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BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application of Rocky Mountain Power for Approval of its Proposed Energy Cost Adjustment Mechanism	**Docket No. 09-035-15**

PREFILED REBUTTAL TESTIMONY OF KEVIN C. HIGGINS

REGARDING FINAL EBA REPORT AND TESTIMONY

The Utah Association of Energy Users ("UAE") hereby submits the Prefiled Rebuttal Testimony of Kevin C. Higgins in this docket regarding the Division of Public Utilities' Final EBA Report, testimony relating to the same, and EBA modification testimony.

DATED this 16th day of November 2016.

HATCH, JAMES & DODGE

/s/ ________________________
Gary A. Dodge
Attorneys for UAE

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served by email this 16th day of November 2016 on the following:

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Rebuttal Testimony of Kevin C. Higgins

On Behalf of the

Utah Association of Energy Users

Regarding EBA Final Report and Testimony

November 16, 2016

I. INTRODUCTION AND SUMMARY

Q. Please state your name and business address.

A. My name is Kevin C. Higgins. My business address is 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 ("UAE").

Q. Please summarize your qualifications.

A. My academic background is in economics, and I have completed all coursework and field examinations toward a Ph.D. in Economics at the University of Utah. In addition, I have served on the adjunct faculties of both the University of Utah and Westminster College, where I taught undergraduate and graduate courses in economics. I joined Energy Strategies in 1995, where I assist private and public sector clients in the areas of energy-related economic and policy analysis, including evaluation of electric and gas utility rate matters.

Prior to joining Energy Strategies, I held policy positions in state and local government. From 1983 to 1990, I was economist, then assistant director, for the Utah Energy Office, where I helped develop and implement state energy policy.

From 1991 to 1994, I was chief of staff to the chairman of the Salt Lake County Commission, where I was responsible for development and implementation of a broad spectrum of public policy at the local government level.

Q. Have you previously testified before the Utah Public Service Commission (“Commission”)?

A. Yes. Since 1984, I have testified in thirty-eight dockets before the Utah Public Service Commission on electricity and natural gas matters.

Q. Have you testified previously before any other state utility regulatory commissions?

A. Yes, I have testified in approximately 180 other proceedings on the subjects of utility rates and regulatory policy before state utility regulators in Alaska, Arkansas, Arizona, Colorado, Georgia, Idaho, Illinois, Indiana, Kansas, Kentucky, Michigan, Minnesota, Missouri, Montana, Nevada, New Mexico, New York, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, Texas, Virginia, Washington, West Virginia, and Wyoming. I have also filed affidavits in proceedings before the Federal Energy Regulatory Commission and prepared expert reports in state and federal court proceedings involving utility matters.

Q. What is the purpose of your testimony in this case?

A. My testimony responds to several issues discussed in the Final Evaluation Report of PacifiCorp’s EBA Pilot Program (“DPU Report”) filed on May 20, 2016 by the Division of Public Utilities (“DPU”) and the Direct Testimony of

DPU witness Charles E. Peterson. Specifically, I address the importance of the Energy Balancing Account ("EBA") sharing mechanism, the inclusion of wheeling revenues in the EBA, and concerns raised by DPU regarding the so-called "mismatch issue." My testimony also responds to certain issues raised in the Modification Testimony of RMP witness Michael G. Wilding.

Q. Please summarize your response to issues discussed in the DPU Report and Mr. Peterson's Direct Testimony.

A. I offer the following responses to issues raised by DPU:

(1) I fully agree with DPU's conclusion that the sharing mechanism provided a meaningful incentive for the Company to manage its net power costs ("NPC"). I recommend that the sharing mechanism be reinstated if the EBA is extended beyond December 31, 2019.

(2) I disagree that wheeling revenues should be eliminated from the EBA. Including wheeling revenues in the EBA provides appropriate symmetry with the treatment of wheeling expenses.

(3) In my opinion, the so-called mismatch issue is not a problem and therefore does not require any change in practice.

Q. Please summarize your response to proposals in Mr. Wilding's Modification Testimony.

A. I offer the following responses to the Company's proposals:

(1) The Commission should reject the additional items that RMP proposes to add to the EBA.

(2) I disagree with Mr. Wilding's assertion that the EBA should be made permanent.

II. RESPONSE TO DPU REPORT

a. Sharing Mechanism

Q. Please describe the role of the sharing mechanism in the operation of the EBA.

A. From the inception of the EBA pilot program, the Commission has required a sharing mechanism in which deviations from net power costs in rates were shared between customers and the Company in a 70-30 proportion. Through Schedule 94, the Company deferred in the EBA 70% of the difference between Actual Utah NPC and Wheeling Revenues and Base Utah-Allocated NPC and Wheeling Revenues.[1] However, following a lobbying effort by RMP at the Utah Legislature during the 2016 session, the sharing mechanism was eliminated, at least for the time being.

Q. Please explain the recent legislative changes to the sharing mechanism.

A. In March 2016, the Utah Legislature passed Senate Bill 115, the Sustainable Transportation and Energy Plan Act ("SB 115"), which mandated elimination of the 70-30 sharing mechanism from June 1, 2016 to December 31, 2019. SB 115 added Utah Code Section 54-7-13.5(2)(d), which provides that an

[1] The monthly EBA deferral is calculated by subtracting the Base Utah-Allocated NPC and Wheeling Revenues per Base MWh (as determined in the most recent general rate case or other applicable case) from the Actual Utah NPC and Wheeling Revenues per Actual MWh, and multiplying the difference by Actual Utah MWh. Through May 31, 2016, this product was multiplied by 70%.

electrical corporation with an energy balancing account established before January 1, 2016 shall be allowed to recover 100% of its prudently incurred power costs beginning June 1, 2016. The mandatory 100% recovery is subject to a sunset provision, in that Subsection 54-7-13.5(2)(d) is repealed on December 31, 2019.

Q. What comments were offered by DPU regarding the EBA sharing mechanism in the DPU Report?

A. The DPU Report states that the removal of the sharing mechanism represents "a significant shift in risk to ratepayers not only in the raw dollar amounts involved but in the manifest lessening of the incentives aligning the Company with ratepayer interests."[2] The DPU Report stresses that DPU's EBA audits are not attestations of the material correctness of the Company's net power costs, but rather are limited to a few items due to time and resource limitations and the complexity of PacifiCorp's operations.[3] In light of the limitations of DPU's prudence reviews, DPU appreciated that the sharing mechanism aligned the Company's incentives with ratepayer interests.

Q. What is your response to DPU's comments regarding the sharing mechanism?

A. I fully agree with DPU's conclusion that the sharing mechanism provided a meaningful incentive for the Company to manage its costs. The 70-30 sharing mechanism struck a reasonable balance between customers and shareholders with

[2] DPU Report, p. 18.
[3] *Id*., p. 5.

respect to the sharing of risks associated with deviations in actual NPC relative to what is established in rates. If any extension of the EBA is permitted beyond December 31, 2019, I recommend that the 70-30 sharing mechanism be reinstated.

Q. How does a 70-30 sharing mechanism provide important incentives to the Company?

A. A 70-30 sharing mechanism is a clear and straightforward means to give RMP a material stake in each of its actions and decisions related to power costs, thereby aligning the interests of the Company with those of its customers. When a firm stands to gain or lose from its cost management decisions, the pursuit of its economic self-interest gives it a powerful incentive to perform well in managing its costs. The 70-30 sharing mechanism provided such an incentive.

Q. One of the arguments that is sometimes used in opposition to a sharing mechanism is that energy costs are largely outside a utility's control. Do you believe that energy costs are largely outside a utility's control?

A. No. Although the Company may not control market prices, this does not mean it is a mere passive bystander when it comes to managing its power costs. It is in the overall management of its resources, as distinct from control over market prices, that incentives matter. Every hour of every day, RMP needs to be managing the dispatch of its system to achieve minimum costs, subject to the reliability constraints under which it operates. This requires a sophisticated approach to managing utility-owned resources, as well as conducting a large volume of transactions – purchases and sales – throughout the year.

For example, in 2015, the Company made more than 14.0 million MWh of long-term and short-term firm sales, which is an average of 1,600 MW each hour of the year. These sales were conducted with 75 counterparties.[4] The Company also transacted for more than 12.1 million MWh of long-term, intermediate-term, and short-term firm purchases, and approximately 4.9 million MWh of exchanges, consummated with 88 counterparties.[5]

The depth and breadth of the Company's around-the-clock dispatch and balancing requirement is clearly extensive. It is critical that RMP have the proper incentives for these transactions, as well as in the management of its fuel procurement, to produce the greatest possible net benefit to customers. This incentive is most efficiently implemented by a regime in which RMP significantly shares in the benefits and risks of its decisions. To ensure sound utility cost-management performance, it is far preferable to harness the natural economic self-interest of the Company than to rely on after-the-fact prudence audits to review the reasonableness of past actions.

Q. How else do incentives play a role?

[4] According to PacifiCorp's 2015 FERC Form 1 data, as compiled by SNL Financial. Excludes Requirements Service (RQ), Out-of-Period adjustments (AD), Service from designated generating units (LU), and Other service (OS).

[5] According to PacifiCorp's 2015 FERC Form 1 data, as compiled by SNL Financial. Excludes Requirements Service (RQ), Out-of-Period adjustments (AD), Service from designated generating units (LU and IU), and Other service (OS).

A. Incentives also play an important role with respect to the Company's own operations. For example, it is important for RMP to schedule plant maintenance in a manner that takes into account the impact on NPC. By scheduling outages when replacement power is likely to be less or least expensive, the Company is able to control its net power costs. A sharing mechanism provides the Company an economic incentive to take proper account of NPC when scheduling outages. Absent an incentive mechanism, RMP would be economically indifferent between scheduling a maintenance outage during a period when the price for replacement power is relatively high versus scheduling it at a time when the price is relatively low. This is not a healthy economic arrangement, as shareholder interests and ratepayer interests are not aligned. Further, under a sharing mechanism, if the Company experiences forced outages that are more frequent or of greater duration than is reasonably projected in rates, the Company shares in the economic consequences of these events. Likewise, if forced outages are less frequent than had been reasonably projected, the Company shares in the benefit of such superior performance. None of this occurs with a 100% pass-through to customers.

Q. Does the Company's participation in the Energy Imbalance Market ("EIM") with the California ISO suggest that incentives to manage power costs are no longer important?

A. No. Quite the contrary. While the EIM has resulted in a more automated intra-hour dispatch operation, this does not obviate the need for a sharing mechanism. RMP must still actively manage its NPC outside the intra-hour dispatch handled through the EIM.

Q. Do other PacifiCorp jurisdictions have sharing mechanisms for their NPC adjustors?

A. Yes. The Company's Wyoming jurisdiction has a 70-30 sharing arrangement that is nearly identical to that which Utah employed. Idaho has a 90-10 sharing arrangement, but also generally uses a historical test period to set rates in a general rate case. Oregon and Washington have mechanisms that are subject to material deadbands. Only California has the type of 100% pass-through that is currently in effect in Utah.

Q. Please describe the Oregon mechanism in more detail.

A. The Oregon mechanism, called the Power Cost Adjustment Mechanism ("PCAM"), was adopted in December 2012.[6] Oregon has an asymmetrical deadband ranging from negative $15 million to positive $30 million on an Oregon-allocated basis. Outside the deadband, a 90-10 sharing mechanism is applied, with customers absorbing 90% of incremental costs above the deadband and receiving 90% of the benefits below the deadband. In addition, PCAM recovery is subject to an earnings test, with zero recovery or refund if the Company's actual return on equity ("ROE") is within 100 basis points of its authorized level.

Q. What type of sharing arrangement is in place in Washington?

[6] Oregon Docket No. UE-246, Order No. 12-493 (December 20, 2012).

A. The Washington Power Cost Adjustment Mechanism ("PCAM") was implemented in May 2015. The Washington PCAM has a deadband of +/- $4 million on a Washington-allocated basis.[7] Outside the deadband, PCAM recovery is governed by three tiered sharing bands:

- 50/50 sharing for positive NPC variances between $4 million and $10 million.
- 75% customer / 25% Company sharing for negative NPC variances between -$4 million and -$10 million, i.e., customers receive a refund of 75% in this range.
- Symmetrical 90% customer / 10% Company sharing for NPC variances outside +/- $10 million.

Q. What is your recommendation to the Commission regarding the use of sharing bands in the EBA?

A. If any extension of the EBA is permitted beyond December 31, 2019, I strongly recommend that the 70-30 sharing mechanism be reinstated. The 70-30 sharing mechanism will provide a critical incentive for the Company to manage its costs and will strike a reasonable balance between customers and shareholders with respect to the sharing of risks associated with deviations in NPC relative to what is established in rates.

[7] Washington Docket No. UE-140617 et al., PCAM Settlement Stipulation. Approved May 26, 2015.

b. Wheeling Revenues

Q. What does DPU recommend on the subject of wheeling revenues, as explained in the Direct Testimony of Charles E. Peterson?

A. DPU recommends that wheeling revenues be eliminated from the EBA because they are not a component of NPC. Mr. Peterson notes that with the elimination of the sharing mechanism, ratepayers will take on all the risk of changes in wheeling revenues.[8] However, based on DPU's analysis, ratepayers have received a net benefit from the inclusion of wheeling revenues in the EBA, on average.[9] DPU does acknowledge, if parties support a true-up of wheeling revenues between rate cases, that it would likely support a wheeling revenue tracker.[10]

Q. What is your response to DPU's recommendation on the treatment of wheeling revenues in the EBA?

A. I disagree with DPU's recommendation on this point, and I recommend continued inclusion of wheeling revenues in the EBA. While wheeling revenues are not formally a component of NPC, wheeling *expenses* are. Including wheeling revenues in the EBA provides appropriate symmetry with the treatment of wheeling expenses. Moreover, I believe that including wheeling revenues in the EBA is simpler and preferable to a separate revenue tracker mechanism.

[8] Direct Testimony of Charles E. Peterson, pp. 8-9.
[9] See Mr. Peterson's Supplemental Exhibit 5.2.
[10] Direct Testimony of Charles E. Peterson, p. 10.

c. Mismatch Issue

Q. Please explain the "mismatch issue" discussed in the DPU Report and Mr. Peterson's Direct Testimony.

A. The mismatch issue refers to a situation in which all the months in an EBA filing period (i.e., designated by month and *year*) do not exactly correspond to the months and year in the test period that was used for setting rates in the most recent general rate case. In other words, in such a "mismatch" situation, base NPC would be set using one discrete set of months (i.e., the test period) and the EBA filing period would be measuring actual NPC over a different set of months (for example, Actual NPC in September 2018 might be compared to Base NPC in September 2017, if the latter was part of the test period in a general rate case). DPU cites this situation as a potential concern because the timing difference between the test period used to set base rates in the general rate case and the period used for the EBA filing could contribute to a divergence between NPC included in rates (set in the general rate case) and actual NPC (measured in the EBA filing).

DPU outlines two possible solutions to resolve this issue.

One approach presented by DPU is to forecast NPC in a general rate case for several years and implement multi-step rate adjustments based on the NPC forecast, utilizing the multi-year NPC forecast as the baseline. DPU acknowledges that such an approach would have the undesirable effect of subjecting customers to more frequent rate changes.[11]

The other approach presented by DPU is to have the Company file, concurrently with its EBA filings, a new forecast NPC baseline to go into effect the next calendar year. This would require parties to evaluate the new NPC forecast as the EBA is being evaluated. In addition to being more complex than the current approach, DPU acknowledges that there may be a question of the legality of this method as it is roughly equivalent to conducting a partial rate case each year.[12]

DPU notes that a third option is to continue with the current practice.

Q. What is your response to DPU's discussion of the mismatch issue?

A. In my opinion, the so-called mismatch issue is not a problem, and therefore, does not require any change in practice. Consequently, I strongly recommend against adoption of either of the alternative approaches discussed in the DPU Report. I agree with DPU's assessment of the shortcomings of the alternatives presented in the DPU Report and submit that those shortcomings are significantly more objectionable than the perceived problem the alternatives are intended to address.

The objective of the EBA is not to provide perfect forecasting per se, but to allow for an adjustment to revenue recovery when actual NPC deviates from NPC in base rates. This objective is completely met using the current approach.

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[11] *Id.*, p. 5.
[12] DPU Report, p. 25. Direct Testimony of Charles E. Peterson, p. 6.

By its nature, the EBA is concerned with the differences between Actual NPC and NPC in base rates. Such differences are expected; otherwise there would be no reason for the mechanism in the first place. In this context, there is nothing inherently wrong with the specific months used in the EBA filing differing from the specific months used in the test period. The whole point of the EBA is to address the inevitable deviations in NPC values between the two.

III. RESPONSE TO RMP MODIFICATION TESTIMONY

Q. What additional items does the Company propose to include in the EBA, according to the Modification Testimony of Michael G. Wilding?

A. The Company proposes to include chemical costs, start-up fuel/gas costs, and production tax credits in the EBA, effective on the rate effective date from the next general rate case.[13] Mr. Wilding also suggests that in the future, subject to Company request and Commission approval, the EBA could be used to true-up the costs and benefits of special contracts.[14]

Q. What justification does Mr. Wilding offer for including chemical costs, start-up fuel/gas costs, and production tax credits in the EBA?

A. Mr. Wilding explains that these items are similar to NPC because they are volatile and vary with generation and weather. The majority of the Company's chemical consumption is attributable to pollution control equipment and the costs fluctuate with megawatt hours generated. Mr. Wilding explains that number two

[13] Modification Testimony of Michael G. Wilding, p. 3.
[14] *Id*., p. 7.

diesel fuel and natural gas are used as start-up fuel by the Company's coal-fired plants, and the costs are exposed to volatile market prices. Production tax credits, which offset the Company's federal income taxes, are dependent on the generation produced at eligible renewable facilities, and will begin expiring in 2017.[15]

Q. What is your response to the Company's proposal to include additional items in the EBA?

A. I recommend that the Commission reject RMP's proposal to expand the list of items included in the EBA. It is typical for utilities to request to expand the list of cost items that are recoverable through single-issue adjustor mechanisms such as the EBA because doing so shifts the risk of changes in these costs to customers. However, utility ratemaking is not an exercise in expense reimbursement. The EBA was adopted to address the perceived problem that material changes in NPC could affect the financial health of the Company in between rate cases if changes in costs were to go unrecovered.[16] Expansion of the list of EBA-eligible items is not necessary to meet this objective. Moreover, while the production tax credits will vary with output from eligible facilities, the primary forward-going changes will be associated with the expiration of these credits for existing facilities, as those facilities age and their eligibility expires. This impact is not volatile, but is known and predictable.

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[15] *Id.*, pp. 3-6.
[16] Docket No. 09-035-15, Commission Corrected Report and Order issued March 3, 2011, page 66.

Q. Mr. Wilding states that the EBA should be made permanent and continue after 2019.[17] What is your response to this proposal?

A. I recommend against making the EBA permanent at this time. Rather I agree with the conclusion in the DPU Report that, as the pilot program nears its end in 2019, a full evidentiary docket should be established to consider changes to, or elimination of, the EBA.[18] Further, I would strongly recommend against making the EBA permanent without a robust sharing mechanism.

Q. Does this conclude your rebuttal testimony?

A. Yes, it does.

[17] Modification Testimony of Michael G. Wilding, p. 2.
[18] DPU Report, p. 49.