BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

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| In the Matter of the Application of Rocky Mountain Power for Authority to Increase its Retail Electric Service Rates in Utah and for Approval of Its Proposed Electric Service Schedules and Electric Utility Service Schedules and Electric Service Regulations | ) | Docket No. 08-035-38<br><br>DPU Exhibit No. 1.0 |

Pre-Filed Direct Testimony

of

Joni S. Zenger, Ph.D.

**TEST PERIOD**

On Behalf of the

Utah Division of Public Utilities

October 7, 2008

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## I. INTRODUCTION

**Q. Please state your name and occupation**.

A. My name is Dr. Joni S. Zenger. I am employed by the Division of Public Utilities (Division) of the Utah Department of Commerce as a Technical Consultant.

**Q. What is your business address?**

A. Heber M. Wells Office Building, 160 East 300 South, Salt Lake City, Utah, 84114.

**Q. On whose behalf are you testifying?**

A. The Division of Public Utilities.

**Q. Please describe your education and work experience.**

A. I completed my Doctorate degree in economics at the University of Utah in early 2001. Prior to that, I earned my Bachelor's degree and Master's degree, also in economics from the University of Utah. I began working for the Division in the fall of 2000. In addition, I taught various economics and statistics courses for a ten-year period from 1996 through 2006, first at the University of Utah and then at the University of Phoenix.

**Q. Have you previously submitted testimony on the issue of test year selection before the Public Service Commission (Commission) of Utah?**

A. Yes. In Rocky Mountain Power's (the Company) prior rate case, Docket No. 07-035-93, I submitted testimony on behalf of the Division regarding the appropriate test year. I also provided test year testimony in Questar Gas Company's rate case filing, Docket No. 07-057-13. Please see my attached Exhibit DPU 1.1 for a complete listing and dates.

## II. PURPOSE AND RECOMMENDATION

**Q. What is the purpose of the testimony that you are now filing?**

A. My testimony generally addresses the selection of the test period filed by the Company that is used to determine the revenue requirement for this case. In addition, my testimony specifically responds to Company witness Mr. Steven R. McDougal's testimony as it pertains to the test period selection, as well as his recommendation to include an end-of-period adjustment in calculating the revenue requirement for this case.

**Q. What is the Division's recommendation with respect to the two aforementioned purposes?**

A. For reasons that I will describe in my testimony, the Division does not oppose the Company's test period beginning July 1, 2008 and ending June 30, 2009. Second, the Division recommends that the Commission reject the Company's inclusion of an end-of-period rate base adjustment, which the Company states is used to compensate for regulatory lag.[1] Instead, the Division recommends the Commission approve a test period based on average rate base. The averaging concept produces a matching of the rate base

[1] Direct Testimony of Steve R. McDougal, p.11, lines 259-260.

investment, expenses, and revenues during the test period. The Division finds it unworkable to try to make substantial, difficult, and complex adjustments to test year revenues and expenses necessitated by end-of-year rate base in the manner proposed by the Company.

## III. BACKGROUND AND STATUTORY FRAMEWORK

**Q. Please describe the Company's Application as it pertains to the test period selection.**

A. On July 17, 2008, the Company filed an application with the Commission for an increase to its retail rates in Utah to recover additional annual revenues of approximately $160.6 million above the currently effective rates, without reference to any incorporation of revenue increases requested by the Company in the 2007 general rate case. At the time the Company filed this rate case, although hearings on the prior case had been concluded, no Commission Order had been issued. The Commission Order on revenue requirement in the prior rate case, Docket No. 07-035-93, was issued August 11, 2008, and on September 10, 2008, the Company filed certain updated information for this case.

The Company requests a total revenue requirement of approximately $1.592 billion and the approval of its proposed electric service schedules and electric service regulations to become effective March 14, 2009. The Company's request was based on a return on equity (ROE) of 10.75 percent and a forecasted test year beginning July 1, 2008 and ending June 30, 2009. The Company's forecasted test period data are based on an historic base period ending December 31, 2007.

**Q. Would you please briefly present the statutory framework with regard to the selection of the appropriate test period?**

A. Yes. Section 54-4-4(3) of the Utah Code specifies the statutory charge to the Commission regarding the test period selection:

> (a) If in the commission's determination of just and reasonable rates the commission uses a test period, the commission shall select a test period that, on the basis of the evidence, the commission finds best reflects the conditions that a public utility will encounter during the period when the rates determined by the commission will be in effect.
>
> (b) In establishing the test period determined in Subsection (3)(a), the commission may use:
>
> (i) a future test period that is determined on the basis of projected data not exceeding 20 months from the date a proposed rate increase or decrease is filed with the commission under Section 54-7-12;
>
> (ii) a test period that is determined on the basis of historic data; and adjusted for known and measurable changes; or
>
> (iii) a test period that is determined on the basis of a combination of:
>
> (A) future projections; and
>
> (B) historic data.
>
> (c ) If pursuant to this Subsection (3), the commission establishes a test period that is not determined exclusively on the basis of future projections, in determining just and reasonable rates the commission shall consider changes outside the test period that:
>
> (i) occur during a time period that is close in time to the test period;
>
> (ii) are known in nature; and
>
> (iii) are measurable in amount.

## IV. THE DIVISION'S ANALYSIS OF TEST PERIOD SELECTION

**Q. Please explain the reasons that you are not opposing the Company's proposed test period?**

A. The Division recognizes that, in order for the Company to meet future load growth and the Company's obligation to serve, it must invest in capital projects for generation, distribution, and transmission. Many capital projects have been planned for years and are identified in the Company's Integrated Resource Plan. In Mr. McDougal's testimony and accompanying exhibits, the Company outlines specific projects that are either currently underway or are expected to be in construction at some point during the July 1, 2008 to June 30, 2009 test period. In Mr. McDougal's Exhibit 8, he cites a total of approximately $1.974 billion of total plant additions that the Company will incur during this test period using the 13-month average and approximately $2.385 billion for the test period using the year-end rate base methodology.[2]

One such example is the Populus-to-Terminal Transmission line that the Commission recently approved for construction. The transmission line is one small segment a larger future transmission project, the Energy Gateway project, which will accommodate the delivery of renewable energy sources. According to the Company, the project, when completed, will provide multiple options to serve the Company's customer load growth and will also enhance the reliability of the transmission grid. In addition to the

[2] Direct Testimony of Steve R. McDougal, Exhibit 8, Plant Additions 13-month average calculation, p. 8.11.4.

significant capital projects, the Company's net power costs are also a large driver of costs in this case.[3]

The current economic factors and uncertainty in Utah, as well as in the country as a whole, are unfortunately not favorable to the Company's current build cycle and affect the ability to accurately forecast into the future. Many of the of the forecasts made and filed by the Company prior to the recent financial crisis may need to be altered as a clearer understanding of the short and long term effects the crises will have on the Company's operations. Under these circumstances, the Division believes that a 12-month forecast is a reasonable balance of these issues and concerns. Therefore, the Company's proposed test period that projects 12 months into the future (of the 20 months allowed by statute), is reasonable and should allow the Company an opportunity to recover its costs, maintain its return on equity, and serve its current and projected native load while mitigating potential forecast errors.

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**Q. You referred above to economic factors. Do economic factors affect the Company's load growth?**

A. Yes. All other things being equal, we would expect the Company's load growth to grow in direct proportion to customer and economic growth. While we presently appear to be in particularly uncertain economic times, indications are that customer and economic growth will continue in the long run. Given the relatively long lead times required in the

[3] Application, Docket No. 08-035-38, July 17, 2008, p. 5, ¶ 9.

Company's planning processes, it is reasonable that the Company be allowed to not only meet current demand but anticipate a certain amount of future demand. The relatively short 12-month forecast test period is a reasonable period for such anticipated future growth. Of course, the current uncertainty may have a dampening effect on load growth, and we could see slower growth in the near term than we have seen in the past. The Division's staff, therefore, will scrutinize the Company's forecasts to ensure they are reasonable in the face of such uncertainty.

**Q. What economic factors are you referring to in the previous response?**

There are many economic factors, but I primarily refer to those factors that the Commission identified that should be considered either directly or indirectly in making a test period determination.[4] The general inflation rate (as measured by the Consumer Price Index) is increasing, construction costs have increased at a rate faster than general inflation, other inputs to build generation and transmission plant have increased, and therefore, utilities are likely in an increasing-cost industry. The current financial crisis has surprised many investors and commentators with its speed and intensity. At the present time, it is difficult if not impossible, to predict how it will play out. This results in a great increase in uncertainty which necessarily affects any forecast based on economic and financial inputs. This argues for shorter-term forecasts and more frequent updates of those forecasts.

[4] Order Approving Test Period Stipulation, Docket No. 04-035-42, October 20, 2004.

**Q. How much of an effect have the economic factors played in the Company's need to build capital projects or to obtain financing to build plant additions?**

A. Let's begin with construction inputs. Iron and steel prices have increased by 8 percent in 2003, 10 percent in 2004, and 31 percent in 2005.[5] Other inputs to production for electric utilities include cement and concrete products. These products, as well as the composite cost index for all construction commodities, have shown similar, but smaller increases in 2005 and 2006. The Energy Information Administration's (EIA) Annual Energy Outlook 2008 states the following:

> Recent increases in the costs of basic commodities and increases in capital costs for energy equipment and facilities could have significant effects on future energy supplies and consumption. Higher capital costs could change both the competition among fuels and technologies and the marginal costs of new energy supplies. In the electric power industry, costs for individual construction projects to be completed over the next ten years have increased by 50 percent or more in recent years.[6]

The Handy-Whitman index for electric utility construction (which is used as a proxy for all electric power industry projects) provides an average cost index for six regions in the United States, beginning with 1973. The index shows the national trend for power plant construction relative to the cost index for construction materials. The sharpest increases in electric utility construction costs occurred over the past three years; the electric utility construction cost index for 2007 is 17 percent higher than its low point in 2000.

[5] Energy Information Administration Office of Energy Statistics, Annual Energy Outlook 2008 with Projections to 2030.
[6] Energy Information Administration Office of Energy Statistics, Annual Energy Outlook 2008 with Projections to 2030.

Another economic indicator is the unemployment rate, which the Utah Department of Workforce Services reports at 3.7 percent for Utah in August 2008, compared to 6.1 percent nationwide for the same time period. Utah's job growth rate is at 0.4 percent, compared to the national rate of -0.1 percent.[7] However, the Division notes that Utah lost 10,900 construction jobs during the period from June 2007 through June 2008.[8] This means that Utah is still performing better than the national levels, but employment and unemployment are affecting Utah's economic climate. This means that Utah appears to be still performing better than the national levels, but employment and unemployment are affecting Utah's economic climate. Furthermore, similar to, but perhaps more dramatic than the previous rate case, our current economic environment is volatile. In the previous general rate case, the Commission wrote: "We are uncertain how changing economic conditions will affect forecasts of revenues, expenses, and investments."[9] Therefore, the Division believes that shorter rather than longer forecast periods are appropriate. The Division can still support a 12-month forecast test period as being sufficiently short-term to deal with current uncertainties.

Recent increased economic uncertainty and financial crises may lead to reduced economic activity, or a recession. Such reduced economic activity could range from slower growth to actual declines in absolute terms. This suggests that demand for electricity may also grow more slowly or even decline. The relatively higher

[7] Department of Workforce Services, Employment and Unemployment tables.
[8] Utah Department of Workforce Services, http://jobs.utah.gov/opencms/wi.
[9] Order on Test Period, Docket No. 07-035-93, February 14, 2008, p. 3.

unemployment rates and economic uncertainty than represented in the Company's forecasts may lead to an overstatement in load growth at least over the short-run.

**Q. What other sources of economic information have you reviewed?**

A. I consulted published reports of Demographic and Economic Analysis (DEA) section of the Governor's Office of Planning and Budget to determine the trend in Utah's population growth.[10]

**Utah Population 2000 – 2007 with Three-Year Projections**

| Data Type | Year | Population | % Change |
|---|---|---|---|
| Actual | 2000 | 2,246,553 | |
| Actual | 2001 | 2,305,652 | 2.6% |
| Actual | 2002 | 2,358,330 | 2.3% |
| Actual | 2003 | 2,413,618 | 2.3% |
| Actual | 2004 | 2,469,230 | 2.3% |
| Actual | 2005 | 2,547,389 | 3.2% |
| Actual | 2006 | 2,615,129 | 2.7% |
| Actual | 2007 | 2,699,554 | 3.2% |
| Estimate | 2008 | 2,781,954 | 1.7% |
| Estimate | 2009 | 2,856,158 | 1.7% |
| Estimate | 2010 | 2,927,643 | 1.7% |

The table above shows that Utah has experienced a steady growth in population over the past ten years, but predicts that the population will increase at a decreasing rate beginning in 2008. Again, population data are important to consider in light of the test year

[10] Source: Governor's Office of Planning and Budget, 2008 Baseline Projections. http://governor.utah.gov/dea/popestimates.html.

selection because the Utah population growth determines the need for system expansion and plant additions that the Company must invest in to meet demand and energy needs. Unless there is an offsetting increase in per capita demand in electricity, declining population growth rates suggest that electric load growth rates may also decline. The Company, to this point, does not appear to have included slower population growth in its forecast. Company witness Mr. Peter Eelkema describes the forecasts of the number of customers, usage per customer, load forecast, and system peaks for the twelve-month period ending June 30, 2009.[11]

**Q. Are customers using more power or trying to conserve and cut back on usage?**

A. This question involves all types of the Company's customers: residential, commercial, industrial, irrigation, street and highway lighting, and public authority. Many residences and business are implementing energy efficiency measures. In Mr. Eelkema's Direct Testimony, he reports slowing sales growth on the residential and commercial side, but notes that requests for industrial service are increasing.[12] However, regarding peak demand, Mr. Eelkema reports that in the Company's jurisdictional serving territory, Utah has the highest growth in contribution to coincident peak both in terms of megawatts and percentage.[13]

[11] Direct Testimony of Peter Eelkema, pp. 2, 3, 5.
[12] Id. at p. 9, lines 134-147.
[13] Id. at p. 6, lines 115-116 and p. 7, Table 3.

**Q. Overall, what are the effects of these economic and demographic data on the quality of forecasts?**

A. Generally, the current economic trends and issues suggest that the near-term economic growth will be slowing, probably resulting in reduced growth in electricity demand. The increased uncertainty fed by the current financial crisis highlights the desirability of not locking oneself into long–term forecasts. Given these issues, the Division still supports a 12-month forecasted test year as a reasonable balance of the issues or concerns.

**Q. Please explain how these economic variables apply to the appropriate test period selection?**

A. Clearly the economy is struggling with weak employment, volatile market conditions, declining home and equity prices, and until recently, surging gasoline prices. However, the economic data show that the Company is in an increasing-cost industry at present. The adverse effect of inflation is described as one of the Commission's test year factors. While general inflation means that the general level of prices is higher, I have also shown that prices directly related to the Company's build cycle have increased and outpaced inflation. While these uncertainties bring into doubt the ability to make accurate forecasts too far into the future, the increasing cost to build suggests the reasonableness of a forecasted test period to a limited degree. Therefore, the balancing of these factors suggests that the Company's proposed test period selection is reasonable.

**Q. Will you please discuss the factors identified in the its 2004 Order that the Commission considers in determining an appropriate test period?[14]**

A. In the 2004 Order, the Commission identified several factors that need to be considered in selecting a test period. These are the same factors that the Commission looked at as evidence in making its test period determination in the last general rate case (Docket No. 07-035-93).[15] In this case, the Division considered each of the factors identified in the Commission's Order, which are listed below:

The general level of inflation. The Commission has determined that the adverse impact of inflation justifies the use of a future test year.[16] Inflation is measured by the Consumer Price Index (CPI), which estimates the nationwide rate of inflation for a standard selection of goods and services.[17] The CPI data show that inflation increased to 5.4 percent during the period from August 2007 to August 2008.[18] The previous year's inflation rate of 5.6 percent was the largest increase in 17 years.[19] Therefore, we are in an inflationary economy, and the Company can expect costs to increase at or greater than a general level.

At this time it is too early to determine how the recent credit fallout and economic crises will affect prices and inflation. The initial reaction of the financial markets was decidedly negative with much speculation of a severe recession. Generally an economic

[14] Order Approving Test Period Stipulation, Docket No. 04-035-042, October 20, 2004.
[15] Order on Test Period, Docket No. 07-035-93, February 14, 2008.
[16] Report and Order, Docket No. 89-057-15, 1989 Test Period Rate Case, November 21, 1990, pp. 3-4.
[17] There is no CPI data specific to Utah, so we use national CPI data for examination.
[18] http://data.bls.gov/cgi-bin/surveymost.
[19] Id.

downturn will result in reduced commodity prices and reduced inflation rates or even deflation if things get bad enough.

Inputs and goods needed to build additional electrical plant are also more costly than in the past. Elevated fuel and purchased power prices continue to drive the need for a rate increase.[20] This suggests that the Company's June 2009 test period is reasonable, but projecting any further to the future would possibly unduly shift the risks of uncertainty onto ratepayers rather than shareholders.

Changes in the utility's investment, revenues or expenses. On the one hand, as previously stated, the Company is in a construction cycle and its expenses are likely to increase due to inflation (or prices in general), and the fact that costs for inputs to production are outpacing inflation. The general price level (inflation) is beyond the Company's control. Certain major costs can be only partially managed by the Company. For example, the Company can manage fuel costs through hedges and contracts; capital projects can be managed through the timing of the projects' start date; and operating expenses such as non-critical maintenance and repairs can be controlled through delays. However, in order to provide and maintain service, the Company will eventually face these costs at their market rates at some point.

Changes in utility services. The Division is uncertain as to the Company's changes in utility services. Mr. McDougal notes the installation of automatic meter readings.[21] In

[20] Chupka, Marc W. and Basheda, Gregory, The Brattle Group, "Rising Utility Construction Costs, September, 2007.
[21] Direct Testimony of Steve R. McDougal, p.7, lines 156-158 and p. 43, lines 970-976.

the Company's September 2, 2008 press release, the Company suggested several changes to its utility services, such as: a hiring freeze, curtailment of contractors, limiting overtime, reducing property tax payments, eliminating discretionary maintenance, discontinuing funding and research for renewable energy and for clean coal technologies, and reviewing its types and levels of philanthropic contributions. [22] Therefore, the Division is uncertain at this point as to what changes in utility services will unfold. The Division, and others, have submitted several data requests in this area and will be evaluating the effect on the Company's rate request in this case.

Availability and accuracy of data to the parties. Overall, the Company has been cooperative in providing information to the Division in data responses and other queries. I do not think this factor is heavily weighted in this case. However, the Commission identified this factor in the past due to the fact that the Company always maintains control over what information it chooses to provide.

Ability to synchronize the utility's investment, revenues and expenses. In its present filings, the Company has made no attempt to synchronize its investments, expenses and revenues. While the Division's accountants work to ensure that the utility's investments and expenses are properly synchronized in a rate case filing, making the necessary adjustments given the Company's proposed end-of-period adjustment, would rather difficult and complex accounting adjustments. The Division argues, since the Company

[22] http://www.pacificorp.com/Press_Release/Press_Release84095.html. September 2, 2008.

controls the necessary information, it is the Company's burden to provide an auditable synchronized filing.

One of the critical underlying principles that governs rate proceedings is the effort to match capital, expenses, and revenues in a test period. In fact, *Accounting for Public Utilities* states that: "The selection of the timing of the test year may be the most significant single factor in the rate-making process."[23] Changes in investment, revenue and expenses do not occur in isolation and need to be properly matched or synchronized within a test year. If the components are not properly matched, then a distortion of the relationship between the various ratemaking components will occur. The authoritative book also states:

> The test period, by nature and by design, is a surrogate for conditions of the period of rate use and, to repeat, is presumed to be representative of future conditions. [24]

While the Division recognizes the difficulty that regulatory lag places on the Company, Utah procedures are designed to balance the risks to all parties, and should not be used as an excuse to allow such distortion. The Division believes that it is ultimately the Company's burden to provide such adjustments that will properly synchronize all aspects of the case, which is why the Division believes the proposed test period is acceptable, but the end-of-period adjustment may be unworkable.

[23] Hahne, Robert L, Aliff, Gregory E., and Deloitte & Touche LLP. *Accounting for Public Utilities* Volume 1, 2007, p. 7-4..
[24] Id. at p. 7-11.

Whether the utility is in a cost-increasing or cost-declining status. The utility is in a cost-increasing status, as previously described. Many of these costs are beyond the Company's control. Therefore, it is important that the Company use its forecasted test period selection as the basis for calculating the revenue requirement and, in the end, the Company's authorized rate of return. In the previous general rate case, Docket No. 07-035-93, the Division recognized the increasing costs of the utility industry and advocated for a full 20-month forecast for the test period. In this case we still believe that the Company faces a difficult build cycle, but given uncertainties in the current economic climate, we find the Company's proposed 12-month test period (excluding the end-of-period adjustment) acceptable in this case.

Incentives to efficient management and operation. Mr. Richard Walje, in his testimony, identified internal cost control efforts, such as reducing Company-paid premiums on health insurance policies, implementing a change to a cash balance pension plan for non-union employees, and achieving cost savings since the Company's acquisition by MidAmerican Energy Holdings Company (MEHC).[25] Mr. McDougal also notes that the Company has cut its share of health care expenses. During the time the Company filed the rate case and until the Commission issues its Order approving new rates, the Company has incentives for efficient management and operation as part of its internal cost control efforts. This incentive is one of the positive effects of regulatory lag.

[25] Direct Testimony of A. Richard Walje, p. 5, lines 108-109 and p. 6, lines 118-126.

Length of time the new rates are expected to be in effect. The Division gives this variable little weight in the current test year determination because there is uncertainty as to the length of time the new rates will be in effect. The current trend in the industry is to have more frequent rate cases.[26] However, the Commission noted in its February 14, 2008 Order on Test Period, that the purpose of establishing a test period is not to determine the amount of time between rate case, but rather to set just and reasonable rates for the Company and its ratepayers.[27] The June 2009 test period allows the Company to project out 12 months, and this might allow the Company a chance to better match its expenses with its revenues rather than a nearer-term test period or one projected out too far in an uncertain economy. Under the present circumstances, more frequent rate cases with near-term forecast periods will help the Company match costs, assist ratepayers in not over/under paying for lengthy time periods, and mitigate the adverse effects of regulatory lag.

**Q. Are there any other factors or concerns that you wish to address as they relate to the appropriate test year?**

A. The Commission's 2004 Order identified several concerns to be considered when making an appropriate test period determination.[28] Throughout my testimony I have addressed many of those concerns, but one important concern is the ability of parties to effectively

[26] The Electricity Journal, Volume 19, Issue 5, June 2006, pp. 15-26; also see www.tradingmarkets.com "Ameren foresees more frequent rate filings., November 11, 2007.
[27] Order on Test Period, Docket No. 07-035-93, February 14, 2008, pp. 3-4.
[28] Order Approving Test Period Stipulation, Docket No. 04-035-042, October 20, 2004.

analyze the Company's forecasts and the accuracy of the Company's forecasts. The Division and other parties will be able to analyze the results from the 2007 calendar year base period and to project the data to the June 2009 period.

In its Order in the 2007 general rate case, the Commission asked the parties to submit a template for a variance report that would serve the purpose of comparing actual results to forecasts. The Division is currently working on this template and plans on submitting it by the November 30, 2008 due date. In addition, we have been collecting historical results as they become available to compare them to Company forecasts. This pertains to the test period determination because the more accurate the Company's forecasts are, the more comfortable the Division is in recommending a test year projected into the future. The Division continues to gather data on the Company's forecasting accuracy, but can presently recommend that the Commission approve the test period going out 12 months.

After considering the current regulatory and economic environment, the Commission's factor analysis, and the Company's forecasting ability, the Division does not oppose the Company's proposed test period in this case and recommends that the Commission approve the June 2009 test year.

## V. THE DIVISION'S ANALYSIS OF AVERAGE VERSUS END-OF-PERIOD RATE BASE CALCULATIONS

**Q. Company witness Mr. McDougal, in his Direct Testimony, claims that due to the fact that the Company selected a test period that does not best align the test period**

**with the rate effective period, Adjustment 9.2 End-of-Period Rate Base should be used in this case.[29] Do you agree?**

A. No. The Company has the opportunity to select the most appropriate test period that it chooses to file in a general rate case. On Page 5, Mr. McDougal states:

> The Company's proposed Test Period is a conservative choice that balances the need for adequate cost recovery with the need for transparency and risk sharing between the Company and its customers. The primary objective of determining a test period is to develop normalized results of operations based on a period of time that will best reflect the conditions during which time the new rates will be in effect."[30]

The Company has already proposed to use the test period ending June 2009 as its test year selection (as stated above) in this case. The Division understands and does not contest that the choice of which year to file is a policy decision within the Company's discretion, as long as it conforms to Utah law.

The Company implies that an end-of-year rate base more accurately reflect conditions expected when new rates will be in effect than would an average-of-year rate base. The Company is proposing this new adjustment because of regulatory lag.[31] The Division recognizes the existence of regulatory lag as a delay in cost recovery due to the regulatory process. However, the effects of regulatory lag are mitigated by the use of a forecasted test year. Therefore, the existence of regulatory lag is not a compelling reason

[29] Direct Testimony of Steven R. McDougal, Docket No. 08-038-38, July 17, 2008. See page 12: "Using a test period ending December 31, 2009. . . would have better aligned the test period with the rate effective period of this rate case."
[30] Id., at lines 117-122.
[31] Id. at p.11, lines 259-260.

for including some end-of-period adjustments to the rate base used to calculate the revenue requirement.

**Q. Please state your objections to using an end-of-period rate base adjustment?**

A. As briefly mentioned above, an end-of-period rate base requires numerous adjustments to be made to revenues and expenses. Second, an end-of-period rate base represents a single point in time, which our Commission has objected to in the past:

> An end-of-year rate base is a mere snapshot, a potentially misleading picture of rate base at one point in time. An end-of-year rate base requires that substantial, difficult adjustments, fraught with policy implications, be made to revenues and expenses.[32]

According to an often-referenced book, *Accounting for Public Utilities*, in the past many commissions were required by statute to use historic data in revenue requirement calculations. Therefore, the year-end approach was used to produce the effect of moving test period forward by a full six months.[33] In the present case, the practical effect of the Company's proposed end-of-period rate base, approximately achieves an average rate base with a 2009 calendar year test period, without matching other expenses and revenues that the calendar year would provide.

[32] Report and Order, 1989 Test Period Rate Case, Docket No. 89-057-15, November 21, 1990, p. 8.
[33] Hahne, Robert L, Aliff, Gregory E., and Deloitte & Touche LLP. *Accounting for Public Utilities* Volume 1, 2007, see pp. 7-4 through 7-6.

However, when using forecasted data, such as in this case, the rate base investment is most often averaged over a 12-month period and related to the results of operations for the period. The authors further make the following statements:

> This averaging concept produces a matching of the rate base investment with the revenues generated by the investment and the costs incurred in the process. If the period forecasted coincides with the period in which the new rates will be in effect, the matching of investment levels to operating results should produce the earnings levels authorized. Any deviation should be solely due to the inability to forecast with perfect foresight.[34]

The Commission also cited several reasons for its preference for average rate base: The Commission has relied on average rate base in the past and recent cases, there has not been any compelling reason to depart from that practice, and end-of-year rate base requires difficult adjustments be made to revenues and expenses."[35]

The Division conducted a hypothetical example to show a different perspective on the revenue requirement increase the Company is requesting. The Company's current request of a $114.5 million rate increase is based on a test year that utilizes a year-end rate base with an ROE of 10.75%. If the Company had filed a "normal" average rate base test year with an ROE of 12% (11.99482%), the same revenue requirement of $114.5 million would have resulted. An ROE of 12% would most likely be seen as

[34] Id. at p. 7.5.
[35] Report and Order, Docket No. 89-057-15, 1989 Test Period Rate Case, November 21, 1990, p. 8.

unreasonable by most parties. Even the Company itself has not requested an ROE of more than 11.25 percent in the last ten years.[36]

**Q. Will you provide an example of the proposed effect on ratepayers using the end-of-period adjustment method?**

A. Rates are based on the conditions during a future test year that are assumed to best represent the rate effective period. These conditions include a rate base with generation plants that provide benefits to customers. Accordingly, ratepayers should pay for the benefit received from a generation plant. If during the test year a new generation plant is built the last month of the test year, the customers will only be receiving that benefit for one month of the test year. Therefore, customers should only pay for one month of benefit received.

Under the average rate base methodology that the Company normally uses, 1/13 of the new generation cost would be added to rate base. For example, assume that a generation plant of $100 million is estimated to come online the very last month of the test year. Utilizing the average rate base methodology, customers would be paying a return on a rate base that would only include $7.7 million of the generation plant addition. The Company's current filing utilizes a year-end rate base, which means that customers would be paying the return on a rate base that includes in this example all $100 million of the new generation addition. In other words, customers will be paying as if the plant had

[36] Docket No. 97-035-01. (The Company asked for 11.25% and received 10.50% ROE.)

been online for the entire duration of the future test year and not just one month. This violates the principle of matching what the customer pays for with the benefit the customer receives.

**Q. On the other hand, will you please describe the appropriateness of using an average rate base?**

A. The Division recommends an average-of period rate base for several reasons. First, this is what has been used most often in past and recent rate cases by the Commission. The Commission writes the following:

> Second, an average-of-year rate base provides an appropriate basis for matching the annual flows of revenue and expenses to the average annual stock of plant and equipment employed by the utility and to the manner in which the utility has been operated.[37]

Finally, an average rate base eliminates the need for complex adjustments that would have to be made using the end-of-period (or Adjustment 9.2) calculation of rate base. Due to the fact that the Commission is already faced with the complication of overlapping rate cases and an overlapping test year, rate base should be averaged over the test period upon which the Company has proposed.

**Q. Has the Company provided calculations of all the components of revenue requirement calculations using the end-of-period approach?**

[37] Id.

A. No. This is the problem in this case. The Company annualizes rate base data as of the June 2009 test period, but other data have not been annualized the same way. In response to the Committee of Consumer Service's (CCS) Data Request 4.6, the Company states that it has not even conducted such analysis. Therefore, components such as year-end customer count and usage levels, reflection of the full year's renewable energy tax credits, effects on power costs, the Chehalis plant, etc. have not been calculated and filed consistently in this case. The Company would have to provide this information, and it would almost take a refilling of the rate case to bring all items to the end-of-year.

## VI. THE DIVISION'S RECOMMENDATIONS AND CONCLUSION

**Q. What test year does the Division recommend be used for this rate case?**

A. The Division has no objections to the use of the test period proposed by the Company beginning July 1, 2008 and ending June 30, 2009, subject to the conditions explained below. Although there will always be increased uncertainty and perhaps controversy with a forecasted test period, the Division believes that its auditors and other staff can reasonably make appropriate accounting adjustments that may arise. The Company's proposed test year, if adjusted appropriately, can reasonably reflect the conditions the Company is likely to encounter during the rate effective period.

**Q. What does the Division recommend with respect to the Company's proposed end-of-period rate base adjustment?**

A. The Division disagrees with using the Company's suggested end-of-period rate base adjustment and recommends that the Commission use average rate base in the determination of the revenue requirement for this case due to the difficulty involved in trying to synchronize year-end and average rate base data. The Division asserts that it is the Company's burden to produce a test year that is completely synchronized, and that this burden should not be shifted to regulators and other parties. In this case utilizing an average rate base methodology reduces the Company's requested increase of $114.5 million to $67.1 million.[38]

**Q. Does this complete your testimony?**

A. Yes it does.

[38] These figures were calculated using the JAM model. See Exhibit 1.2.