market purchases, especially in later years of the planning horizon"[5]

Q. Does part of the Division's support for the early purchase of a large power plant stem from the Division's belief that it is in the public interest for PacifiCorp to control generation assets rather than to purchase power on the wholesale market? If so, please explain.

A. In general, yes. As implied above in the quote from the Division's comments on the Company's 2007 IRP the Company claimed that it was being "flexible" in delaying the acquisition of generating resources due to uncertainties surrounding technologies that may not be feasible (i.e. coal and perhaps even natural gas due carbon and other emissions risks) that will, hopefully, become clarified over the next five years or so. In the meantime the Company planned to meet any power shortages through "front office transactions," i.e. purchases from the wholesale power market. The Division was concerned that the Company was understating the risks of this strategy by forecasting a relatively benign wholesale power market in the Western U.S. over the next four or five years. While the Division does not know that this forecast won't, more or less, come to pass, there are reasons to believe that it might not based on indications (mentioned in the Division's IRP Comments) that the western region may be short of power by 2010, which would not bode well for abundant power at a low cost from the wholesale market. While the Division appreciates that there is uncertainty over carbon emissions, the Division also believes that real flexibility would be represented by

[5] Committee Comments, p. 20.

the Company's ability to make economic choices between running its own plants or purchasing power on the open market. The Company's 2007 IRP strategy was to limit this sort of flexibility. While the purchase of the Chehalis plant may not completely eliminate the need for front office transactions, it should enhance the Company's choices between now and the 2012-2014 time frame when it is anticipated that significant additional generation will come online. The Division believes that this enhanced flexibility is a benefit to ratepayers. The same concerns and benefits may be achievable through the use of power purchase agreements, but this is not the subject of this proceeding. There are other risks mitigated by the purchase such as construction cost inflation.

Q. Can this benefit be quantified?

A. Flexibility, as such, cannot be directly quantified. However, the analyses described below, especially the stochastic data do go in the direction of answering the question. Generally, the quantitative answer is that it is a positive benefit. In any case, the Division believes that this flexibility is a benefit that needs to be part of the considerations in determining prudence of the Chehalis purchase.

Q. The Company provided analyses in its original testimony that indicated that over the next 20 years there would be net positive benefits to ratepayers in the [REDACTED] **million range from purchasing the Chehalis plant versus continuing with the IRP plan as is. Do you have any comments about this analysis?**

A. Yes. Based upon data requests made by the Division and the Commission's Independent Evaluator, Merrimack Energy, the Company provided more detailed analyses based upon a complete IRP-style selection and risk-testing process wherein the Chehalis plant was put in competition with both 2007 IRP-selected resources and additional analyses against the bidders in the 2012 RFP. Although there were some problems with the Company's initial responses, the Company provided corrected runs with the analyses the Division and the Independent Evaluator requested. The 2007 IRP analysis assumed that the Company's preferred portfolio would remain fixed, except that a 548 MW gas plant was removed that was expected to be in place in 2011, the Chehalis plan would be available for the program to select, and front office transactions were allowed to vary. The results of this analysis showed a mean net benefit present value of about **[REDACTED]**, or about half of the estimate by the Company as set forth in Mr. Duvall's direct testimony. The stochastic risk analysis indicated that the present values of the net benefits at the extremes were **[REDACTED]** at the 5th percentile and negative **[REDACTED]** at the 95th percentile; the risk-adjusted mean net benefit was **[REDACTED]**. The relatively poor performance of the Chehalis plant in the upper tail may be overstated due to modeling assumptions. In the model the Company swapped the smaller Chehalis plant for the larger IRP CCCT (to come on line in 2011) and made up the difference with front office transactions. The increased reliance on front office transactions, in turn boosted the upper tail risk. This does not mean that with Chehalis in its portfolio, the Company will subsequently plan its portfolio development such that it has this higher upper-tail risk. In sum, this IRP-related stochastic analysis indicates that the inclusion of the Chehalis plant will likely result in positive net benefits for ratepayers.

Q. Please describe the results of the 2012 RFP-related analysis requested by Merrimack Energy.

A. The purpose of this set of analyses was to see whether or not the Chehalis plant would have been selected had it been bid into the 2012 RFP. The Chehalis plant in combination with selected bids D and J was subjected to a complete IRP stochastic analysis, which was compared with 11 different sets of actual RFP bids (also including D and J). The stochastic mean and the risk-adjusted mean of the Chehalis set were superior to the other sets. However, as in the 2007 IRP analysis discussed above, at the upper-tail levels the Chehalis set did not perform as well and was about 1.3 percent higher than the best performing set at the 95th percentile. In general it appears that Chehalis would have at least been very competitive as a 2012 RFP bidder and would likely have been selected.

Q. Which analysis does the Division have more confidence in, the analysis provided by the Company in its direct testimony, or the IRP analysis described above?

A. Although they are based upon somewhat different assumptions so that direct comparability isn’t possible, the Division is more comfortable with the full IRP analysis than the analysis in the Company’s direct testimony. The Division believes it is a more comprehensive review since it includes the stochastic risk analysis. The Division also considers the RFP-related analysis to be useful in that the Chehalis plant is put in competition with actual resources bids in an RFP and not just hypothetical resources selected in the IRP analysis.

Q. Did the Division perform any analyses of its own to test the reasonableness of the benefit calculations by the Company?

A. Yes. The Company assumed that the current cost of the IRP plant that the Chehalis plant replaces would be at least **[REDACTED]** of capacity. This compares to the Chehalis plant purchase price of about **[REDACTED]**[6] Using the response PacifiCorp provided to DPU data request 6.2, the Division determined that the net benefit would be reduced to zero if the cost of the IRP plant were reduced from **[REDACTED]**. This is below the **[REDACTED]** assumed by B&C in its cost approach analysis, and several of the prices indicated in recent sales. The Division concludes that **[REDACTED]** is an unlikely cost for a plant coming online in 2012. Similarly, the Division calculated that a levelized cost increase of **[REDACTED]** annually and a 1.9 percent growth, or about **[REDACTED]** of the total variable costs,[7] would cause the analysis performed by Mr. Duvall in his direct testimony to be a about the breakeven point. This is a further measurement of the degree that the forecast could be in error before the Chehalis plant was no longer a benefit to ratepayers.

Q. Please discuss the short-term versus long-term implications of the proposed Chehalis purchase.

A. In the short-run the Company will be able to acquire an existing and operating relatively new plant in good condition on favorable terms. As discussed above, this will allow the Company greater flexibility in meeting demand and should reduce the Company's need for front office purchases. Financially, the models indicate that for the first three or four years there will be

[6] [REDACTED]
[7] [REDACTED]

negative benefits compared to the Company's business plan primarily due to higher-than-anticipated capital costs. These negative benefits are also the result of the baseline assumptions of a relatively benign market in wholesale power. However, there are risks in this forecast regarding the nature of the wholesale market that could be mitigated by the Chehalis purchase.

Longer-term is where the clearly measurable economic benefits occur. The higher costs to construct or acquire resources expected in the future more than offset any short-term detriments. The risk longer-term is that construction costs will (unexpectedly) return to their levels of two or three years ago.

Q. Are there any other considerations that might be relevant relative to the benefit net present analysis?

A. Yes. In Mr. Duvall's direct testimony analysis the Chehalis plant becomes less of a benefit to ratepayers after 2021. This is due to relatively higher variable net power costs. The reason for these higher costs is that in these out years the Company has forecast the inclusion of "growth stations" which are hypothetical generation resources that primarily serve as "place holders" representing future growth and development. The assumptions associated with these "growth stations" are relatively crude. As it happens the hypothetical growth station costs are slightly less than the better known Chehalis costs, therefore the models dispatch the growth stations preferentially to Chehalis reducing Chehalis' capacity factor and pushing up that plant's relative costs. To the extent that the growth station costs are understated,[8] then Mr. Duvall's direct testimony analysis is conservative in that it potentially understates the net benefits of the Chehalis plant.

Q. What does the Division conclude from these net present value analyses?

A. The Division concludes that there is reasonable evidence supporting the Chehalis plant as a net positive benefit to ratepayers.

Q: You mentioned some problems with the initial responses provided by the Company to some of your data requests. Would you please explain what you meant?

A: Yes. Following up on a data request submitted by the Independent Evaluator, the Division asked the Company to compare the Chehalis plant to the bids received in the 2012 RFP. Subsequent to submitting its response, the Company discovered an error in one of the assumptions or inputs into its models used to perform the analysis.

Although the Company worked quickly to correct the analysis, the error and the subsequent delay caused some confusion and frustration among the intervenors. However, as I discussed above, the Division is satisfied that the errors have been corrected and is reasonably comfortable with the final analysis provided by the Company.

[8] The Company has indicated that taxes, specifically Washington's 3.852 percent sales tax, is included in Chehalis and no similar tax is in the growth station plant costs.

V. Compliance With UCA 59-17-302.

Q. What are the statutory requirements for approval of an asset acquisition such as the proposed purchase of the Chehalis plant?

A. Utah Code Annotated 54-17-302 (3c) lists the following items that must be considered:

(c) is in the public interest taking into consideration:
(i) whether it will most likely result in the acquisition, production, and delivery of electricity at the lowest reasonable cost to the retail customers of an affected electric utility located in this state;
(ii) long-term and short-term impacts;
(iii) risk;
(iv) reliability;
(v) financial impacts on the affected electrical utility;
(vi) other factors determined by the commission to be relevant.

Q. Please explain how each of these items have been considered.

A. With respect to (i), the analyses involving the IRP stochastic modeling indicates that the purchase of the Chehalis plant will likely result in net benefits to ratepayers over the current Company plan. Similarly, regarding (ii) and (iii), these stochastic analyses along with the analysis provided by Mr. Duvall in his direct testimony, evaluate the short- and long-term impacts and risks associated with the purchase, again demonstrating likely net positive benefits to ratepayers. The Division believes that the acquisition of this plant which appears to be well-maintained and in nearly-new condition, improves reliability (i.e. (iv) above) and risk with respect to increased flexibility of the short run and lower costs in the long-run. The financial impacts of the purchase on PacifiCorp were dealt with in the direct testimony of the Company's treasurer, Bruce Williams. The Division also believes the Company has sufficient financial backing to take on this transaction. The Division believes that all of these factors contribute to the purchase of the Chehalis plant being in the public interest.

VI. Conclusions and Recommendation

Q. Please summarize the Divisions conclusions and recommendation.

A. The Division concludes that the purchase price of the Chehalis plant is fair and in the range of market value for relatively new 500 MW natural gas power plant that has been operated as a merchant plant without long-term contracts. The plant has been well maintained and is in nearly-new condition. Purchase of the Chehalis plant now versus waiting approximately four years for a similar plant to come online per the Company's IRP likely results in net positive benefits to ratepayers. For these reasons the Division believes that the proposed purchase of the plant is reasonable and in the public interest. The Division recommends that the Commission approve PacifiCorp's purchase of the Chehalis plant as just and reasonable and in the public interest.