BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

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IN THE MATTER OF THE APPLICATION OF ROCKY MOUNTAIN POWER FOR APPROVAL OF ITS PROPOSED ENERGY COST ADJUSTMENT MECHANISM.	)	DOCKET NO. 09-035-15

TRANSCRIPT OF HEARING PROCEEDINGS

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E X H I B I T S

January 12, 2010

9:17 a.m.

P R O C E E D I N G S

CHAIRMAN BOYER: We are now on the record in Docket 09-035-15, which is captioned In the Matter of the Application of Rocky Mountain Power for Approval of its Proposed Energy Cost Adjustment Mechanism, and, for the record, we've had a discussion before we went on the record to consider a proposal made by Mr. Monson, counsel for Rocky Mountain Power, to consider parties waiving cross examination at this time, giving all of the witnesses an opportunity to summarize and state their positions in this matter, and then perhaps reconvene later for legal arguments.

Also, today at five o'clock is scheduled the public witness hearing.

And so we decided all parties are agreeable to that approach, as is the Commission, and so we'll commence in that fashion, beginning with the Company, Rocky Mountain Power. We'll turn then to the Division, then to the Office of Consumer Services, and go around to the other parties who are here with us.

So let's take appearances at this point in time and let's begin with Mr. Monson and Ms. Hogle.

MR. MONSON: Gregory Monson and Yvonne Hogle for Rocky Mountain Power.

CHAIRMAN BOYER: Thank you, and welcome.

Ms. Schmid?

MS. SCHMID: Patricia E. Schmid with the Attorney General's Office for the Division of Public Utilities.

CHAIRMAN BOYER: Thank you, Ms. Schmid.

And Mr. Proctor?

MR. PROCTOR: Paul Proctor on behalf of the Office of Consumer Services.

CHAIRMAN BOYER: Okay. And we'll start in that same order again at the other table.

MR. KELLY: Ryan Kelly, and my co-counsel, Holly Rachel Smith, who will be replacing me shortly, on behalf of Wal-Mart Stores, Inc. and Sam's West, Inc.

CHAIRMAN BOYER: And Western Resource Advocates?

MS. MANDELL: Victoria Mandell, representing Western Resource Advocates.

MR. DODGE: Gary Dodge --

CHAIRMAN BOYER: Is that with two L's?

Would you spell that for the record? Is that M-A-N-D-E-L-L?

MS. MANDELL: That's it. Exactly. Thank you.

MR. DODGE: Gary Dodge on behalf of UAE.

MR. EVANS: And William Evans on behalf of the Utah Industrial Energy Consumers Intervention Group.

CHAIRMAN BOYER: Okay. Very well.

MR. MATTHEIS: And, your Honor, I'd also like to enter my appearance. Pete Mattheis on behalf of Nucor Steel.

CHAIRMAN BOYER: Welcome, Mr. Mattheis.

MR. MATTHEIS: Thank you.

CHAIRMAN BOYER: Ms. Wolf?

MS. WOLF: Betsy Wolf on behalf of Salt Lake Community Action Program.

CHAIRMAN BOYER: Welcome, Ms. Wolf. Anybody else who wishes to participate today? Okay. Very well. Thank you for that.

Now, Reporter -- I've forgotten your name.

THE REPORTER: Renee.

CHAIRMAN BOYER: Renee. Did you get all the spelling of all counsel?

THE REPORTER: I'll need to get cards from

a couple people. I can do that at the break.

CHAIRMAN BOYER: Perhaps at the break if you could speak with the reporter and make sure your names are spelled properly in the record.

Okay. With that, then, we will commence by hearing from Rocky Mountain Power who has requested the ECAM.

MR. MONSON: Thank you. Actually, we have -- there are two witnesses that aren't even here, because we already talked about, last week, whether anyone had any questions for them, and one of them is our witness, Mr. Williams. The parties have all agreed that his testimony could be admitted without cross examination, subject to a stipulation that we made with Western Resource Advocates that we would stipulate on the record that, as of January 8th, 2010, PacifiCorp's first mortgage bonds were rated A by Standard & Poor's and A2 by Moody's Investor Service, so I guess the first thing we'd want to do is offer the testimony of Bruce Williams, the supplemental direct testimony of Bruce Williams.

CHAIRMAN BOYER: Very well. Are there any objections to the admission of Mr. Williams' testimony, subject to that stipulation on the current credit ratings of Rocky Mountain Power?

MR. PROCTOR: No.

MR. DODGE: No.

CHAIRMAN BOYER: Very well. Mr. Williams' testimony is admitted.

MR. MONSON: So our next witness would be Mr. Greg Duvall.

CHAIRMAN BOYER: Mr. Duvall. I think this is a new docket, Mr. Duvall, even though you were here a couple of weeks ago. You probably haven't been sworn in this case, have you?

MR. DUVALL: No, I haven't.

CHAIRMAN BOYER: This is our first hearing. Please raise your right hand.

GREGORY N. DUVALL

called as a witness and sworn, was examined and testified as follows:

CHAIRMAN BOYER: Thank you. Please be seated.

DIRECT EXAMINATION

BY MR. MONSON:

Q Please state your name for the record.

A My name is Gregory N. Duvall.

Q And by whom are you employed and in what capacity?

A I'm the director of long-range planning and

net power costs for PacifiCorp.

Q And did you cause to be filed in this case direct testimony, supplemental direct testimony, and rebuttal testimony?

A Yes, I did.

Q Do you have any corrections you wish to make to that testimony?

A No, I do not.

Q If I were to ask you the questions set forth in that testimony, then, today, would your answers be the same?

A They would.

MR. MONSON: So we would offer the direct testimony of Mr. Duvall, with two exhibits, the supplemental direct testimony of Mr. Duvall, and the rebuttal testimony, with three exhibits.

CHAIRMAN BOYER: Are there any objections to the admission of Mr. Duvall's prefiled testimony, direct, supplemental direct, rebuttal, together with exhibits?

MS. SCHMID: None.

CHAIRMAN BOYER: Seeing none, they are admitted into evidence.

Q (BY MR. MONSON) Do you have a summary of your testimony that you'd like to present to the

Commission?

A   Yes, I do.

Q   Go ahead.

A   Good morning, Chairman Boyer, Commissioner Campbell, Commissioner Allen. I'll cover four areas in my summary of my testimony. First, I'll explain why we want an ECAM. Second, I'll discuss the changes from 1990 when the EPA was eliminated. Third, I'll address incentives, and finally I'll talk about the issue of over-reliance on market purchases.

First, we're requesting an ECAM for two reasons. First, customers should pay for prudently-incurred net power costs, nothing more, nothing less. And second, net power costs are large, volatile, unpredictable, and largely outside the control of the Company.

Over the past eight years, using forecast model, net power costs for Rocky Mountain's Utah customers had been $300 million more than what's been included in rates, so customers have underpaid by an average of about $40 million a year. This is not sustainable. It is unfair to both the customers and the Company.

An ECAM is more accurate. Regulating ECAM is straightforward as compared to regulating power

cost models.

I think the net power costs are large. They represent 20 to 30 percent of the Company's revenue requirement. They're volatile. Over the past few years we've seen them bounce around from 900 million to 1.1 billion, back to a billion, and we expect them to go to 1.3 million by 2011.

To quantify this volatility, I produced a stochastic study for the calendar year 2012 that shows that even when fully hedged for a known net open position, net power costs increase by $80 million a year, solely due to the combined volatility of loads, forced outages, and hydro. This did not include the volatility of the 1,500 megawatts of wind that PacifiCorp now has on its system.

Net power costs are unpredictable. It's a hundred percent certain that any forecast will be wrong. Net power costs are driven by multiple simultaneous and differently correlated, volatile, and unpredictable components, including the weather, which affects temperature, wind, and rain, fuel and commodity pricing, the timing, magnitude, and duration of forced outages, both transmission forced outages and generation forced outages, and the economy as it affects customer loads.

And, finally, net power costs are largely outside the control of the -- outside the Company's control. And I think this is a key point, because there's really two dimensions to hedging, and one is the loads and the resources and the other is the prices, and so what we have is large significant volatility in our resources going up and down, and at the same time, we have our prices moving, and it's that combination of events that makes it impossible for us to hedge our position fully.

So, going on to the changes since 1990, in my supplemental direct testimony, I present three tables. Table 1 on Page 4 shows that net power costs were relatively low and stable during the '90s. They spiked in 2001 and have remained high and volatile since that time.

Table 2 on Page 9 shows the changes in the resource mix from 1992 through 2009. The reliance on wind has increased by 10 percent. The reliance on natural gas has increased by 16 percent. The combination of these two results in 3,800 megawatts of wind and natural gas on our system today that did not exist in 1990.

At the same time, coal dropped from 66 percent to 43 percent of total capacity, and the

amount of coal supplied from captive mines dropped from about 60 percent to about 30 percent. So the landscape is quite different.

In addition, I also note that Utah loads and net power costs have each doubled since 1990, making the dollar impact of the net power cost forecast error quadruple.

On incentives, I indicate that the robust IRP and RFP process in Utah act as a safeguard against inefficient actions regarding resource planning and acquisition. Any bias towards purchased power under ECAM is mitigated with a single-item rate case, which allows the matching of the fixed and variable costs.

In addition, there's really no inherent bias for the Company towards purchased power, since purchased power does not provide a return. At best, we get our money back.

And then, finally, the regulatory auditing and review with the potential of disallowances for imprudent actions provide safeguards against inefficient operations. And you might recall we have six commissions, 20 commissioners, that look over our shoulder all the time with regard to prudence, and I can tell you from my 30 years of experience with the

Company, the risk of disallowance from a prudency finding is a very, very strong incentive to the Company to do the right thing, with or without an ECAM.

With regard to the reliance on -- over-reliance on purchased power, I presented two pieces of evidence. One is Table 1 on Page 20 of my rebuttal that shows that RMP's reliance on purchased power in its current IRP is less than the reliance on purchased power in the last acknowledged IRP. In fact, it's less by a fair amount.

I also show that in the current IRP that, by 2012, the Company is only relying on 4 percent of market purchases to meet its firm obligations, and even by 2016, only 10 percent of its firm obligations are expected to be met by market purchases.

I conclude from that that there's no basis to hold up an ECAM to conduct an investigation into this topic.

So, in summary, over the past eight years, Utah customers have underpaid for net power costs by over 300 million under the current system. The stochastic study that I present proves that even when fully hedged, net power costs increase by $80 million a year due to the interaction of volumetric and

pricing variances within the course of a year that the Company has no ability to hedge.

Regulating an ECAM is straightforward, unlike regulating net power costs. There's a significant difference between 1990 and today that allow the Commission to implement an ECAM consistently with prior Commission orders, and I firmly believe that the evidence that I've provided, along with that of Mr. Williams, Dr. McDermott, and Mr. Graves, meet the burden of proof that an ECAM is in the public interest in the state of Utah. Thank you.

CHAIRMAN BOYER: I guess he's available for questions from the Commission at this time, correct?

Commissioner Allen, any questions of Mr. Duvall?

COMMISSIONER ALLEN: I have a question that just recently occurred to me, so -- with the precaution that I'm not trying to foreshadow any kind of decision or policy position I'm taking. It's just, honestly, a question. I'll have it for the other parties, probably, too.

If we were to consider -- as we're considering the public interest phase of this, would it benefit or reduce the public interest if we

considered this ECAM as a pilot program, particularly if it were a long-range pilot program that would have milestones and could be reviewed?

THE WITNESS: I don't think it would have any effect.

COMMISSIONER ALLEN: Okay. Thank you.

CHAIRMAN BOYER: Commissioner Campbell?

COMMISSIONER CAMPBELL: Under current regulation, could you explain to us how hedging -- your hedging practices benefit customers?

THE WITNESS: Well, the --

COMMISSIONER CAMPBELL: I mean, it really is leading to the question, are you hedging today to benefit customers, or are you hedging today to try to solidify your net income?

THE WITNESS: Well, I think, you know, in the first instance, if our Commissions tell us that, "We want to have fixed rates for our customers," then that gives us a signal that we need to go hedge the volatility, so that's really the direction we're getting from the Commission, and that does protect the shareholders, but it also flows through to the customers since our hedging practices go out -- you know, out multiple years, as well as even in the first year, and when we do our grid studies, we --

when we do a grid study, we do an extract out of our system to pull in all of the most recent trades, and those are reflected in grid, and so to the extent that those trades were made as part of the hedging practices, they are reflected in the grid model.

COMMISSIONER CAMPBELL: You mentioned that the prudence review for new plant is something that the Company takes seriously as a strong incentive for you all to make the right decision, and the question is, then -- you have that today, and now that you add an ECAM, does that somehow change the balance of the way you look at that?

THE WITNESS: Well, from my perspective, the answer is no, and I think with the people that I work with, they're all very proud of the work they do, and everybody is, you know, focused on making sure we get the lowest costs we can, and I think many of the people that work at the Company have no clue whether there's an ECAM or not and don't even know what it is.

CHAIRMAN BOYER: A couple of questions, Mr. Duvall. Some of the parties have suggested that the reason Rocky Mountain Power has had trouble recovering their net power costs is because of the forecasting problems and errors and inaccuracy.

What's your response to that?

THE WITNESS: I think it goes back to what I was explaining about sort of the multi-dimension that we have. We have volumetric changes and price changes going on at the same time, and I know of no model that could possibly predict that, and I think our track record has basically shown that it's been pretty bad.

CHAIRMAN BOYER: You currently use the grid model, which, as I -- I'm not a modeling expert by any means, but, as I understand it, it will determine a price at a given point in time, a single point in time.

THE WITNESS: Right.

CHAIRMAN BOYER: And then in your testimony you talked about using the stochastic -- the kind of a stochastic analysis that you would typically use in IRP development to show the volatility and so on. Would using that sort of a forecasting methodology increase the accuracy, do you think, of the Company's net power cost forecasting in the future? Is that a possibility?

THE WITNESS: Well, it would certainly increase the complexity. I think it would help on the accuracy, but it would certainly increase the

complexity.

CHAIRMAN BOYER: This question is probably better addressed to Dr. McDermott and I'll ask him, if I remember when we get around to him, but when I was in law school, you know, in the last century, we were taught about risk allocation, and one of the concepts or one of the principles of risk allocation is that risk is most appropriately placed on the person or parties who can best mitigate risk, and so when you're talking about things like fuel costs, it's pretty difficult for, you know, Ted, the customer of Rocky Mountain Power, to do much about hedging and so on and so forth.

What's your take on that? Is it appropriate to place that risk on customers? Do you think the ECAM -- first of all, I guess I should say, would an ECAM place that risk on customers more than it is now, and if so, is that an appropriate allocation of the risk?

THE WITNESS: Yeah. I think where I start is with customer loads, and that is that the customers of Rocky Mountain Power decide whether they're going to use electricity, how much they're going to use, so they do have some control over that. They could do demand side management, for example, to

reduce their takes.

The Company is in a position to be able to manage those risks, and as long as the Company manages those risks prudently, then the customers who are using the electricity should pay the cost.

CHAIRMAN BOYER: Okay. I read recently in the "Wall Street Journal" that because of the recent discoveries of natural gas -- and one of the fuel costs that's most volatile -- or at least can be volatile is natural gas -- that natural gas producers are now willing to consider longer term contracts than they have historically, you know, a year or two years or something like that, some going out as far as 20 years.

If that were a possibility, would that help to reduce the net power cost forecasting issues?

THE WITNESS: Well, it would help in terms of a known net open position, and that's some key words that I have in my testimony, is the known net open position, and that's what grid looks at. It's the snapshot in time. You know what it is, and you can hedge that pretty well.

The problem is, tomorrow there will be a different open position, and it's driven by changes in volumetric changes and in the -- you know,

simultaneously with changes in prices, so your open position changes day by day by day by day by day in the backdrop of prices that are moving all over the place, and there's just no way, even if you had long-term gas contracts, that you'd be able to hedge that.

CHAIRMAN BOYER: My last question relates to prudence review. You indicated that the possibility of being second-guessed on prudency of some of your decisions, purchasing, hedging, those sorts of things, tend to function to keep you, you know, making prudent decisions. They work as an incentive to make prudent decisions.

Would increasing reliance on prudence review, would that create an unacceptable burden on the regulatory community? Would we be looking at every purchase, your reliance on market purchases, your hedging techniques?

THE WITNESS: Well, I'm not an expert in how to do a prudence review, but I would expect that a prudence review would be done by exception and that you would have an expectation of what you would expect to happen, and to the extent that things aren't turning out that way, you know, you would investigate further, so you'd peel a layer of the

onion each time you saw something like that.

But, you know, other entities are doing prudence reviews. The Utah Commission used to do prudence reviews on -- or at least review when the EPA was around. That was manageable. And I would suspect that, you know, folks are looking at our results of operations all of the time, and a lot of that work is already being done.

I don't think going through, you know, decision by decision by decision is, you know, even a reasonable sort of approach, and I think Dr. McDermott may have some -- be a good person to ask that question to.

CHAIRMAN BOYER: Thank you. Let's see. Did my questions trigger any additional questions of the commissioners?

Back to you, Mr. Monson. Do you have any redirect?

MR. MONSON: No. I guess I don't have any redirect. I mean, I think it would probably be inconsistent with this stipulation. That's what I thought everyone would say. So I don't.

CHAIRMAN BOYER: Okay. Very well. Thank you, Mr. Duvall.

THE WITNESS: You're welcome. It was a lot

shorter than last time.

CHAIRMAN BOYER: Yes, a lot shorter. But your testimony was appropriately lengthy, so that offsets that.

MR. MONSON: Our next witness is Dr. Karl McDermott.

CHAIRMAN BOYER: Dr. McDermott, would you please raise your right hand?

KARL A. McDERMOTT

called as a witness and sworn, was examined and testified as follows:

CHAIRMAN BOYER: Thank you. Please be seated, and welcome.

THE WITNESS: Glad to be here.

DIRECT EXAMINATION

BY MR. MONSON:

Q Please state your name for the record.

A Karl, with a K, McDermott, M-C-D-E-R-M-O-T-T.

Q By whom are you employed and what's your position?

A I'm the Ameren Distinguished Professor of government and business at the University of Illinois, Springfield, and a special consultant at NERA.

Q And I believe this is the first time you've appeared in person before this Commission. Is that correct?

A That is correct.

Q Could you just give the Commission a very brief background on your experience in the public utility industry?

A I've been in the business about 30 years. Started at the National Regulatory Research Institute. From there I went to the Illinois Commerce Commission as a staff person, worked for the governor's sunset committee on rewriting the Public Utility Act in Illinois in the mid '80s. Started the Center for Regulatory Studies at Illinois State University. Did that for about eight years before the governor asked me to become a commissioner. Served as a commissioner of the Illinois Commerce Commission from 1992 to 1998, and then left at that time and became a vice-president at NERA and have served in that capacity for about eight years, and then I left to become a professor.

Q Did you prepare supplemental direct testimony, which included two exhibits, and rebuttal testimony, which also included two exhibits, and file that in this case?

A I did.

Q Do you have any corrections you wish to make to that testimony?

A No, sir.

Q If I were to ask you the questions set forth in that testimony then today, would your answers be the same?

A Yes.

MR. MONSON: We offer Dr. McDermott's supplemental direct testimony and his rebuttal testimony with the accompanying exhibits.

CHAIRMAN BOYER: Are there any objections to the admission of Dr. McDermott's supplemental direct testimony and rebuttal testimony, together with exhibits?

MS. SCHMID: None.

CHAIRMAN BOYER: Seeing none, they are admitted.

Q (BY MR. MONSON) Dr. McDermott, do you have a summary of your testimony?

A I do.

Q Could you present that to the Commission now?

A I shall. Thank you.

Mr. Chairman, Commissioners, thank you for

the opportunity to summarize my testimony for you.

What do I think this case is really about? I believe it's about structuring a fair regulatory process, a process where customers pay only the actual costs of serving them, and the utility can only recover its prudently-incurred costs.

Does an ECAM mechanism fit the description of a fair regulatory process? I believe and I think many of the commissions around the country believe that it does.

Now, how did they come to this conclusion? Well, it's by asking a set of threshold test questions, the first being, are these costs a large component of the companies' and the customers' cost of service? Secondly, are these cost components volatile? And finally, are these cost components outside the control of management?

These are really the threshold issues that you employ in evaluating whether an ECAM can be in the public interest.

Are there other issues that arise? Well, most certainly. And the parties in this case have raised a number of issues. For example, the question of incentives is a legitimate question to raise; however, I believe it's a design question. The power

of a prudence review is a very strong incentive, I think, that regulators have available to them, and I believe that it's efficient to discipline the utilities in their purchasing practices.

If evidence does exist regarding specific problems or patterns of behavior, then those should be addressed in the design phase, because if you believe you have an issue, then you should address it, but you have a tool to address it with.

So, in that sense, I don't think that the incentive question rises to the level of negating the other threshold issues. It's not going to be something that would turn into a public interest question.

Another issue that seems to be a concern of the parties is that an ECAM is unduly shifting risk, and it's risk that the Company should bear, it seems. First, let me say that I don't really see this as a risk-shifting issue, per se, but, rather, a shifting of the cost responsibility based on a fair regulatory process.

As rates are set now, a forecast of net power costs is employed to set the cost responsibility of customers; however, the actual pattern of net power cost changes after this forecast

has been submitted. As the evidence in this case indicates, the Company has experienced a pattern of under-recovery in the last few years. The ECAM basically re-allocates these costs to customers, just as it would do if then it set the forecast in a way that we could be accurate all the time, and it would be the actual costs.

Now, unfortunately, given the inherent characteristics of costs that are at issue, no fixed a priori estimate will ever be, even on average, I don't believe, the same as the actual costs, because the numbers are based on two different sets of information. We forecast based on past knowledge, and then the actuals are based on actual knowledge that's revealed to us in time.

So there's no amount of really better forecasting, I don't believe, that can reconcile that kind of problem. There will always be errors in forecasts.

Therefore, what we do know is that the utility, under the existing process, will virtually never recover its prudently-incurred costs because of the errors in forecasting. But that also means that the customers could end up bearing it, because if we found a pattern of errors that were actually -- that

the costs were falling, but we had set the forecast based on past information, then the customers would be overpaying, and I don't want to see that, either. Everybody should either be getting the actual costs or paying the actual costs.

Now, this pattern is kind of revealing, because it does show that this current process can be unfair to stockholders today and unfair to ratepayers if that cost pattern should change. Why is there a focus on paying the actual costs with a true up mechanism that would make sense, that an ECAM would make sense?

Well, under the current process parties are all kind of at risk unfairly, and what the ECAM basically does is mitigates the risk that either party would bear, depending upon the pattern of cost changes over time, so, by adopting an ECAM that makes everyone pay or receive the actual costs, I believe you're actually mitigating the risk.

Now, I know some people have concerns about an ECAM introducing adverse incentives for the utility to operate its system efficiently. This concern is intuitively understandable. It's something that a casual observer would always think. If we change the rules, there's going to be some

change in the incentives.

First of all, I think that the academic literature which we've been presented with as evidence in this docket for the proposition that there is an incentive problem are, in general, not applicable to the programs that RMP is asking to have put in place. Many of the old studies that are being relied on are actually examining ECAMs that were put in place when there were no prudence reviews.

In the early '70s, if you look at that literature that occurred, that's the kind of thing we had in place, and so when the academics went back and looked at it, yes, they found some problems, but that's not what's being proposed here. You would have all the prudence review capability at your fingertips.

Secondly, the ECAM approach does use the ex post prudence review as part of the regulatory process. I think what you're really doing if you adopt an ECAM is having a two-stage process. You're setting base rates, and you have a chance to review all those costs, and then you're -- you know, in that process you set the future price, and then you have a chance to reconcile that and look at it and see if there are any errors. And you also have an ability

to change the incentives inside the ECAM if you ever do find there's a problem.

So you may start out with no incentives, but you can always add some if you found that that adoption of an ECAM seemed to indicate that there were incentive questions arising, so you could go back and change it again and implement something like that.

And we have evidence and we presented evidence where states do have some forms of incentive mechanisms embedded in their ECAMs, so some states believe they do have problems with some of their utilities.

I don't think you have to assume that's the case to begin with, but if the fact pattern reveals itself, then you can adopt an incentive.

So is an ECAM in the public interest? I believe it is, and to the extent that the Commission has additional concerns, I believe those concerns can be addressed in the design phase of this proceeding.

In conclusion, I would encourage the Commission to acknowledge that an ECAM is in the public interest and move on to the second phase of this case. Thank you.

CHAIRMAN BOYER: Thank you, Dr. McDermott.

Commissioner Allen, any questions for Dr. McDermott?

COMMISSIONER ALLEN: Yes, Mr. Chairman. Along the same line of questioning, I'm just curious, have other states found that it was in the public interest to implement their cost adjustment mechanisms in phases or using pilot programs first, that you're aware of?

THE WITNESS: There may be some that were done that way. I'd have to go back and re-examine the literature, because some of the earlier ones may have done it that way. I do know that, you know, you can -- in the sense that you have control and authority over this type of process from day one until its end, you can always, you know, go back and modify it, so you can think of it as a pilot from day one, but I don't think that would stop you. You know, you have that ability to do it, and that would still be reasonable.

COMMISSIONER ALLEN: And even if it were determined that's in the public interest to do that and there were additional -- there was some additional oversight and some milestones that would be part of that period, would it even be practical to determine if there had been any actual shift in

incentives? How would we measure that? How would we even determine that?

THE WITNESS: Well, I think this goes to sort of a prudence review process you would probably be putting in place. As Mr. Duvall said, you're looking at exceptions, so there's probably going to be benchmarks that you establish, and -- for example, I know there's been concerns raised about, you know, availability of plant, and so you have a historic set of data on the availability of Rocky Mountain Power's plant.

If, after you've adopted the ECAM and you find that that deteriorates and that's not explainable by some other reason outside of the management's control, then you have evidence that there's a problem, and that's the kind of review you would be conducting, I think, under this process.

COMMISSIONER ALLEN: Thank you.

CHAIRMAN BOYER: Commissioner Campbell?

COMMISSIONER CAMPBELL: I was wondering maybe if you could elaborate a little bit more on the prudence review. I understand what Mr. Duvall said about exceptions, and I just heard you talk about benchmarks, but could you just describe for us the typical prudence review that takes place with ECAMs

around the country?
THE WITNESS: Well, you know, in some cases what we've done is -- we have a fair understanding of how much fuel is being consumed by all the different units, and so you have quantities, you have the variation in loads, you have a bunch of data that you can use to establish a series of benchmarks, and typically in the monitoring processes that may go on, the Commission's staff will be looking at those indices to see if there's any significant change.
In some cases, some years you may find no significant deviations and the review process is pretty straightforward. If there are significant deviations, then the Commission may even launch other investigations, for example, on, you know, why is the availability of our units down, things of that nature, so you could delve into those questions a little more. And that's typically the way it's done.
In Illinois we had many cases that were sort of pro forma, and then other times there would be an issue, because we had large numbers of nuclear plants and they were having availability problems at times, and so we would investigate those, and that's typically the way the processes ran.
COMMISSIONER CAMPBELL: In your review of

other states' ECAMs, have you drilled down to understand how limited or comprehensive those mechanisms are compared to what the Company is proposing here?

THE WITNESS: Well, in a large number of cases, it's all the costs. I mean, all the fuel types, all the purchasing power. It's an ECAM, as opposed to a fuel adjustment clause, because, you know, in the Company's operation, you're relying on all of these different components to try to minimize the cost of operation, so, in general, the Commissions are trying to be all inclusive. Not all of them are, and I haven't drilled down on each one to try to see the exact -- which ones are exempted from certain costs, but it tends to be as comprehensive as possible.

COMMISSIONER CAMPBELL: So let me rephrase that. Is the Company's proposal -- based on your understanding of what the other states are doing, is it more comprehensive, less comprehensive, or average?

THE WITNESS: It's right in line with what other states are doing.

CHAIRMAN BOYER: A couple questions, Dr. McDermott. You heard my little exchange with Mr.

Duvall on forecasting and forecasting accuracy, and I assume you've had an opportunity to look at some of the data for Rocky Mountain Power in preparation for your testimony. Would you say that Rocky Mountain Power's net power cost forecasting is more or less accurate since we started using forecast test periods? Does that have any influence on the accuracy?

THE WITNESS: Well, I think anytime you're forecasting -- it's like I was saying in my summary, you're using historic data to try to forecast, and we hope that the past is indicative of the future, and so when the world is stable, forecasts tend to be better and more accurate because, you know, the underlying trends and costs don't change. But I think the very issue and the reason why the Company has come before you is that the volatility in many of the cost components and in the marketplace that they're relying on for both purchases and sales are volatile, and that's what's causing it.

I don't know that we could -- you know, there's always somebody who is going to come up with a better model, I hope. I mean, that's what the academics would like to have, but I don't know that there's any inherent better or worse forecasting that

the Company or any of the parties can do. I think -- and, again, this is a group effort, often, right? They come in with a forecast, and everybody else has opinions about the forecasts and other specialists, and the result that is adopted in the rate case is often a compromise, so that adds another flavor to the fact of how -- you know, is it the Company's model that we're actually using all the time or is it a compromise that's been struck?

All of that adds to the difficulty of forecasting, but I think that's why the ECAM eliminates that concern, because you're truing up and you're just paying the actual.

CHAIRMAN BOYER: Would a stochastic approach, do you think, improve forecasting?

THE WITNESS: I think any -- I think you have to use a number of models. To the extent you can use a stochastic model and show that that's improved performance on some different dimensions of performance and how we even measure the forecasting errors, then we should be looking at it, yes.

CHAIRMAN BOYER: You mentioned this morning that misforecasting can cut both ways, I mean, they can understate net power costs or overstate net power costs. Do you find it curious that, for some period

of years, they've been incorrect in the same direction?

THE WITNESS: Well, that's sort of indicative of the fact that the costs have been, you know, inflating over these last few years, and the other aspect of this is -- I believe your first gas plant came in around 2001, and so all of a sudden at that point you have to factor in the volatility of gas prices into forecasting, so that would have added, you know, another potential for more error to occur in the modeling process, so it's a dynamic activity that you're engaged in, and the fact that it seems to be under-forecasting on a consistent basis means we're just trying to catch up to the inflation.

What will happen, potentially, is if we have a deflation, it will reverse the other way, right? And the errors will be sort of serially correlated where the customer is paying too much. I want to avoid that as well, because the ECAM will always make you pay the actual, not the forecasting.

CHAIRMAN BOYER: In your opinion, having reviewed a number of different states that have ECAMs, does having an ECAM influence resource choice, going forward?

THE WITNESS: I don't think so, because you

have -- they have to come before you for prudence review of all the plants they choose, all the resource planning dockets that will be brought before you. You have many ways of checking on that and questioning them. I don't think there would be any reason for them to not act in a cost-minimizing fashion, because they have to come before you to have it reviewed, and all these parties are going to keep them honest.

CHAIRMAN BOYER: You wouldn't see, for example, a bias towards gas generation if you could pass off, you know, the actual gas or fuel costs?

THE WITNESS: If that happened, then they're going to propose it in a docket where you review that, and all of the parties are going to say, "Wait a minute. Wouldn't a coal unit or wind or hydro prove your case?" And I don't think on the basis of just having the fuel pass-through that that would necessarily, you know, tilt the scale that way.

CHAIRMAN BOYER: Have you had an opportunity to review Rocky Mountain Power's hedging strategies, techniques?

THE WITNESS: Not in a technical sense, no.

CHAIRMAN BOYER: So you wouldn't know whether they're mainstream, good, bad, indifferent,

better than average?

THE WITNESS: No. That was more Mr. Graves' area.

CHAIRMAN BOYER: I'll ask Mr. Graves that. Okay. And I think you addressed my questions on risk allocation already in your opening statement. So thank you very much. I think that's all the questions we have of Dr. McDermott. Thank you for coming.

THE WITNESS: Thank you.

MR. MONSON: Our next witness is Frank Graves.

CHAIRMAN BOYER: Mr. Graves, raise your right hand, please.

FRANK C. GRAVES

called as a witness and sworn, was examined and testified as follows:

CHAIRMAN BOYER: Thank you. Please be seated.

DIRECT EXAMINATION

BY MR. MONSON:

Q Please state your name for the record.

A My name is Frank, middle initial C, last name Graves, G-R-A-V-E-S.

Q And by whom are you employed and in what

capacity?

A I am a principal at the consulting firm, The Brattle Group, in their Cambridge, Massachusetts office. I've been with them for 15 years and I've been consulting to the electric and gas utility industries for 30 years.

Q Do you want to -- this is your first appearance before the Commission?

A Yes, it is.

Q I don't know if you want to add anything on your background or experience, but if you do, please go ahead.

A Sure. As mentioned, I've been consulting on planning matters and regulatory approval matters for the electric industry and gas industry since 1980, at which time I had left MIT with a master's degree in finance and a focus in risk management and valuation.

Over that time frame, I have worked with most regions of the country and other parts of the world on virtually every aspect of long-range resource planning, valuation, risk management, and pricing that utilities incur. Those kinds of problems I've looked at along every link in their supply chain from generation through transmission,

distribution, and service design.

Most recently, in the last decade, I've focused heavily on how utilities can operate effectively and efficiently in the context of the restructuring that occurred in the late '90s in which wholesale competitive markets were created and there was a move to separate the functions of generation, transmission, and distribution and then use various kinds of contracting and risk management to put the service back together so that it would still satisfy customer needs at the delivery end, even though it was being provided through less integrated segments.

I've testified many times on integrated resource planning matters, risk management strategies, forecasting, procurement techniques, market performance, market efficiency, and so the ECAM questions in this case are quite central to the kind of planning and regulatory work I've done over the last ten years.

Q Did you prepare and have filed in this case supplemental direct testimony with one exhibit?

A I did.

Q And rebuttal testimony with no exhibits?

A That is correct.

Q Do you have any corrections you wish to

make to the testimony that was filed?

A I do not.

Q So if I were to ask you the questions in your testimony today, would your answers then be the same?

A They would.

MR. MONSON: We would offer Mr. Graves' supplemental direct testimony, with one exhibit, and his rebuttal testimony.

CHAIRMAN BOYER: Are there any objections to the admission of Mr. Graves' prefiled testimony, the supplemental direct with exhibit and rebuttal testimony? Seeing none, they are admitted.

Q (BY MR. MONSON) Mr. Graves, do you have a summary of your testimony?

A I do.

Q Could you present that to the Commission, please?

A Yes. I'd like to thank the commissioners for the opportunity to appear today to explain my views of what are the merits of the ECAM proposal that Rocky Mountain Power has put forward.

As a general contextual matter, I'd like to state that I agree that the three-prong test that's been discussed is the relevant standard for whether a

fuel adjustment and power purchase adjustment mechanism ought to be created and applied, and I think the preconditions in those tests strongly apply with respect to the Company and its recent past and its likely future.

To give a few sample statistics, of which there are many more in my report, today PacifiCorp's total net power costs are about a billion dollars, representing about 20 to 30 percent of their total retail supply costs. That number is about two and a half times their net income and about three times their annual interest on long-term debt, so variances in collecting those amounts are potentially material to the financial health of the Company, and, indeed, they have had past variances that have been quite large.

One of the tables in my rebuttal report shows that in 2007 the annualized difference between projected, that is, in rates, allowances for net power costs and actual net power costs was about $300 million for that -- for a 12-month period based on those rates alone, so amounts that are on the order of magnitude of net income or interest expense themselves as annual variances. So these are large and certainly material.

It is also true that the major components of the net power costs are very volatile, and I believe have been increasingly so in the past few years. They're also largely uncontrollable, and to clarify why this is the case, I focused in my reports primarily on two components of the net power costs, the net revenues from short-term sales and purchases and the natural gas expenses, and this is not to say that the other components are not volatile and important, but I simply focused on these two because I think the intuitions can be made quite compelling for why they are part of the problem.

So, again, natural gas expenses and purchases and sales in the wholesale market inherently are exposed to volatile and uncontrollable unit costs because those costs are determined in the -- through the numerous transactions among the third parties in the wholesale markets. Obviously Rocky Mountain Power is a price taker for those, and those prices have been very volatile in the past few years.

Even more importantly to why an ECAM is becoming important, the volumes associated with those transactions are highly uncertain and so are very difficult to forecast or hedge, and that is

fundamentally because of the role that these resources play in what Rocky Mountain Power calls balancing their system. That is, these are the resources at the top of the supply ladder of the available units for producing power, and so they respond to changes in conditions on the system that occur and are only knowable over the short term.

So, for instance, they are what are used after the base load plants have been run and after things like renewable resources have taken out whatever portion of the requirements they're able to provide, but they're very weather sensitive and unpredictable. So the top part of the problem is much more volatile than the problem as a whole, and those resources are the ones that are turned to whenever unexpected conditions arise; that is, you adjust your gas generation or your power purchases and sales. And those adjustments to unexpected conditions can involve large costs.

Again, to provide a few statistics -- my rebuttal report shows several examples, but the gap between the rates that have been -- the costs that have been associated in rate filings with expected power purchases and the realized volume and cost of power purchases has sometimes been more than a

billion dollars a year just for power purchases, and, similarly, more than a billion dollars a year in variances for power sales.

Now, to some degree, those offset, but not fully, and so the variances in those short-term costs that are not part of the forecast that's made at the time of the base rates for NPC are themselves often as large as NPC as a whole, so these are -- there is material exposure to unexpected costs, and that exposure isn't arising because of any kind of inefficiency or failure to forecast. It's simply that operating resources in a complex dynamic system inevitably involves lots of short-term adjustments, and those risks and costs are incurred again in the spot market where the price of them is not particularly controllable.

Now, some intervenors have expressed the belief that maybe these variances could be reduced if better forecasting and hedging was applied. I do not think this is the case, although there's always room for looking for improvements. In my review of the Company's practices, I found that they have sophisticated hedging and forecasting practices in place and have had for several years, but, nonetheless, these kinds of variances have accrued

even in a setting where they're directly exposed to them through the fact that they don't have an ECAM mechanism.

So there's no reason to believe that they're neglecting some opportunity to apply a better technique to eliminate these kinds of problems.

As Dr. McDermott said, there simply are going to be inevitable differences between forecasts made well in advance of operations and the realized cost, and so those are -- since those are not known and knowable at the time of the rate case, they aren't built into the hedges or the forecasts at the time.

I also reviewed the pattern of these to see whether they tend to dampen out over time or be one offsetting another, and I did not find that you can reasonably expect these variances to just be noise about the NPC-based rate. There are some -- sometimes they offset each other, but not reliably enough over long periods of time to say that the variances aren't going to be large, and, indeed, as I mentioned, sometimes they are hundreds of millions of dollars over even a one-year period.

And, again, for the same reason these are difficult to forecast, they are also difficult to

hedge. Rocky Mountain Power does have an elaborate and sophisticated risk management capability in place under which they buy nearly all of their forward requirements for gas and power purchases and sales opportunities for the next one or two years against what they can expect to see, and this hedging practice is very closely controlled by formal procedures that I think are as good as I've seen in the industry. They're state of the industry and, in many cases, state of the art techniques that involve forward procurement targets that are quite acidulously honored, rules for what kinds and sizes and types of hedging can be obtained, daily measurement of the probability distribution of their open positions to see whether those are becoming riskier than they were the day before, risk controls to look at the cumulative changes in those exposures over time, and all sorts of layers of organizational review that allow them to keep track of responsibilities for controlling those costs.

And those practices have kept their exposure to extreme changes, I think, under a fair degree of control. There's been a benefit from that hedging, but, as I mentioned, not everything can be hedged away.

By the way, those same techniques that they've been using have been embedded in the net power cost filings in the past, so all that technology is somewhat familiar to the Commission already and would continue to be part of the tool kit that's available to manage the ECAM in the future.

It's my view that, if anything, the difficulties in trying to forecast and hedge these kinds of costs have increased in the past few years. A review of spot and forward prices shows that -- for both gas and electric power show that they have both become more volatile in the past few years, and the complexity of the volume forecasting has also increased.

As Mr. Duvall mentioned, there is increased renewable resources on the system and increased reliance on gas-fired generation. Those are useful resources, but they have complex operations that are weather sensitive, and the gas resource use is very spot price sensitive, so there is more exposure to resources now that have -- whose use is ultimately determined in the short term rather than resources whose long-term usage can be reasonably well predicted back in a base rate case.

So that basically means that it's pretty

much inevitable that, absent an ECAM, customers are going to be charged amounts that don't represent the true cost, but an ECAM would rectify that, and, in so doing, recover what I believe are prudent operating costs that are incurred in the course of those short-term decisions.

I also believe that an ECAM will improve the process of regulatory review and price setting from the system that RMP is operating under now, and not just for the Company, but it will improve it for regulators, for intervenors, and for the Company itself.

As Dr. McDermott mentioned, virtually every state in the country has adopted fuel cost recovery mechanisms like the ECAM, and when you study this problem, you realize that that's an efficient thing to do, because the process and the time frames and the standards for regulatory review and scrutiny of operating costs, I believe, are very different than the standards and process and criteria that should be applied for reviewing long-term resource decisions, and if you adopt an ECAM approach, you clearly separate these two and allow each to be studied on its own terms on a more timely basis.

You can, A, target attention to the

controllable resource decisions a utility makes about what its resource mix should be, and then you can sharpen the focus on whether they're operating their system and hedging it in an efficient and reasonable way through the ECAM review process, and you can do those under time frames that are more well suited to each.

There's been a concern from some intervenors that if you approve an ECAM, it will create adverse risk shifting to customers and perhaps a diminution of incentives. I also don't believe those fears are justified.

In terms of risk, we are already sharing a forecasting risk between customers and the Company. That is, the NPC is being set on the basis of a forecast, but if you look at the forecasting itself, those -- the forecasts have been neither very accurate nor very stable, so we're adjusting all the time, and we're going to end up, under an ECAM, adjusting to what the actual costs are.

It's not clear that that will be necessarily any more volatile, but it will be more accurate than the measure that's -- the approach that's being taken now.

And in terms of incentives, I think this

notion that the Company might become indifferent to the costs of their net power and that the Commission might be -- have difficulty in monitoring and reviewing whether they are letting things lapse is not a well-founded fear, either.

The Commission, as I mentioned, will, in fact, I think, gain a better mechanism for reviewing the operating costs. Certainly these costs will not automatically be recoverable but will depend on a review by the Commission as to whether they're just and reasonable, and the tools of risk management that the Company already has in place will continue to be applied and can be one of the -- can supply some of the information for the review process, and it also provides a knob that can be turned if, in those reviews, the Commission should decide that too much of a certain kind of risk is being incurred. There is a possibility of adjusting the risk management protocols with the tools that are in place to achieve alternative ends.

So there's actually a fair amount of infrastructure ready to go to support an ECAM. And if, for some reason, something should appear to be going off the rails, it's quite readily possible to create incentives targeted at particular problems,

such as plant efficiency or plant availability. Those are the kinds of things that would be monitored, and it's easy to fix those after the fact.

So, in sum, I'd like to stress that I think accurate cost recovery for utilities generally is critical to their financial health, and this is especially important now when utilities like Rocky Mountain Power are embarking on generally expanded capital expenditure programs in a tight credit market where concern about the reliability of cost recovery and the ability to service debt and so on can become major constraints, and if those are felt, the Company would have to delay or forgo things that might otherwise be desirable for the system and for customers.

And in a worst case, the Company would find itself having to repair damaged financial health, and that's much harder than sustaining financial health. Credit agencies are very conservative. They react slowly to -- quickly to bad news and slowly to good news, and so if the Company is -- should slip, it's much harder to fix than to prevent.

So an ECAM helps prevent that problem. As I mentioned, I think it also provides a regulatory benefit by making a more efficient separation of

resource planning decisions and operating efficiency evaluations, and based on my review of the three-prong test all of the preconditions are more than met by the Company, and I would recommend adopting an ECAM with design details to be sorted out in phase two.

CHAIRMAN BOYER: Thank you, Mr. Graves.

Commissioner Allen, any questions?

COMMISSIONER ALLEN: Thank you, Mr. Graves. I think I know the answer to this first question based upon what you said when you talked about risk is already shared by Rocky Mountain and by its customers. In terms of the assertion by some parties that it's not in the public interest to go to phase two because there's not -- there hasn't been some sort of up-front protection or reduction in the allowable rate of return, that's when they talk about the assertion by some parties that there will be a reduction in their risk, there should be attached to the very early phase of this, at least the way I'm reading the testimony, some sort of compensation or some sort of adjustment for reduced risk, but would you care to take your comments and just specifically address that particular assertion?

THE WITNESS: Sure. I would not recommend

that that occur, for several reasons. First of all, part of the reason the Company is seeking an ECAM is because they have found that the risks of not having one have been growing, and so they are facing a -- and I believe they will continue to grow, because I think the market complexity and volatility is likely to grow over the next several years.

So there is -- on the one hand there is increasing risk, and some of it may be reduced by an ECAM, but it's not clear that it's a net reduction which causes -- which would justify reducing the ROE or any overall measure of cost of capital.

Second, just as an economic theory matter, there's actually -- it's quite a difficult problem to figure out whether the kinds of errors that will be reduced under an ECAM actually meet the test of being the kinds of risks that cause financial investors to demand a premium. In general, in financial theory and statistical evidence, only so-called systematic risk, that is, risks of cash flow movements that are correlated with the stock market as a whole, require compensation, because those are undiversifiable risks, and many of the risks that are involved in moving to an ECAM I don't think are likely to be systematic.

Again, it's an empirical question, but it would be speculative to assume they are at this stage, and, instead, I would suggest that an ECAM be adopted and, over time, the measures of the Company's financial performance will give you evidence as to whether there's a reduction in risk.

And I guess the third thing I would say is I understand that the Company uses the same kinds of techniques for estimating its cost of capital as are used in other settings, and usually that involves looking at proxy companies to look at the rate of returns required on their equities, and virtually all the utilities in the United States already are operating under ECAM-like mechanisms.

So, to the extent there is a discount in risk that tends to be associated with ECAMs, it's probably already embedded in the data that you're collecting now, and what you probably aren't collecting is whether there's a premium for not having an ECAM, so I don't even know that you aren't already ECAM adjusted in some sense by the way your data is arising.

COMMISSIONER ALLEN: Thank you. And then along the other lines of my other questions for the other parties, you know, we're looking at the risk --

as a Commission, we're looking at the risk of having unintended consequences. We're making a major policy shift here, and so, of course, that's what results in my question about whether or not a pilot program would be appropriate.

In your view, would it give us greater control over the potential risk of unintended consequences? Would it give us more oversight or would it be redundant? Of course, depending upon how that looked.

THE WITNESS: It might help if I got a little better understanding of what you mean by "pilot," because sometimes that implies a practice focused on a subset of customers and only a few of them participate --

COMMISSIONER ALLEN: In this case I'm talking about a time period in which they have to basically prove it or lose it, that it hasn't created other problems, and so you would do a three-, a four-, a five-year pilot and say, "We're going to have some benchmarks, and is it working system wide and have we had any unintended consequences before it goes on?" So that would be my notion of a pilot.

THE WITNESS: I think that approach could work. I think what would actually happen is, as you

go forward, is you could adopt an ECAM and start deciding, over the course of the next two to three years, what kinds of performance metrics you want to keep track of, what sort of reporting you need to see to feel confident that risk management protocols are being applied in a reasonable way.

You could do diagnostics of things like extreme events to say, "Well, if the ECAM went up Y percent this year compared to what we had forecasted, what were the causes?" Do some variance analysis and see if it's due, for instance, to a few price spikes or due to a plant outage, and, if so, is there something that can be done to reduce exposure to that kind of thing in the future?

I am quite confident that your program would iteratively improve over time, like over the course of, say, three years.

Now, whether you would then, you know, want to reach a drop dead or re- -- you know, major restructuring decision -- I suspect that might be not necessary. I suspect it would be more evolutionary rather than an all-or-nothing kind of decision at some point downstream.

COMMISSIONER ALLEN: So I think what I'm hearing you say is if we have proactive prudence

review, we wouldn't necessarily need a use-it-or-lose-it pilot program. We would just need to be more proactive because it's new. Is that fair to say?

THE WITNESS: Yes. I think that is a fair summary.

COMMISSIONER ALLEN: Thank you.

COMMISSIONER CAMPBELL: Understanding that hedging is used to reduce volatility and not minimize costs, would you be willing to comment on the amount of Company hedging as it would relate to cost minimization?

THE WITNESS: Let me make sure I understand your question, because there -- I can compare the amount of hedging they do to what I have seen many other utilities do, but --

COMMISSIONER CAMPBELL: Actually, that was a follow-up question I'm going to ask you about, is how their hedging compares to other companies that have ECAMs. I guess -- I guess my question is, is how does one determine how much hedging to do? There are those that would suggest the Company's hedging is to protect income and that there's been very little benefit to customers under our current mechanism, and I guess, from an outsider's view, as you've had a

chance to look at that, if you have an opinion on that.

THE WITNESS: Sure. It's probably fair to say that in a situation where you don't have an ECAM, then you are being asked to try to keep your costs in line with the forecast in a given fixed rate. Hedging arises as a way of protecting the investors largely from the variances that you might otherwise incur.

The Company does a lot of hedging in that regard. They -- as I mentioned, virtually all of their year one and two gas and purchase expectations are -- and fuel costs are hedged forward on a continuous basis all the time. They try to be hedged almost a hundred percent for the next two years. And they keep track of their daily exposure to changes in value of their unhedged positions.

Now, all those things help them mitigate their cost recovery risk of exposure to excursions in the market, but they're exactly the same techniques that can be applied to keeping the average cost of power within an ECAM under control within targeted bounds over longer periods of time, and the same controlling techniques can be used.

So I think it's had a -- it's been designed

probably with Company exposure in mind, but the platform is quite general, and it's very capable of being used for the same purposes of protecting the customer from seeing too broad a range in costs under the ECAM. Some of the reports might have to be modified a little bit and some of the -- you know, eventually some of the hedging prices might be varied, but the --

COMMISSIONER CAMPBELL: So --

THE WITNESS: -- (inaudible) looks good.

COMMISSIONER CAMPBELL: So the follow-up question is, under an ECAM, will the Company, in your opinion, hedge more or less? Is there incentive for them now, because they get recovery, to hedge less? And then that might be the right answer as it relates to cost minimization. I don't know. But I'm just curious of your opinion, watching and seeing other companies with ECAMs, whether the amount of hedging is going to go up or down.

THE WITNESS: I doubt they would hedge less, for a couple of reasons. One, they have procedures in place that they know how to work with that are -- that involve, as I mentioned, virtually a hundred percent hedging over the next couple of years of expected open positions, that is, positions where

they can predict likely use of their gas plants and likely purchases, and so the problem has not been -- that's motivating an ECAM has not been variances in those items. It's the variances in the uncontrollable items that happen in a short run that, as it turns out, have costs on the same order of magnitude as the NPC itself.

Those items are not as amenable to hedging. There are some tricks that could be done, and I suspect what would happen is the Company would discuss with the Commission and intervenors whether additional hedging strategies to trim some of those are desirable. For instance, you could over-hedge your requirements to reduce your exposure to upward price movements. You thereby increase your exposure to having to dump hedges that aren't needed at a small loss in off peak periods, for instance, but you can bias your hedging beyond your expected needs if there is great concern about extremes, or you can use other kinds of hedging instruments.

So I think the issue would not be, should they do more or less hedging, but would you gradually decide over time that a different pattern of exposure to future costs is what the customers ought to face, and, if so, does a different schedule and type of

hedging better serve that?

COMMISSIONER CAMPBELL: I want to ask some risk questions, but I think they're the ones that you asked previously, so I think I'll just defer.

CHAIRMAN BOYER: I was going to, but go ahead.

COMMISSIONER CAMPBELL: You go ahead, if you want to ask those. I'm assuming you're going to ask the risk questions about the customer versus the Company's ability to control the costs. I wanted to explore that, but I assume --

CHAIRMAN BOYER: I'll start that out, and then you can play, too, whatever you wish, Commissioner Campbell.

I asked this, I think, of Mr. Duvall and Mr. -- and Dr. McDermott as well, but this concept of allocating risk to those most able to mitigate, and the fuel costs, it seems to me, is a perfect example of that, whereas an individual customer really doesn't have any arrows in his or her quiver, but the Company does have a number of options. What's your take on that? Is an ECAM shifting that risk?

THE WITNESS: I think that the factors that are making an ECAM important are, to a large extent, not very controllable by the Company, either. Once

you have a plate of resources that has been chosen because, on average, over the long run it looks like it has favorable cost-benefit ratios, you then pretty much do the following in operations: You try to schedule those efficiently, you try to keep their availability up, and you offer them into the western power markets to see if they're the cheapest way to supply your customers, or if somebody else has something cheaper.

So they get scheduled and utilized in the short run in response to a lot of conditions that aren't under your control, and in response to shifting market prices that certainly aren't under your control for the cost of the fuels and so on that are involved.

And it's the unexpected usage of those resources that is causing a lot of the variation in total net power cost, and there's no -- it's -- neither the Company nor the customer can really make that risk go away. It's just out there. There's going to be plant outages, there's going to be days when the wind doesn't blow, and on those days, the Company is going to have to turn on more gas units, and that's the efficient response.

There's not a controllable way that the --

in the short run that the Company could have prevented that. Only over time can you ask, "Well, is that problem happening again and again, and is it costing us a lot? Perhaps, if so, we should alter our resource tool kit as a whole, our long-run resources, so that we can reduce our exposure."

But it really isn't the case that there's a controllable -- that all these cases are either controllable by one party or the other. Many of them really just aren't very controllable. That's part of the penalty of moving to restructured competitive markets. On the other hand, we get, hopefully, other benefits from that process.

CHAIRMAN BOYER: Using your example of operational kinds of risks, however, a Company would have, within its resources, prudent maintenance schedules, efficient operation, dispatching, and those sorts of things, whereas a customer wouldn't be able to manage that at all, really, would they?

THE WITNESS: That's absolutely right. Those are Company responsibilities, and those are the kinds of things that I think would be part of the focus of an ECAM review process, is to say, "Are the operational procedures that the Company is using, you know, consistent with good business practice, and is

there any evidence for neglectful anomalies or, you know, circumstances that arose that should have been preventable?"

I think you can do that review by exception. You don't have to become plant operators or managers at the Commission level to tell if something is going on any more than you don't have to be an automotive engineer to have a sense that your car isn't working quite right and, you know, probably something is wrong with the brakes. There will be high-level indicators of something going wrong that you can study and layers of detail, and creating an ECAM will, I think, actually bring that kind of attention to operations in a way that I doubt occurs now when the NPC is set up as part of base rates.

CHAIRMAN BOYER: I was going to ask you, because I was going to ask you if that would pertain with and without an ECAM, and you're saying that an ECAM would actually enhance the prudence of operations and maintenance and those sorts of things, you think?

THE WITNESS: Potentially, because it certainly sharpens the focus on the question of, is operational efficiency being pursued and achieved, which is a separate question from, you know, what

should our base rates be and what sorts of long-run costs should be recovered through those mechanisms.

CHAIRMAN BOYER: Let me turn now to fuel cost volatility. Say we're trying to mitigate volatility of, say, natural gas as a fuel stop. The Company can engage in hedging, which it does, and you've already explained that you think they have very mainstream and maybe above-average hedging techniques. You've been a hundred percent hedged a year or two in advance, but there are other techniques that could be used to mitigate that. Fuel cost volatility, one could buy natural gas resources, one could buy storage, one could use a number of those sorts of things. Customers wouldn't have those kinds of options available to them.

THE WITNESS: Absolutely right.

CHAIRMAN BOYER: So, again, how would the regulatory community incent the Company to engage in those very best, most prudent practices? Through prudence review?

THE WITNESS: I think that problem would be less than a prudence question and more of a resource planning question. I think what would happen is, over time, after a few years of observing your ECAM performance and trying to -- and reviewing

diagnostics of what's causing the variations that are occurring, you might begin to reach a sense that natural gas winter prices are a big factor in what's been going on, and if so, that raises the question of whether storage could be a mitigating resource.

That is not a problem that you could -- the utility can solve or should have been solved in the previous year because that's a long-run resource planning problem, so it doesn't really bear on the prudence of last year's ECAM costs, but it does motivate that question for the next IRP or base rates procedure to say, "What are you doing about getting" -- "evaluating whether a resource of that type would be useful in the long run?"

Nearly all those decisions you don't want to make just based on a year of a few anomalous periods of operation, but also on, you know, does this look like it would pay off over a five-, ten-, 20-year period, which are questions that go far beyond the time frame of the data that you would evaluate in an ECAM. That's part of the reason, I think, that separating those two functions is a good idea, so that you can focus on long-run questions in one and short-run questions in the other.

CHAIRMAN BOYER: So you don't think that

ECAM would provide a disincentive to the Company to pursue those?

THE WITNESS: Not at all. I think it would ultimately provide diagnostics that might help you be alerted to when those questions should arise in a way that might not be forthcoming in the current practice.

CHAIRMAN BOYER: I have a couple more questions, but Commissioner Campbell probably has some follow-up.

COMMISSIONER CAMPBELL: I just want to follow up on your resource planning answer, and I guess my question to you is, where is the hammer in resource planning? The experience that we've had in this state over the last decade, you have a utility that has to plan for multiple states, and a college in Wyoming made the observation it seems like they want to get approval in Oregon and they don't care that they're getting nonacknowledgments in our states or other states, because the plan doesn't conform to how we view the world or what our requirements are, so if that were the case -- let me make this a hypothetical. Let's hypothetically say that they have not had an acknowledged IRP in our state the last couple times because they seem to listen to

concerns in Oregon.

Where's our hammer in resource planning as it relates to your answer to the chairman's question?

THE WITNESS: I guess ultimately -- usually resource planning imprudence does show up in operating costs. People ultimately complain that, you know, we shouldn't have been exposed to this operating problem because you neglected to build or maintain a facility that would have been attractive, or you built something that proved to be way too costly and undesirable, so there is an interaction between the two, and I guess at some point I think it would be plausible that the Commission could say, "Look, we've asked for this resource question to be evaluated two, three times now," whatever the right threshold of frustration is, because of doubts in the ECAM process about whether some of the operating costs are justifiable, "and if we don't see a response to that, we will start concluding that they are being neglected," and portions of the ECAM costs would, you know, be marked down for what you think the next best alternative would have provided, and then the process becomes a more elaborate review to say, "Well, what would the world have been like if we had done something else?"

CHAIRMAN BOYER: Mr. Graves, just a couple more questions, if you'll bear with me. Just in summary fashion, what's in it for the customers? What are the benefits of the ECAM to customers? You've mentioned credit worthiness of the -- or the credit ratings of the utility and, you know, access to financial markets and so on and so on. Any other benefits that you can see that would inure to the benefit of the customers?

THE WITNESS: I suppose it's a bit a matter of taste, but if I was a customer, I would actually prefer to be knowing that I'm actually paying the operating costs that the Company is incurring rather than a forecast of what they were incurring at some past time, recognizing the inevitably large forecasting errors that can creep in.

In a very long-run sense, that will also provide more efficient information for them about, you know, the costs of things they can do. It may help them motivate their own consumption practices and home design and conservation decisions.

CHAIRMAN BOYER: A more contemporary price signal?

THE WITNESS: Potentially you could -- besides worrying about the hedging practices in the

ECAM, you could worry about the cost recovery pace and timing and you could move to a more efficient schedule that is much more contemporaneous and still recover the same total cost but be providing a better signal -- that's virtually impossible now under the forecasting approach -- so that you could get some efficiency benefits.

And eventually it may also show up that the cost of funds is lower. I think generally having a healthy utility and what I believe will also be more transparency here as to what's causing the performance of the utility to be good, bad, or indifferent are ratepayer benefits. They're sort of intangible, but, in the long run, I think they're important.

CHAIRMAN BOYER: My last question, Mr. Graves, is, would you -- if an ECAM mechanism were approved in this jurisdiction, what would you expect to see happen to the Company's credit rating? Would they improve, would they remain the same, would they avoid being downgraded? What would you expect to happen, based on your experience and what you've seen in other states?

THE WITNESS: I haven't reviewed recent statements by the ratings agencies about their

concerns about Utah, but I know that generally the presence of cost recovery mechanisms is looked very favorably upon by ratings agencies, and so, at the very least, it has to provide some improvement in the buffer before you're exposed to a downgrade, and potentially, if the companies have already been perceived as being on the threshold of riskiness, it might raise their ratings a bit, and then that would show up in reduced financing costs or easier access to capital, as we know liquidity is, in some ways, as important as the cost of capital nowadays, and I think it would certainly help that.

CHAIRMAN BOYER: Okay. Well, thank you, Mr. Graves. You may step down.

Mr. Monson, do you have another witness?

MR. MONSON: We don't. Mr. Griffith's testimony is listed here, but his testimony goes to phase two issues, and so we weren't planning on offering that.

CHAIRMAN BOYER: All right. Why don't we take a ten-minute recess, and that will give our able reporter a break, and reconvene here in about that time, five to the hour.

(Recess, 10:43 a.m.)

(Reconvened, 10:58 a.m.)

CHAIRMAN BOYER: Okay. Let's go back on the record in Docket Number 09-135-15 in the matter of approval of Rocky Mountain -- or the matter of the application of Rocky Mountain Power for approval of its proposed energy cost adjustment mechanism, and I think now we're going to hear from -- oh, I'm sorry. We do have a new attorney here. Or a different attorney.

MS. SMITH: I believe Mr. Kelly had entered my appearance this morning. I'm Holly Rachel Smith. I'm here on behalf of Wal-Mart Stores, Inc. and Sam's West, Inc.

I just wanted to let you know that, due to the changes in the schedule today, I anticipate that Wal-Mart's witness should be landing around noon today, and we should be able to get him here, although we had previously informed all the parties that we really needed a date certain of tomorrow because of Mr. Christensen's other engagements, but I will do everything I can to get him here.

CHAIRMAN BOYER: Very well. We'll hope that that happens, and if not, we'll make the appropriate adjustment. And welcome, Ms. Smith.

Okay. Let's -- I'm sorry. I wasn't looking left. I should have.

Ms. Schmid, I assume we're going to hear now from Mr. Peterson.

MS. SCHMID: Yes. The Division's witness is Mr. Charles E. Peterson. Could he please be sworn?

CHAIRMAN BOYER: Mr. Peterson, please raise your right hand.

CHARLES E. PETERSON

called as a witness and sworn was examined and testified as follows:

CHAIRMAN BOYER: Thank you. Please be seated.

DIRECT EXAMINATION

BY MS. SCHMID:

Q Good morning.

A Hello.

Q Could you please give your name, business address, and by whom you are employed for the record?

A Charles E. Peterson, Heber Wells Building, Salt Lake City, Utah. I'm employed by the Division of Public Utilities.

Q Have you participated on behalf of the Division in this docket?

A Yes.

Q Have you filed testimony listed on the

exhibit list that I have distributed to the parties and the Commission, your direct testimony, DPU Exhibit 1.0, with Exhibits 1.1, 1.2, and 1.3, rebuttal testimony designated as DPU Exhibit No. 1.0R and surrebuttal testimony designated as 1.0SR, with Exhibits 1.1SR through 1.2RD -- 1.2SRD?

A Yes.

Q Do you have any changes or corrections to those exhibits?

A No.

Q If I were to ask you the same questions contained in your prefiled testimony, would your answers today be the same?

A Yes.

MS. SCHMID: The Division would like to request the admission of the aforedescribed exhibits of Mr. Peterson.

CHAIRMAN BOYER: Are there any objections to the admission of Mr. Peterson's direct rebuttal and surrebuttal testimony, together with exhibits? Seeing none, they are admitted.

Q (BY MS. SCHMID) Mr. Peterson, do you have a brief summary to give?

A Yes.

Q Please proceed.

A Thank you. The Division understood that the principal purpose of this phase of the docket was to evaluate whether or not some form of power cost adjustment mechanism in Utah for PacifiCorp was in the public interest. The Division believes that such a mechanism may be in the public interest. The Division has a number of reasons to support this somewhat lukewarm support for an ECAM.

One reason is that the Company may be unable or has been unable to earn its allowed rate of return for several years. It is plausible that that is partly due to net power costs being unexpectedly high.

The Division believes that there are some power costs that are largely beyond the control of the Company's short-term -- beyond the Company's short-term control and cannot be easily mitigated or hedged away. In this regard, it is the Division's view that, to a certain extent, the Company's arguments that it should recover the cost it prudently incurs in behalf of serving ratepayers has merit.

Specifically, Company witnesses Mr. Duvall and Mr. Graves have identified system balancing purchases and sales involving both energy directly

and natural gas purchases and sales as a portion of the Company's system costs that are not amenable to easy control by the Company.

In my surrebuttal, I suggested that the Division could consider supporting an ECAM that was structured around these items. The Division also believes that power cost fluctuations may become large enough that the Company could be financially damaged if it is not able to reasonably recover costs from large fluctuations.

Avoiding such financial damage would be in the long-run interest of the public; therefore, it is reasonable that a mechanism be put in place to protect the Company from such an eventuality. In my direct testimony, I outline five principles that the Division believes an ECAM should follow to be in the public interest. This is in addition to the three-prong test that has normally been proffered, that an ECAM not reduce Company incentives to provide electricity to customers at the lowest cost and least risk prudently possible, that the mechanism not reduce Company incentives to cover its load and prospective load growth with owned generation rather than through market purchases, that the mechanism not unreasonably shift risk from the Company to

ratepayers, that incremental power costs be offset by incremental revenues before any additions are made to a balancing account, and that the mechanism only cover those costs that are truly outside the Company's control and cannot be anticipated and are significantly mitigated. That, of course, is similar to the three-prong items.

While these principles may be open to subjective interpretation, they help create a framework wherein the Division, at least, intends to judge any actual ECAM proposal. This leads to the next part of my summary. Much of the testimony filed by both the Company and the responding parties in this docket to base the specific ECAM proposed by the Company on its original filing. The Division generally agrees with the responding parties that the Company's proposed ECAM is not in the public interest.

As demonstrated in my own testimony, the proposal does not pass muster with the five principles I mentioned a moment ago. Furthermore, outside the possibility -- outside of the possibility of the extended discussion of short-term balance in purchases and sales and natural gas costs made by Mr. Graves in his rebuttal testimony, the Company has

not really provided a straightforward, lucid explanation of the exact problem it faces that only an ECAM can effectively solve. It has, thus, left itself open to the criticisms, for example, that it should do better at forecasting its net power costs or that the Company is fully hedged and doesn't need an ECAM or that Utahns should not have to pay for hydro power shortfalls.

However, much of the debate misses the point of phase one. The issue in this phase really is whether some ECAM could be in the public interest and not whether or not the Company's initial proposal was in the public interest.

The Office argues that two additional issues need to be decided before this docket moves any further. Those issues relate to the Company's current hedging practices and also to the Company's practices of making both short- and long-term market purchases to supply its power needs.

The Division agrees with the Office, but these are important issues that merit serious attention; however, the Division does not agree that it is necessary to shut down this docket until these issues are decided.

In sum, in spite of the criticisms of the

Company's specific proposal, the Division believes that there are reasons for moving the docket on to the design phase, phase two, to see whether or not an ECAM can be designed that is in the public interest.

The Division, therefore, recommends the Commission move this docket on to its next phase of ECAM design. Thank you.

CHAIRMAN BOYER: Thank you, Mr. Peterson.

Mr. Allen, do you have any questions for Mr. Peterson?

COMMISSIONER ALLEN: Thank you, Mr. Chairman.

Mr. Peterson, I believe the Division has some experience with managing, in other dockets in other cases, pilot programs, do you not?

THE WITNESS: Yes, that's true.

COMMISSIONER ALLEN: And, of course, this is just a continuation of my interest in whether this might be helpful. Do you think that if we were to move this forward to phase two but move it forward as a pilot, would that strengthen the public interest component?

THE WITNESS: I believe it would, and the Division, in fact, although we haven't said so in my testimony, we have discussed that that's what we

would push for in phase two, that it would be implemented as a pilot. We believe that a pilot program would give us the opportunity to gain experience with the ECAM as well as work out any potential bugs in the system as well as evaluate whether it would be in the public interest to continue the program.

COMMISSIONER ALLEN: Do pilots in themselves, assuming that it's well designed and has certain deadlines, do they give you more tools in your toolbox to improve prudence and to review?

THE WITNESS: They're usually set up to have the benchmarks and milestones that the Company witnesses previously mentioned. Those would be, of course, helpful, and also it is helpful to regulators and other parties to have the hammer over the Company that perhaps, after a time certain, if we're not happy, the program might be pulled.

COMMISSIONER ALLEN: Thank you.

COMMISSIONER CAMPBELL: How would you see a phase two unfolding? I mean, insofar as the Company has filed their proposal and all these parties have their objections to this proposal, do you see somehow a stepping back where parties would negotiate different opinions and see if they can come to a

consensus? Do you see the Company just re-introducing or maintaining their position and all the other parties maintaining theirs and -- how do you envision that?

THE WITNESS: I envision that in a phase two situation, at least behind closed doors, there would be more reasonable positions taken, more reasonable in the sense that it wouldn't be all or nothing. Certainly if the positions the parties have taken, the Company, the respondents, remains steadfast in their public positions in this hearing, then phase two would fail. That would be clear.

But I believe that there would be room for negotiation and that we would look at specific items that we could work with the Company on, and hopefully the Company itself would see the wisdom in negotiating with the parties to perhaps more limited ECAMs for the pilot program that Commissioner Allen apparently would like to see, if I may be so bold to conclude that.

CHAIRMAN BOYER: Just a couple questions, Mr. Peterson. You mentioned forecasting, and we heard from other witnesses about the problems with forecasting net power costs. What actually is being misforecast? I mean, is it cost? Is it fuel costs?

Is it operational costs? Is it demand? Why are we off by a country mile here year after year?

THE WITNESS: Well, that seems to be one of the mystery questions of this matter. In fact, it was the subject of a data request by the Division, and the answer that was supplied was not very satisfactory in the sense that the Company was specific, but X, Y, and Z are the cause of the under-forecasting.

The Company, of course, does not believe that there is an inherent bias in their forecasting methodologies, but it is a concern to the Division that they're now saying that eight years have gone by and they haven't been able to, to use Dr. McDermott's terminology, been able to catch up with the changes. I can see a catch-up situation going for a year or two, but it's hard to understand, from the Division's perspective, why they haven't had some years of over-forecasting as well as under-forecasting.

I mean, this is beyond the question of what gets decided in a rate case. This is the starting forecasts that the Company provides us with, and there is a concern there, and it's something that we would like to look at further as we discuss this, if we do proceed into phase two and discuss the

possibility of setting up a working ECAM pilot.

CHAIRMAN BOYER: And you've mentioned the three-prong test, as have the other witnesses, and then you listed today five principles which an ECAM that was in the public interest should contain, but let's assume hypothetically for a moment that you're king for a day. What -- specifically, what would an ECAM look like if you were tasked with designing an ECAM that was in the public interest, to the benefit of both the Company and customers?

THE WITNESS: Well, I'd be fibbing if I said I hadn't thought about that a little bit, although I can't say that a detailed design has been worked out by either myself or the rest of the Division staff.

I would envision an ECAM, though, entailing some protections for the Company with respect to spot purchases of natural gas, that a price target would be set, and around that price target we would evaluate or perhaps have a zone where the price is allowed to fluctuate, but if it gets above or below that zone, there could be recovery or a refund of costs.

With respect to the short-term balancing purchases and sales that the Company makes, I

would -- I can foresee that the -- an ECAM would entail some coverage of those. If there's a very unusual hot day in July -- it gets to be 110 degrees here in Salt Lake -- certainly the Company wasn't anticipating that and would have to scramble to cover the power demands, and I could foresee that an ECAM would take into account such fluctuations, or, on the opposite side, if, on the 4th of July it was only 75 degrees and no one was running their air-conditioners, it would go the other way.

So those are the areas that the Division -- or the -- maybe I shouldn't say "the Division" -- that I, personally, would see an ECAM being developed to cover. The issue of forecasting would be something that we would want to look carefully at in implementing an ECAM, because we -- we would -- and I think I can speak for the Division. We would like to get away from this situation where the Company is always under-forecasting and always being out of the money, apparently, in their forecast.

So that's kind of an outline of what I would see the Division supporting at this point. Of course, as we get further into it, that could change as we discuss with other parties and with the Company, but that's where I see the Division heading

at this time.

CHAIRMAN BOYER: Okay. And one last question. You mentioned in your opening statement that there are certain elements of net power costs that are not easily controllable by the Company, and you just enumerated some of those. Weather, for example, would be one. What are some of the others?

THE WITNESS: Well, of course, weather is a cause of fluctuation in power demands. The short-term fluctuations that the Company faces, whether they're caused by weather or some other source, such as a forced outage of a power plant, what we're looking at or what the Division believes we should be looking at is the cost at the margin or the balancing costs that the Company incurs to keep the system in balance.

The Company may be over-forecasting on a particular hour or under-forecasting, and so the Company either has to back off power or increase its energy or its power to meet the load, and these short-term fluctuations, I think we're in general agreement with Mr. Graves, especially Mr. Graves' discussion that those are most likely largely beyond the Company's ability to control and to forecast.

Likewise, when the Company has to go out

into the market, we believe that, by and large, the Company is a price taker. They do not, at least in most situations, influence the market prices. So, again, it's the short-term sorts of fluctuations that we believe and agree, at least at this point, with the Company that they probably can't do a lot about them.

However, as I've also mentioned in my direct testimony, in the longer term, we might be able to identify areas that the Company could reduce its exposure through increasing -- for example, through increasing its gas storage ability or reducing its need for market purchases.

CHAIRMAN BOYER: Okay. Thank you, Mr. Peterson. You may step down.

Let's turn now to the Office of Consumer Services. Mr. Proctor?

MR. PROCTOR: Thank you, Mr. Chairman. As with Mr. Williams, we had asked the parties to waive cross on Ms. Schell, and so we would just simply like to offer her testimony into evidence, with one change, and that is Exhibit -- an exhibit has been mismarked. It should be -- it was marked as Exhibit 1; is that correct, Michele? And it should be marked as Exhibit OCS 2.1.

CHAIRMAN BOYER: And, for the record, you're referring to Ms. Beck?

MS. BECK: We have another witness, Ms. Lori Schell, and that's who he's speaking of.

CHAIRMAN BOYER: I'm just trying to make sure that the record is clear. He said "Ms. Schell," and then he looked at you and said "Michele," and it sounds like the same to me.

MR. PROCTOR: So we have three witnesses in total, Ms. Schell, Ms. Beck, and Mr. Chernick. With that one correction, we would offer to admit Lori Schell's testimony marked as OCS-2D Schell.

CHAIRMAN BOYER: Thank you. Are there any objections to the admission of the testimony of Ms. Schell? Okay. It's admitted.

MR. PROCTOR: All right. And then the next witness would be Ms. Beck.

MICHELE BECK

called as a witness and sworn, was examined and testified as follows:

CHAIRMAN BOYER: Please be seated.

DIRECT EXAMINATION

BY MR. PROCTOR:

Q Ms. Beck, would you state your name and the position you occupy with the State of Utah?

A My name is Michele Beck, and I'm the director with the -- of the Office of Consumer Services.

Q Have you prepared, in connection with these proceedings, direct, rebuttal, and surrebuttal testimony that's been marked OCS-1D, 1R, and 1SR Beck?

A Yes.

Q Do you have any corrections to any of those testimonies?

A I have one correction to the surrebuttal. This is on Page 15, the penultimate page. On Line 323, I referenced the 2008 IRP as -- I, unfortunately, gave it the wrong docket reference, so I wrote 07203501, and it should be 09, so just that single-digit correction.

Q And so, with that correction, if I were to ask you today the questions that you responded to in your direct, rebuttal, and surrebuttal prefiled testimony, would your answers remain the same?

A Yes, they would.

MR. PROCTOR: The Office would offer for admission the testimony that I've referred to.

CHAIRMAN BOYER: Are there any objections to the admission of Ms. Beck's direct, rebuttal, and

surrebuttal testimony with the correction noted? Seeing none, they are admitted.

Q (BY MR. PROCTOR) Ms. Beck, is it not true that today is your birthday?

A Yes, it is true.

Q Do you have a summary of your testimony?

A I do have a summary. Overall, the Office's position is that the Company has not demonstrated its need, it has not met its burden, and as well as that we've expressed concerns about management incentives under ECAM and concerns about a regulatory review under an ECAM, and the Office's witness, Mr. Chernick, provides substantial evidence supporting those conclusions.

But beyond that, the Office also has the position that no ECAM could be in the public interest until two threshold issues have been addressed and resolved, and those issues, as I stated, I think, in all three parts of my testimony, are natural gas hedging policies, as well as what the appropriate reliance on market energy should be.

In our view, an ECAM does shift risk, and, in particular, customers have no management control over these threshold issues. Further, the Commission has not approved or endorsed the Company approach in

either issue, and for those reasons, we're considering them to be threshold issues.

As a matter of fact, there may be other issues raised by other parties that could be in the same category, but we are just advancing these two.

To speak a little bit to each of these issues and why they are a threshold, the first one is natural gas hedging policies. As we noted and as we -- as I noted in my surrebuttal, and it was noted by Company witnesses as well, there is likely a higher cost associated with removing the volatility of the natural gas costs and that removing the volatility is the focus of the Company's hedging policy.

So, under an ECAM now, customers would both pay that premium and pay any higher prices that arose, anything that was higher than projected, but because of the policy and the level of hedging, there's not much potential benefit from the prices going lower, so we think that results in a situation that cannot be seen to be just and reasonable for consumers.

Conversely, the Company could entirely shift its policy, because this is not a policy that has been approved or endorsed, so they could shift

it, now that the cost recovery method could be shifting, and, you know, taken to the extreme, it could re-introduce all volatility to prices. Regardless of what they decide to do, they would be deciding if this would be within the Company decision, not taking into account consumer and regulatory preference for volatility and overall costs, unless the Commission determines that this is to be examined separately.

Our biggest question with respect to this is how could a prudency challenge possibly be made when there hasn't been any kind of a standard established first? The electric market energy -- the reliance on electric market energy is a very similar issue, despite the Company claim of no inherent bias towards market purchases or building new generation facilities.

I do explain in my surrebuttal how the Company decision not to build could lead to too high of an exposure to future price spikes, so, regardless of the kind of -- whether there's this theoretical underlying existing bias, there is an actual existing situation that's leading to exposure that consumers wouldn't otherwise have. Under the current system of recovering costs, the Company bears all risks

associated with this decision to use market purchases instead of new generated resources.

However, as I explained in my surrebuttal, if we switch to an ECAM, now the consumers would bear that risk, despite not having a real voice in what the appropriate level should be.

As I also said in the surrebuttal, I noted that the Company suggests the IRP is the appropriate forum for considering this. If that's true, then we need to change the IRP process and consider it. It's not currently addressed specifically, and the Company has indicated that the last time it received direction from the Commission on this issue was in the 2004 IRP, despite a two-year-long process that ended in a 44-page order from this Commission in the 2007 IRP.

So, again, I would ask the question, as I asked in my prefiled testimony, how could a prudency challenge be made when a standard is expected to be set in another docket but doesn't exist?

For these reasons, we believe that it is only after threshold issues are resolved that ECAM could possibly be designed to be in the public interest. The key is that these issues are sequential and must be sequential, and if and only if

the threshold issues are resolved, then we could consider design issues, but the Office is not, at this time, indicating confidence that public interest would be clear or automatic with resolution of these issues. We're just suggesting it would be possible.

I suggested in my surrebuttal testimony a couple of different paths that the Commission could pursue to address these threshold issues, either the two dockets that remain open now or inserting a new phase two within this ECAM docket prior to examining design issues, but we feel strongly that, without having this kind of careful process, it isn't clear at all how some kind of wide-open process addressing design could possibly yield anything coherent, let alone in the public interest.

So, to conclude, we urge the Commission to first examine these two threshold issues before moving forward with any kind of ECAM.

CHAIRMAN BOYER: Thank you, Ms. Beck.

Commissioner Allen?

COMMISSIONER ALLEN: Thank you, Mr. Chair.

Ms. Beck, I suspect you may have divined my question already.

THE WITNESS: Uh-huh.

COMMISSIONER ALLEN: But, to phrase it more

pointedly toward your testimony, if we decided to move to phase two, would moving it as a pilot program help meet the public interest test for you?

THE WITNESS: Well, I did expect that question, but I'm not sure if I understand entirely what you're envisioning, because I think one thing that should be absolutely clear is that the Commission cannot move forward to a pilot unless it's first determined that the rates would be just and reasonable. I think that it would be a bad move to move forward to see whether the resulting rates turned out to be just and reasonable. So perhaps that could be an issue that's addressed in phase two.

If we get to a point that we're looking at design, then we could talk about a pilot to gain practice in the review of such a thing, but I don't think a pilot in any way bridges any gap in determining public interest. I think that has to be made first and separate from the pilot.

COMMISSIONER ALLEN: Thank you.

COMMISSIONER CAMPBELL: Let me ask you a few questions related to the 191 account for Questar Gas as it relates to your proposal here. I guess the first is, do you consider that the office has a clear standard as it relates to auditing Questar Gas's

hedging policies?

THE WITNESS: I think that's a very good question. I think that the dialogue has been open enough among the parties that we feel comfortable with where their hedging policies have been recently, but I don't think that there is a clear standard.

COMMISSIONER CAMPBELL: Are you aware that we had a 191 before we even had hedging policies with Questar Gas? It was before your time, so I'm just --

THE WITNESS: Right, right. I think that's the case across the country. I think that extensive utility hedging is a fairly recent phenomenon, so certainly I'm aware of that. And in some jurisdictions there's no hedging, and that's proven to be a problem, and in other jurisdictions, getting approval of hedging has proven to be a problem.

I mean, it's still somewhat new, I think, for commissions to be looking at it, but not so new that I don't think there exist best practices out there.

COMMISSIONER CAMPBELL: I like your comment on the point made about transparency and whether our experience with Questar Gas maybe proves that point. We've actually, I think, as regulators, looked at Questar Gas's hedging policies because they have a

191 account where we -- it's an area of focus. Conversely, we have not done so with this utility. So do you believe that there would be greater transparency on some of these issues with an ECAM where there would be greater prudence reviews of some of the operational costs than are currently performed?

THE WITNESS: I don't. I don't think that there's evidence that there's a greater prudency review in the Questar case. I think we've talked about it, but I think that the Company -- that Questar takes cues from feedback it receives in these open public meetings, but I don't think that there's any kind of standard that has been set forth, and my experience in working with power cost adjustment mechanisms is not one of increased prudency review.

COMMISSIONER CAMPBELL: Kind of a final question, and it was also asked of another witness. Since you're kind of the voice -- we look to you as kind of the voice of our residential consumers. Do you think consumers would be more comfortable knowing their prices were set on actual costs versus forecasted or guesstimates in a rate case?

THE WITNESS: I think our office exists

because most consumers don't consider such questions, to be perfectly frank.

COMMISSIONER CAMPBELL: So you think consumers really don't care? They just want rates set in a process that they believe will give them fair rates?

THE WITNESS: I think that's true for some. I think some care a lot. I sometimes receive calls from consumers who are livid about Questar and the fact that they think they are paying higher than market costs without understanding how the 191 account for Questar works.

I think there's also a strong signal from consumers that they like price certainty, given the percentage that tend to be on the even bill pay plans, so I think there's a variety of opinions from consumers, but, by and large, I think they don't give it a lot of consideration.

CHAIRMAN BOYER: Ms. Beck, just a couple of questions, and I don't want to put words in your mouth, but I want to make sure that I understand completely your position. You're not saying that the Company shouldn't be entitled to the opportunity to recover prudently-incurred costs, are you?

THE WITNESS: No. I don't believe I've

ever said that.

CHAIRMAN BOYER: And when you talk about at least two threshold issues, one of which is reliance on markets, are you talking about reliance on markets as opposed to Company-owned resources?

THE WITNESS: Yes, I am. I think that this is an issue that warrants additional evaluation and discussion, but certainly we don't oppose the Company's use of economy energy when there's market energy available at lower costs, the incremental cost of running their own plants, so it isn't a threshold of an absolute percentage, but maybe more when you're looking at peak requirements or, you know, kind of the overall energy mix, how much of that should be with generating resources that they either own or contract with specifically as opposed to market resources that may or may not be there may be subject to price fluctuations.

You know, it's a short-term energy market and a long lead time to build new generating resources, so I'm not confident that you would see price signals of, "Oh, we better move out of the market and into our own facilities" in such a way that it would be possible to accommodate.

CHAIRMAN BOYER: Do you think it's possible

to design an ECAM that would address your concerns about hedging and market reliance?

THE WITNESS: No.

CHAIRMAN BOYER: Banding things or --

THE WITNESS: As I said in my testimony, partially and not easily, because I think that my observations here in Utah, though limited -- I've been here three years now -- is that there does not seem to be a high tolerance for really complex mechanisms.

There seems to be a preference towards things that are a little bit easier to administer, so I don't have confidence that we could design a mechanism that would be accepted within this regulatory community, let's say. I don't mean to suggest that's the Commission or any specific party, but just sort of the system in general.

I do think that if the hedging policies are sort of addressed first, then you could design an ECAM mechanism on that one cost component that could be in the public interest. I do think there's a sequential nature to it, but if it goes sequentially, that that component could be designed. I'm less confident of the possibility of doing it on -- just by design on the market energy. I think somehow we

would need to establish best practices outside of an ECAM.

CHAIRMAN BOYER: Okay. Thank you, Ms. Beck. You may step down.

I guess we'll pass Ms. Smith for the moment as we wait for her witness to come, hopefully today.

COMMISSIONER CAMPBELL: You said Mr. Chernick.

CHAIRMAN BOYER: Oh, Mr. Chernick. I'm sorry. That's right. My goodness.

MR. PROCTOR: Given the hour, Mr. Chernick's summary, because his testimony, like Mr. Graves, is very extensive, would now be a good time to break and also give you a greater opportunity to ask questions? Up to you.

CHAIRMAN BOYER: We could either do that or we could -- what I was thinking about is skipping to Ms. Mandell. Do you have a witness here with you? Are you going to testify?

MS. MANDELL: Yes. Ms. Kelly is here. She's -- I think her summary is going to be approximately 15 minutes or so. Hard to know. Well, the thing is, I'm not sure we're going to be able to finish by noon with her, just to give you a heads-up on that.

CHAIRMAN BOYER: We don't have strong feelings. Why don't we go ahead and hear from Ms. Kelly, then, now. I think the opportunity -- I mean, if we break by 12:30, we still have sufficient time to take an appropriate break. Would that be okay? Are you prepared to go forward right now? Ms. Mandell?

MS. MANDELL: It looks like she's prepared.

CHAIRMAN BOYER: She's always ready.

MS. MANDELL: Yeah.

NANCY L. KELLY

called as a witness and sworn, was examined and testified as follows:

CHAIRMAN BOYER: Okay. And welcome back.

THE WITNESS: Thank you.

CHAIRMAN BOYER: Have you changed your domicile now?

THE WITNESS: No. I still live in Pocatello, Idaho where I've been the last 11 years.

CHAIRMAN BOYER: Okay. Welcome back.

THE WITNESS: Thank you.

MS. MANDELL: Mr. Chairman, would it be easier if I went and stood over there so that she can look at me and not have her back directly to the Commission?

CHAIRMAN BOYER: Why don't you just take a seat there by Ms. Hogle and you can be comfortable and not have to stand.

DIRECT EXAMINATION

BY MS. MANDELL:

Q Ms. Kelly, could you please state your name and address for the record?

A Yes. My name is Nancy Lynn Kelly. I live at 9463 North Swallow Road in Pocatello, Idaho 84201.

Q And who is your employer and what is your -- in what capacity are you employed?

A My employer is Western Resource Advocates. I am the senior policy advisor for Western Resource Advocates.

Q And did you prepare both direct testimony with an Appendix A and two exhibits, and surrebuttal testimony with one exhibit, and have that be filed in this docket?

A I did.

Q Do you have any corrections to the testimony?

A No.

Q There was an issue with the exhibits in terms of the X axis. Did we -- do you have any corrections there?

A We -- with my direct testimony, we had filed two exhibits, and the X axis had disappeared when it was converted to Adobe. Those were refiled yesterday, is my understanding. I saw that e-mail.

Q All right. Okay. Ms. Kelly, if I were to ask you the same questions today that appear in both your direct and surrebuttal testimony, would your answers be the same?

A They would be.

MS. MANDELL: Western Resource Advocates offers, for admission into evidence, the direct, with the corrected exhibits and the Appendix A, and the surrebuttal with additional exhibit.

CHAIRMAN BOYER: Any objections to the admission of Ms. Kelly's testimony, direct with appendices and exhibits, and surrebuttal with an exhibit? Seeing none, they are admitted.

Q (BY MS. MANDELL) Ms. Kelly, I know that you had a very limited amount of time to prepare a summary here, but have you prepared a summary?

A Yes, and I will do my best here.

Q Excellent.

A Okay. Western Resource Advocates -- I believe that an ECAM is not in the public interest and should not move to phase two. It's not in the

public interest because it has what we perceive to be a long-run fatal flaw, long-run planning incentives that would be -- I don't see how that gets corrected by design.

If we were to move to a phase two, I believe that would require re-opening the integrated resource planning process and reviewing that.

Just a minute, please.

In Docket 90-035-06, the Commission examined the public interest benefits of eliminating the energy balancing account and moving to a normalized approach, and in that docket, a number of -- testimony was given for a number of benefits that included rate stability, the appropriate price signals to customers, placing the risk of fluctuating prices on those best able to manage them, operational efficiency, elimination of retroactive ratemaking, and the appropriate placement of risks and rewards on the Company.

It is our position that the Company has not established a need for an ECAM or demonstrated the problem that they're trying to fix. Sorry. I'm trying to find the right set of notes.

CHAIRMAN BOYER: Well, take your time. We've kind of caught you off guard here by asking you

to move up in the line.

THE WITNESS: Let's see. It seems to me that those public interest benefits that were established in the 1990 docket are still there and they're still relevant. Circumstances have changed since then. One of the main things that has changed is that, as a result of past planning decisions, the Company has gone from being long in resources to short in resources, and the benefits to it of an energy -- a power cost adjustment mechanism and energy cost adjustment mechanism are -- have now returned, and the Company has, in fact, desired an energy cost adjustment mechanism since 2001.

They first came to this Commission in 2001 asking for an energy cost adjustment mechanism, and it is just now coming to the Commission. They withdrew two of them. So we don't believe that they've established need.

And one of the things that I wanted to address under need, because we are an environmental agency, is that one of the reasons given for needing a cost adjustment mechanism is because of the volatility associated with wind and needing more resources to back up that wind. Their planning studies show the opposite result. In their planning

studies, the need to regulate upward and regulate downward and to have incremental reserve is already included in their cost. That's integration cost.

And the planning studies show that resources with less fuel volatility, less wholesale purchases, those portfolios actually perform better in reducing upper tail risk and in managing expected costs in the long run.

It was also established in the 1990 docket that management does consider its cost recovery in undergoing long-run planning in resource acquisition, and there is a clear link between the long-run planning incentives of an ECAM and not having an ECAM, and what our -- the main concern with an ECAM is that it introduces a bias toward riskier resources by shifting the full risk of these resources from management in between rate cases to customers.

Right now management doesn't bear the full risk of those resources. It's shared. And what an ECAM does is it shifts the full risk of these -- of these fluctuating prices to customers, and by so doing, it takes away what would be a natural control mechanism so that long-term planning is affected, and this is the real issue with an ECAM, is its effect on long-term resource planning, that it biases the

Company's preferences towards resources that are higher in risk.

Certain resources are more capital intensive. Other resources are more fuel intensive or market intensive. Market purchases are the most. Certain resources can mitigate the risks that are facing us right now. The big risks are the market and fuel price risk. We've talked about the volatility. There's also the potential risk of compliance with carbon dioxide regulation, and renewable resources that have zero fuel cost, energy efficiency that has zero fuel cost, effectively mitigate all three of those big risks, and the concern here is that if you put in place an ECAM, you put in a bias away from those resources that will best protect customers in the coming years.

I would also say that this desire to make a distinction between, you know, long term and short term is kind of an artificial distinction, because the current operating environment today is the result of past planning decisions, and the future planning -- the future cost environment will be the result of current planning decisions, and, also -- and within economics, we kind of have this concept of short run versus long run, and in the short run, most

costs are, quote, uncontrollable, because there's very little you can do in the short run, but, as time passes, you can respond and do the things that are correct to control your costs as you move into the long run.

You asked earlier about the -- what would be the -- how -- I'm sorry. So it has been suggested that long-term resource planning is the place to discuss these particular costs, and it doesn't seem to me that there is a sufficient hammer in the long-term planning process at this point in time to adequately protect customers or to make sure that these long-run biases aren't there.

There have been, I think, nine IRPs filed in Utah since the merger, Ramp 1, Ramp 2, Ramp 3, 4, 5, and 6, IRP 2007, IRP 2004, IRP 2007. Only three of those are fully acknowledged. Two of them were acknowledged, but their action plans were not acknowledged.

There seems to be a breakdown in the long-run planning process, and an ECAM, by distorting long-run planning incentives, would only make matters worse.

CHAIRMAN BOYER: Okay. Thank you, Ms. Kelly.

Commissioner Allen?

COMMISSIONER ALLEN: Thank you. Let's see if I followed some of your comments. I want to make sure I'm clear on them, Ms. Kelly. You talk about the ECAM incentivizing the Company to shift to riskier resources. I imagine you're talking about -- when you say "riskier," you mean resources that burn fuel?

THE WITNESS: Or power purchases in the wholesale market. Going to the wholesale market for capacity as opposed to just making system balancing adjustments.

COMMISSIONER ALLEN: So one of your chief concerns, then, is that an ECAM would harm your efforts to move forward with renewable resources or acquisition? Is that correct, or is that too broad?

THE WITNESS: I think that -- I think that that's too broad. I mean, I think it would have that effect. I think we see the effect already. There's also the concern that it does two things. It harms customers, but it also puts a bias against renewables and energy efficiency, which are the resources that are best able to mitigate the risks going forward that face customers today, and so it's a public interest issue.

COMMISSIONER ALLEN: I guess I'm trying to square that in the context of Mr. Duvall's comments that 1,500 megawatts of wind added a new level of variability in the system, and then I look at issues like capacity factor with renewables and new transmission that has to be built, and how is it that those don't have their own set of risks that the Company would have to consider with or without an ECAM? I'm not quite certain that I'm seeing that just fuel costs and market purchases are offset by the other issues that they have to deal with. Maybe you could help me with that.

THE WITNESS: I think you're right on point, that there are those other issues associated with renewables that they have to deal with, and that is why there's already, I think, a bias in their planning that shows up in the IRP -- it's in my exhibit that I included with my surrebuttal testimony -- that shows that there's already a bias on the Company's part towards shorter term wholesale market purchases and natural gas, and what this does is it intensifies that existing bias.

Now, the issues -- and I think the biggest thing is that it goes against the results of the planning studies in the long -- in the IRP process.

What the planning studies in the IRP process are showing is that wind, for example, mitigates well those risks, and the things that are discussed there, the need to regulate up and regulate down and how much capacity is available when the system is peaking, all of that is taken into account in the planning studies, and the planning studies are still showing that those resources are the resources that best mitigate the risks, and yet what an ECAM does is it creates a reluctance to fully develop those resources for all of the reasons that you have identified.

If, instead they can put a new gas plant in place near load, then there's less concern about all of those. Now, definitely there are some RPSs that the Company needs to meet, but already in their planning process they are not going after as much energy efficiency and the level of renewables that are showing up as optimal in the planning studies.

COMMISSIONER ALLEN: Okay. I'm following you. I just -- these gas plants that they have to buy, to some degree they back up wind and they back up solar if they were to develop large scale solar, and so I'm still not quite following that there's an asymmetrical problem here, so I follow what you say

with -- what you said so far, but I'm still not quite
certain that one of the reasons they might be going
out and buying these riskier resources is because
they're trying to back up the development of their
new wind plants, for instance, and so I'm not
convinced, and I just want to give you an opportunity
to convince me or give me more information as to why
it's not a symmetrical balance as far as risk goes on
these assets, on these sources.

Maybe I didn't phrase that very well,
but when you say there's a bias right now for them,
for instance, buying riskier sources, such as burning
fuel, I think some of that has, in my mind, at least,
has come about and looking at the process that you
say the integrated process still coming across
because they need to back up these new resources, so
I'm not certain that there's not some symmetry going
on.

THE WITNESS: There's a need to meet load,
there's a need to meet peak, there's a need to back
up the resources. I agree with that. The
question -- and I failed to make clear. I think the
cost recovery is, I think, the driving incentive for
the Company, and what they care about is getting
recovery on their resources, and as they're

considering which resources they would like to acquire through the long-run planning process, there is the consideration of, "Which resources are we going to most easily get cost recovery from across our jurisdictions?"

Now, if they have an energy cost adjustment mechanism in place in all of their jurisdictions, the easiest resources to get cost recovery for are the components of net power costs that are in that mechanism, so wholesale power purchases go into that mechanism and it is easier to get cost recovery. You don't have to worry about whether there are going to be adjustments made to the forecast test year and so forth, and natural gas plants are easy -- in a natural gas plant, the larger component of its costs are the operating costs, and the capital component is a smaller component, as opposed to, say, a nuclear plant, for example, to compare the operating versus capital intensive portion.

So what this does, and the literature calls it an input bias, is it biases -- it can bias utilities towards the resources that have a larger fuel component or the wholesale market purchases, as opposed to resources that have a large capital cost, but once they're in place, the fuel on a renewable,

which is zero energy efficiency, those costs are known.

So the difference in these types of resources are certain types of resources you pretty much know what the costs are going to be at the time you acquire them. On other types of resources, like your natural gas resources, it depends on -- what the fuel costs are in the future is going to determine what those costs turn out to be in the long run, so it has to do with the uncertainties around the future cost of resources.

And what an ECAM does is it takes away the Company's concern about managing the costs, the unknowable costs going into the future, because it shifts it in between rate cases to customers.

COMMISSIONER ALLEN: That restatement was helpful, actually. Thank you.

THE WITNESS: Sorry. It's taken me a while to get there.

COMMISSIONER ALLEN: No, that's fine. And then to conclude, then, if the ECAM were to go forward as a defined pilot program with the parameters, would that assuage any of the concerns, or is that outside of your --

THE WITNESS: Not with regards to the

long-run planning incentives. If it is going to go into a phase two, we'd certainly prefer a pilot over, you know, just an acceptance. I also think if it goes into a phase two that we'll really have to address integrated resource planning and that those would have to go together.

COMMISSIONER ALLEN: Thank you.

COMMISSIONER CAMPBELL: I just have one question, and it follows up on your last statement, kind of, and really addresses your "just say no" position. I -- and I think, as you pointed out, we've gone long to short, as far as the Company resources, even without an ECAM, so it's already been in kind of a trend, going long to short, and as you also pointed out, it seems to me there's no teeth in our long-term planning process, so why -- instead of saying because of all this, we're going to say no, because this is an additional incentive, why haven't you -- or have you thought about seeing this as an opportunity to put teeth into some of these things by saying, "Okay. With an ECAM we need to have standards," as Ms. Beck talked about, standards that we can measure against and use ECAM mechanisms to provide greater accountability or greater opportunity for this jurisdiction to incent the Company to move

in the direction that you've stated.

THE WITNESS: The reason I didn't initially is because of the long-run planning incentives. If we were to move to -- if you were to determine to move to a phase two, I think that would be absolutely necessary. That would be a necessary step. I think the problem in my own mind is, when I think of an ECAM, I haven't seen it. It's like the Company witnesses have wanted to sort of separate the long-run planning from the ECAM, and I think, in fact, that they would have to be married.

I have not been able to figure out how you would do that in the design of an ECAM. I think it would require -- I think it would require going beyond an ECAM and looking at integrated resource planning in tandem.

CHAIRMAN BOYER: Ms. Kelly, you've heard this from some of the other witnesses who don't believe that an ECAM -- having an ECAM influences resource procurement going forward. You disagree with that?

THE WITNESS: I do disagree with that.

CHAIRMAN BOYER: And your concern about that there might be a bias towards or risky in terms of fuel costs kinds of resources and also increased

reliance on markets? Is that what you're saying?

THE WITNESS: Yes.

CHAIRMAN BOYER: Has that happened in, I guess, all of the other states that have ECAM-type mechanisms?

THE WITNESS: You know, I'm not -- I'm not familiar with all of the history in other states. I know that New Mexico has an ECAM mechanism that's fairly new and they are having lots of incentive problems and disappointments with that mechanism. What I am aware of is that other jurisdictions within PacifiCorp's service territory have ECAMs, and I am aware of an existing bias in the long-run planning process towards portfolios that are riskier than other portfolios that their studies would show would be optimal, and I don't know the reason for that.

I don't know if that bias is the result of the ECAMs that are already there. I don't know if it's that PacifiCorp has wanted an ECAM in Utah since 2001 and has been working hard to get that objective and that that is showing up in its planning processes.

I don't know if it's interjurisdictional allocation risk and that natural gas and market purchases reduce that risk, but there is a current

bias.

CHAIRMAN BOYER: With respect to your concern about increased reliance on market purchases, doesn't the Company or a company, a regulated utility, have an incentive to acquire their own resources because they can earn a return on them, whereas in the market there's no profit, there's no, you know, arbitrage, if you will, on top of the cost?

THE WITNESS: I agree with that, but if you build a lot of transmission, in order to move that power from markets, then you have a rate-based asset.

CHAIRMAN BOYER: And my last question is, are there any net power costs, in your estimation, that are beyond the control, that are significant and are beyond the control of the Company to manage?

THE WITNESS: I believe it's typical of the time frame you're considering. If it's very short term, in the next ten minutes, no. In the hour, next hour, there are steps that they can take. A year out, there are more steps. Five years out, more steps. So I think it depends on the time frame that you're considering.

My concern is that the incentive effect will affect what they're doing long term so that when you get there, you will have a system that has higher

costs than it needs to have and is riskier than it needs to be.

CHAIRMAN BOYER: Okay. Thank you, Ms. Kelly. You may step down.

Let's -- then let's take an hour and a half recess. We'll come back and take Mr. Chernick and other witnesses. Thank you all so far.

(Recess, 12:13 p.m.)

(Reconvened, 1:47 p.m.)

CHAIRMAN BOYER: Okay. Let's go back on the record in Docket Number 09-035-15, and I think now we're going to hear from Mr. Chernick. And we need to swear you. Please stand and raise your right hand.

PAUL CHERNICK

called as a witness and sworn, was examined and testified as follows:

CHAIRMAN BOYER: Thank you. Please be seated.

DIRECT EXAMINATION

BY MR. PROCTOR:

Q You are Paul Chernick?

A I am.

Q And you are here --

A I thought I got to say that.

Q I'm trying to expedite things.
A Okay.
Q And you're appearing here today on behalf of the Utah Office of Consumer Services, correct?
A Yes.
Q And in that capacity, you have filed direct testimony, marked OCS-3D Chernick, with one exhibit, and surrebuttal testimony marked OCS-3SR; is that correct?
A Yes, that's correct.
Q Do you have any corrections or amendments that you wish to make to that testimony?
A I do not.
Q If I were to ask you today the same questions that you responded to in your prefiled testimony, would your answers remain the same?
A Yes.
Q The Office offers into evidence the exhibits identified.
CHAIRMAN BOYER: Any objection to the admission of Mr. Chernick's direct testimony and surrebuttal testimony with exhibits? They are admitted.
Q (BY MR. PROCTOR) Mr. Chernick, you have a brief summary. Would you please provide that?

A Yes. I guess the top-level summary of my testimony would be that Rocky Mountain Power has not made its case that ECAM is needed or in the public interest, and the Company basically proposes a three-part test for whether an ECAM is appropriate, and that has to do with whether the net power costs are large, volatile, and uncontrollable, and you've heard that this morning from Mr. Graves and Mr. Duvall, and I think everybody agrees that the net power costs are large.

In terms of volatility, the Company offered a large number of analyses in its supplemental direct and rebuttal testimony. All of those analyses of volatility are irrelevant or incorrect, as I pointed out in my direct and surrebuttal, especially in the context of the large level hedging going forward. The Company really hasn't made its case for volatility of costs.

On the uncontrollable point, the Company has been much less specific and quantitative. Most of their arguments have been through largely hand waving about, "Well, we can't control the cost of gas," and they've really failed to acknowledge the obvious, which is that the Company and its employees make tens of thousands of decisions every year that

affect net power costs and they have a wide degree of control. They don't control everything that goes on, but they have a lot of control, and because they have control, there are incentive effects for going to ECAM, which I'll get to in a moment.

So the Company's remaining arguments that have any kind of plausibility are that there's some kind of -- there's a correlation between the Company's need for power and price, either need because of higher-than-expected load or because of a plant being out or low wind generation, and the price of gas or electricity, and I think Mr. Duvall pointed that out, listed that argument this morning, along with the argument that it would increase the expected cost and the average cost over time of net power costs.

At any one point in time it might be higher or lower, but the suggestion is that it would, you know, increase the average cost.

Now, the Company hasn't actually provided an analysis of the magnitude of that effect that they think is there for any historical period. They haven't shown that their net power costs under-collections have been in any way related to that correlation issue, and if there is such a

problem, then that can be addressed in the forecast of NPC. If the Company has been assuming that when -- in a hot spell, when they need more power, then short-term purchases will be at average prices and they should actually be assuming they're a little higher than average pricing. Well, that's a long-run issue that can be fixed, and you don't need an ECAM to deal with that.

Similarly, Mr. Duvall mentioned his stochastic analysis. I pointed out in my direct testimony that there are a lot of problems with that analysis and some of his assumptions are unrealistic, but, again, if some asymmetry exists in the range of prices, maybe the high end of the potential price range is further from your expectation and the low end is low, and if that results in your average price being higher than your best guess, well, that, again, is the kind of adjustment that you can make to the net power cost forecast, and you don't need an ECAM to deal with an issue like that, especially because Mr. Duvall said that he had that issue under control and he could show how big the effect was with his stochastic analysis, and that's something he ought to bring into a rate case for scrutiny if he thinks that that affects the average price.

So, as I see it, the really big issue in this phase of the case is the question of incentives. If the Company was going to behave exactly the same way, regardless of whether it got its power costs on a forward-looking basis, whether it got actual power costs after the fact, whether it was held responsible for management or it was simply managing in its customers' interests, if that was all going to be the same, then whether you had an ECAM or not might not make much difference.

And the Company's experts -- their witnesses largely shrug off the whole issue of incentives, saying that they don't see any incentive issue here.

But, in fact, as I show in my direct, empirical analyses and the kind of authorities that one would go to on these matters universally report that there are incentives from having a fuel adjustment charge, a pass-through of costs.

Dr. McDermott claims that those empirical studies were all done with utilities that didn't have prudence reviews of their ECAM-type costs, but he's never -- he hasn't shown that, and he's clearly wrong about it from any of the studies which are from the '90s and the 2000s.

So, faced with this incentive issue, the Company's witnesses have largely argued that prudence review will solve the incentive problem, that somehow the Commission is going to look over the Company's shoulder and catch anything that they do wrong and that that threat of being caught will make the Company do just as good a job for the ratepayer as it does now when the costs are on its own dime.

But the witnesses today were, I think, pretty straightforward in saying that you can't really be comprehensive in that kind of review. You have to regulate by exception. So you can't oversee a hundred thousand decisions being made every day, the way that the Company's own managers do. You can only wait until you see smoke, or at least smell it, and then go looking to see if you can find fire and figure out what the cause was.

So it's more of a catch-me-if-you-can kind of situation. "Will I do something so suboptimal that you'll be able to spot it in the data, trace it to the root and tag me for it?"

That's a very difficult and time-consuming process. I've done prudence reviews for power purchases, power plant construction, a bunch of other things, and it's very -- it drains a lot of

resources, and you don't have to take my word for it. I quoted the New York Public Service Commission in my surrebuttal testimony on the 10,000 staff hours that went into the review of outages at Indian Point, and the prudence review is quite limited in scope because it's really limited to those situations.

In that case you had a nuclear plant that had repeated long outages, those situations where you can say, "There's clearly a problem here and we can look at where that problem came from."

Looking at whether the Company called the right person on the right day to see whether another utility had a little power to sell the following day or wanted to buy a little that looked like it was going to be excess, whether the Company was following the weather trends and updating its load forecasts on a week-ahead basis and making the proper decisions, figuring out whether they've done those things right and that kind of detail is just beyond the scope of prudence review.

So a lot of little things can slide by, essentially without the Company worrying that they're going to get caught.

The Company witnesses suggested some other factors that might impose some incentives on the

Company even with an ECAM. Mr. Graves talks about basically managerial embarrassment at missing budgets and that sort of thing. I don't think any of those rise to the level of incentives that exist under the current system for the Company to control costs, and given that there are those incentive effects, implementing ECAM would clearly have costs, and the Company really hasn't shown a need or a benefit from ECAM that can't be accomplished some other way, so it's my recommendation that the Commission not move on to the design phase at this time.

If the Commission wants to give the Company another shot at basically the issues that it was supposed to address in phase one, you certainly can do that procedurally in a number of ways, including going to a Phase 2-A where you resolve some issues that have been raised before you go to the detail design, or you could close out this case and give the Company a chance to refile, or I'm sure you could come up with lots of other ways for doing it as well.

But, in any case, before the ECAM process progresses any further, the Company really should be required to deal realistically with the incentive issue, with the costs of regulation under an ECAM structure, and to ensure that whatever can be done

through better forecasting, rather than through a true-up mechanism, be done in the forecast. And that concludes my summary.

CHAIRMAN BOYER: Thank you, Mr. Chernick.

Commissioner Allen, do you have any questions for Mr. Chernick?

COMMISSIONER ALLEN: No.

CHAIRMAN BOYER: Mr. Campbell?

COMMISSIONER CAMPBELL: I'm going to ask just one, and that is, you've testified in a lot of states around this country, as well as internationally, and so what, in your opinion, makes Utah so unique? Differentiate for me. What makes us so different from all of those other states that have adopted ECAMs?

THE WITNESS: Well, I think most states adopted ECAM-like mechanisms at the request of their utilities, and then many of them have spent a fair amount of time trying to make the system work once they did that.

Now, some of those states acted in the face of real emergencies. In the Northeast, in Massachusetts, in New York, as I talked about in my surrebuttal, we were talking about utilities being pushed to the brink of bankruptcy by their oil bills

in the first oil price shock in the early '70s, and there was no question that something had to be done.

In many cases legislatures just said, "Well, we'll let them recover their fuel costs," because there's nothing they can do about what OPEC is doing with the price of fuel. And in some places, like Massachusetts, that meant that the -- even if the Commission found that a cost was imprudently incurred, they had to let it be flowed through because it was a fuel cost.

Gradually states tried to pull back from that. One of the reasons, I think, that a lot of the northeastern states went to restructuring was that they were sick and tired of dealing with this problem of under-performing generation, the poor heat rates, the inability to switch to cheaper fuels, to get cleaner, more efficient plants built, to keep the base load plants operating efficiently, that they just said, "Let's get the utilities out of this business, because we can't make them be efficient. We're going to turn this over to somebody in the private sector, in the really private sector, the competitive market who's got the incentives," and so you've seen all these states go to restructuring, which had the desired efficiency effect. You know,

there have been some problems with the market effects, but I think the plants generally have run better.

A lot of inefficient plants have been shut down and heat rates have improved, availabilities have improved. So the -- I guess the short answer would be every state has its own trajectory over time. Utah had an ECAM, essentially. For reasons unknown, were asked to have that terminated, and they haven't done a good job since then of explaining why they need one and why it's in the public interest.

COMMISSIONER CAMPBELL: Are you familiar with a list of mechanisms that could be part of an ECAM that would give those substitutable competitive pressures that efficiencies can be derived similar to a competitive market?

THE WITNESS: Yes. There are mechanisms for doing that. The ones that are cleanest are those that, rather than looking at actual costs, look at the drivers of costs. For example, one of the Company's concerns is, we could have a situation where, in a particular year, the on-peak performance of the wind plants at high cost periods was just very bad, just bad luck. No wind, summer peaks. No wind at winter peaks. And, as a result, you'd be burning

more gas, buying more short-term power to replace that.

Well, you can work out an index of basically wind speeds and market prices, that is, prices posted for market hub, and say, "To the extent that actual wind is different from the projected wind, we'll use this mechanism to make you whole for that," just a thing that just kind of falls on top of you. But the Company then still has to be responsible. If you want them to have the incentives to operate efficiently, they should be responsible for foreseeing what's happening with the wind, watching the weather report, making the deals with other utilities or with gas providers to get gas to their plants, dispatching them at the right time and so on, rather than just saying, "Well, just run your plants, and whatever it costs, we'll pay you for it."

So that's the kind of mechanism which -- you maybe wouldn't even call it ECAM, because it's not designed to track the utility's actual costs. It tracks a driver. Sort of a weather normalization factor for wind generation.

A cruder approach is to split the difference between forecasted and actual costs, and, again, if the concern is that you're going to drive

the Company into financial distress or increase its cost of capital, you can reduce that by saying, "Okay. You'll keep half of any shortfall or overrun on the net power cost forecast, and the other half will be picked up by the ratepayers," so every dollar the Company can save, the shareholders still retain 50 percent. Every dollar that the Company wastes by not picking up on an opportunity, the shareholders eat 50 percent. So that's still a powerful incentive. It maintains the incentive while reducing the -- the incentives aren't as strong, but it maintains a big chunk of incentives while a proportion of it reducing the effect on the Company's earnings and whatever financial measure you might be concerned about.

So there are ways of addressing some of those concerns, if the Company can get to the point of showing us what the real drivers are that we need to worry about, and at this point their arguments are mostly theoretical, circumstantial.

CHAIRMAN BOYER: Mr. Chernick, I'm going to ask you a hypothetical question, and you may not agree with the assumptions of the hypothetical, but bear with me, if you would.

THE WITNESS: Sure.

CHAIRMAN BOYER: Assume for the purposes of this question that Rocky Mountain Power does have large elements of net power costs that are uncontrollable, to a large extent, or volatile. They might be fuel costs, they might be market forces, force majeure kind of things, I guess war and pestilence and those sorts of things, you know, forced outages, whatever they might be, and then complicated by the imprecise nature of forecasting the power costs.

Are there methods by which the Company can recover its prudent costs under those assumptions in a relatively timely manner outside of ECAM, and if so, what are they?

THE WITNESS: Well, volatility in itself is not a barrier to recovering prudent costs. Almost any cost component in the actual year is going to be different from what the Company anticipated in the rate case, and what you approve may be different things, and sometimes they'll be higher and sometimes they'll be lower, and I think the Company's argument here is, "But net power costs vary more than the number of poles that get hit by trucks and knocked down and need to be repaired."

And while there are other variations, this

is a particularly big variation, and if that variation is large enough to be a problem because of its size, that is, putting the Company in some kind of financial jeopardy, that certainly is an issue, but if it's simply a matter of they do good forecasting in the future, incorporating whatever turns out to be valid about Mr. Duvall's concerns about correlation and the stochastic nature of prices and loads and the -- and they're well hedged so they're vulnerable only to the volatility in the spot market for the excess that they're picking up at some particular point and the surplus that they have to dump at other points and their NPC forecast includes a reasonable allowance for those things that they take into account of that, that they're going to be over-hedged, over-supplied some days and under-supplied other days, and that's a reasonable assumption. You have to have some of those days in each month's forecast.

Then the real costs, the actual costs, are going to vary from your forecast, but whether they vary enough to really make a big difference in terms of the Company's financial condition, whether they vary enough that we need to worry about them and put in some other mechanism, that's an empirical question

that the Company really hasn't addressed, so it's possible that you could have a good forecasting mechanism, which includes a reasonable average allowance for all of those volatilities, so over ten or 15 years it's all going to work out fine. You'll have some good years; you'll have some bad years.

You'll also have some good years because -- the Company will have good years because it was a hot summer and they sold a lot of power, and they'll have bad years financially because there are mild years in which they don't sell a lot of power. These things happen all the time. Utility earnings go up and down because of weather and other similar factors.

There's no particular problem with them going up and down somewhat as a result of volatility in net power costs.

Did I answer any part of your question?

CHAIRMAN BOYER: Yeah. Maybe there's some parts that remain unanswered. Let's see if I can -- you heard my questions this morning about techniques for mitigating, for example, the volatility in the cost of natural gas as a fuel, shortage, longer-term contracts. Are you seeing any of that happening in the marketplace? Are utilities using those kinds of strategies to mitigate that fuel cost volatility?

THE WITNESS: Well, there are certainly utilities that have contracts for gas supply that may involve storage closer to their load center. In terms of the kinds of volatility we're talking about here, a 20-year contract really isn't relevant. A five-year contract would be more than long enough to lock in prices for the period that you'd expect the rates set in any one case to be in effect, and certainly utilities have been moving towards -- well, not even necessarily moving towards. Many of them have had longer-term contracts for coal. At one point for oil and gas it was very hard to get longer-term contracts. For gas, that's no longer true. You can go out several years now.

So utilities are doing more of that, and it does help with volatility, but you don't have to go to 20 years to deal with the kind of volatility that we're looking at here. You may want to go to 20 years to deal with the kind of volatility that you deal with in an IRP in terms of what are prices going to look like out in 2025 or 2030 and do we want to have something that we're locked in for? Do we want to have a hedge against gas prices being high throughout that period?

But, you know, if gas prices go up to $8

and stay there, the Company doesn't have an NPC problem, necessarily, in terms of a recovery because their forecast will have in it their hedged prices, which will reflect the market, and -- you know, so they may match exactly the cost recovery, but in terms of the ratepayers and the ratepayers' exposure to high rates, a very long-term contract has a benefit of a completely different kind. I don't know whether that was helpful.

CHAIRMAN BOYER: Your example was extreme, I know, but it's different from what we've been seeing in the last few years, and I don't have economics training, but what about a mechanism in which net power costs were banded, and if they fluctuated within that band, then we would just say, "Well, we'll deal with it the next rate case and true it up, but if it breaks out, then we'll take some more immediate action"? Would that help resolve the Company's problem?

THE WITNESS: When you say, "We'll true it up in the next rate case" --

CHAIRMAN BOYER: Catch up. I mean, there will be a load ready if you like, but we'll fix it.

THE WITNESS: If you're saying if you're -- if you under-collect by a million dollars this year,

then next year when you file your rate case, you can add that million dollars to your costs and amortize it over a year or two years, then that's essentially an ECAM. It's one uses deferral rather than a current recovery.

But in terms of the incentives, it has the same effect. If a company knows that if you don't do such a hot job of buying power and selling power, buying gas and dispatching our plants and we're a million dollars off, you know, we'll book it, anyway, because it's a regulatory asset, and we can get it back as soon as we have a rate case. So, from that perspective, it really wouldn't deal with the incentives. I think it would deal with the company's concerns because, you know, assuming your numbers aren't large, those regulatory assets would be treated pretty much like cash by the investment community, and you posited that if the numbers did get very large, then they'd be able to come in for some more immediate rate relief, so that sounds like pretty pure ECAM, the way you've structured it.

CHAIRMAN BOYER: My last question is related to the ratings agencies. You heard my questions this morning. What would we expect to see in Utah for this utility with an ECAM, without an

ECAM in terms of the ratings? Are they going to move one way or another? Are they going to --

THE WITNESS: I'd be reluctant to predict that. They might be moved up somewhat, but I suppose perhaps it's the profits. It's regrettable that we didn't actually have Ms. Schell on the stand to answer that question. That's her area of expertise, not mine.

CHAIRMAN BOYER: Okay. Well, thank you very much, Mr. Chernick. You may be seated.

Let's check in with Ms. Smith. Has your witness arrived?

MS. SMITH: My witness has arrived, and we're at your indulgence to put him on the stand whenever you'd like.

CHAIRMAN BOYER: Okay. Mr. Evans or Mr. Dodge, do you have any scheduling problems?

MR. DODGE: She can go now.

MS. SMITH: If I may have the same permission to move over to the --

CHAIRMAN BOYER: Yes, please do. Please do.

MS. SMITH: Thank you.

CHAIRMAN BOYER: Okay. Would you please state and perhaps spell your name?

MR. CHRISS: Do you want to swear me?
CHAIRMAN BOYER: I'll let your lawyer do that. I'll just swear you in.

STEVE W. CHRISS

called as a witness and sworn, was examined and testified as follows:

CHAIRMAN BOYER: Carry on.

DIRECT EXAMINATION

BY MS. SMITH:

Q Good afternoon, Mr. Chriss. Could you please state your name for the record and spell your last name for the court reporter?
A My name is Steve W. Chriss, C-H-R-I-S-S.
Q Could you please identify by whom you are employed and in what capacity?
A I'm employed by Wal-Mart Stores, Incorporated, and my job title is manager, state rate proceedings.
Q Thank you. Mr. Chriss, did you cause to be filed, on November 16th, 2009, a document entitled "Phase one Direct Testimony and Exhibits of Steve W. Chriss on Behalf of Wal-Mart Stores, Inc. and Sam's West, Inc.," consisting of 14 pages of testimony, with two exhibits, consisting of a total of 13 additional pages?

A Yes.
Q Do you have any corrections to make to your prefiled testimony?
A No.
Q If I asked you the same questions today as are posed in your prefiled testimony, would your answers be the same?
A Yes.
MS. SMITH: Mr. Chairman, at this time I respectfully move into evidence the prefiled phase one direct testimony and exhibits of Steve W. Chriss an behalf of Wal-Mart Stores, Inc. and Sam's West, Inc.
CHAIRMAN BOYER: Is there any objection to the admission of Mr. Chriss's prefiled direct testimony with exhibits? They are admitted.
Q (BY MS. SMITH) Mr. Chriss, I understand you have prepared today a summary, and I'm wondering if you could go ahead and proceed with your summary of your direct testimony.
A Okay. In sum, my testimony does not, itself, oppose this Commission's consideration of an appropriate ECAM proposal in a phase two of this proceeding, but strongly cautions that the Commission consider the following: The extent to which the

Company's approved rate of return can and should reflect the reduction in NPC risk and how this should benefit customers; and, two, an ECAM design that demonstrably improves the transparency of NPC rates, which would send price signals to customers to drive more informed consumption decisions by customers that can benefit the individual customer and the utility system as a whole.

With regard to regulatory objectives that this Commission should consider in evaluating the appropriateness of an ECAM, the most basic standard regulatory objective is to provide for just, reasonable, and adequate rates and charges.

A second objective is to make the regulatory process as simple and understandable as possible so that it is acceptable to the public, feasible, expeditious, efficient to apply, and designed to minimize controversies over interpretation and application.

A third objective is to protect against wasteful use of public utility services. Each of these objectives are articulated in Section 54-4a-6 of the Utah Code.

Wal-Mart advocates that rates be set based on the utility's cost of service. This produces

equitable rates that reflect cost causation, send proper price signals, and minimize price distortions. Setting NPC rates based on the utility's cost of service, ensuring that the collection timing better reflects when the utility incurs the cost is critical for two reasons.

First, NPC rates represent a large portion of the total bill received by customers, and second, more transparent fuel rates can drive more informed consumption management decisions by customers that can benefit the individual customer and the utility system as a whole.

My testimony also highlights concerns about the Company's ECAM proposal. The ECAM, as proposed by the Company, is not in the public interest and should be rejected by the Commission. On balance, the potential costs to ratepayers outweigh the potential benefits. The proposal as written, which allows RMP to continue to collect net power costs in base rates, as well as to annually true up collection through a fuel clause, if adopted, would not result in a just and reasonable rate because there's no proposal to adjust the Company's rate of return to reflect the reduced NPC risk.

In addition, the proposed ECAM denies

customers the transparency in rates that is a major benefit of transitioning to a fuel clause.

In my testimony, I highlight a concern that the removal of the Company's risk for recovering actual NPC potentially harms customers. RMP's rate of return, as currently approved by the Commission, reflects the Company's current operational circumstances, which include the risk that the Company will not fully collect its actual NPC. If RMP's rate of return is not adjusted to reflect the reduction in NPC risk, customers would be harmed because they would be compensating the Company for risk it no longer faces.

A second concern I raise in my testimony with regard to the Company's proposal is that it will not result in more transparency in NPC costs. The proposed ECAM at its core is only a mechanism for the correction of past revenue collections and does not serve as a forward-looking mechanism to promote price-responsive demand and efficient use of RMP's system.

There are three issues with the implementation of the ECAM, as proposed, that affect its ability to produce more transparent NPC rates. First, the ECAM proposal does not appear to

incorporate any NPC updates that would allow it to better reflect realities in the market and in RMP's own system and minimize the deferral amounts charged to or collected from customers.

Second, the collection of the deferral amounts built into ECAM rates will significantly lag actual market and system conditions, so the resulting price signals will be stale.

Finally, as proposed, the ECAM may produce rates that provide inaccurate and potentially counterintuitive price signals that may potentially promote inefficient and wasteful use of public utility services.

Finally, my testimony explains the efficacy of incorporating NPC updates into the ECAM. If NPC updates were included in the ECAM proposal, it would allow RMP to potentially better match the Company's expenses and rates charged to the customers and attempt to minimize the deferred amounts charged to customers.

It is important that the price signals that come from NPC rates reflect true fuel and purchased power costs as they are being incurred by RMP and not be driven by large deferral levels.

This concludes my summary of my direct

testimony.

CHAIRMAN BOYER: Thank you, Mr. Chriss.

Commissioner Allen?

COMMISSIONER ALLEN: No.

CHAIRMAN BOYER: Mr. Campbell?

COMMISSIONER CAMPBELL: Just one question. It's obvious that you don't agree with the Company's proposed ECAM. Is there, in your experience, a state that would have a model ECAM that you would recommend?

THE WITNESS: It's funny that you ask that, because the model that I would recommend, I think, is one that the Colorado Commission just rejected. Excel in Colorado currently has a quarterly fuel mechanism so the prices are updated every quarter, and they include deferred amounts from the previous quarter, whatever wasn't collected or what was over-collected.

The Company came in with a proposal to move it to monthly, and we supported that, and the Commission decided to stay with the quarterly, but I think that that mechanism of, you know, really timely flow-through of the fuel prices is how we'd like to see fuel costs be done.

CHAIRMAN BOYER: Well, he stole my thunder.

I was going to ask, if you were in charge of designing an ECAM, how would you do it, and what would be the basis for having a timely flow-through of these fuel costs? To give a price signal or what was the concept?

THE WITNESS: Well, the price signal is important, and I think it's really the primary reason. Obviously, I haven't studied RMP's fuel costs in depth. It looks like there's not a tremendous amount of volatility, you know -- or not volatility, but variation between maybe what you're seeing in December versus what you might see in June. I'm not totally sure about that, but to -- you know, assuming that prices are higher in the summer, if you're having customers pay a lower rate and then a rate that's also made lower by an additional deferral amount, perhaps, you know, are customers efficiently going to use energy in that period? You know, signals like that are important.

And then, from a practical perspective, our operators don't spend their days sitting and, you know, reading utility tariffs and digging in. They have businesses to run, they have stores to run, and so there's a disconnect between what they see going on in the markets. You know, lots of people watch

the gas markets and the oil markets and they see the prices go up and down. If there's large price declines in the markets and utilities rates are shooting up, there's a disconnect there, and they don't understand why, and oftentimes, you know, when you explain, "Well, there's deferred accounting or there's these other reasons that there's a mismatch in prices," it doesn't go over so well, so a lot of the push has really been from our operators that want to see costs that reflect what's going on in the markets and want to be able to understand our utilities rates and the prices that they're being charged.

CHAIRMAN BOYER: Okay. Thank you very much, Mr. Chriss.

THE WITNESS: Thank you.

CHAIRMAN BOYER: You may step down.

Mr. Dodge, you've been waiting patiently there on the sidelines. Shall we hear from UAE at this point?

MR. DODGE: Please.

CHAIRMAN BOYER: Mr. Higgins, would you raise your right hand, please?

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KEVIN C. HIGGINS

called as a witness and sworn, was examined and testified as follows

CHAIRMAN BOYER: Thank you. Please be seated.

DIRECT EXAMINATION

BY MR. DODGE:

Q Thank you, Mr. Higgins. I'm not nearly as nice as the ladies to my left, so I'm going to make you crank your neck a little.

A I'm getting too stiff.

Q Would you state your name and your employment and on whose behalf you're testifying?

A Yes. My name is Kevin C. Higgins. I'm employed by the consulting firm Energy Strategies where I am a principal, and I'm here testifying on behalf of UAE.

Q Mr. Higgins, UAE filed in this proceeding prefiled testimony in the form of UAE Exhibit 1, direct testimony, with Attachment A, and UAE Exhibit 1SR, surrebuttal testimony. Does that testimony represent your testimony here today?

A Yes, it does.

Q And do you have any corrections?

A Yes. I have a typo to correct that I

repeat twice. It occurs for the first time on Page 13 of my direct testimony, Line 270, and my typo was in the docket reference. I refer, in my testimony, to Docket Number 08-035-08 and that "08" should be corrected to say "38," and due to the power of copy and paste, I made the same typo on Page 8 of my surrebuttal testimony, Line 168.

Q Mr. Higgins, would you please provide a brief summary of your testimony?

MR. DODGE: First of all, Mr. Chairman, let me move the admission of the two exhibits I've identified.

CHAIRMAN BOYER: Thank you. Are there any objections to the admission of Mr. Higgins' direct and surrebuttal testimony? Okay. Seeing none, they are admitted.

Q (BY MR. DODGE) Mr. Higgins, would you please proceed with your summary?

A Yes. Thank you. I do not believe that adoption of an ECAM for Rocky Mountain Power in Utah is in the public interest at this time in light of all relevant considerations. An ECAM is a form of single-issue ratemaking and should only be applied after carefully weighing the justification for such an approach against its several drawbacks.

Some of these drawbacks include reduced incentives for management to control costs, the shifting of risk from utility to customers, and reduced economic incentives for the utility to undertake demand side management actions.

I do not dispute that net power costs and its constituent components change over time. That is not sufficient cause for an ECAM. ECAMs are typically justified on the basis of fuel price volatility, yet when ECAMs are adopted, they typically bring many other types of risk transfers, weather-related risk, resource portfolio-related risk, and performance-related risk, to name but a few.

Significantly, however, Rocky Mountain Power has argued against recognizing any reduction of risk in the Company's allowed return on equity associated with the adoption of an ECAM. In my opinion, if the Commission is otherwise inclined to proceed to phase two, a necessary precondition should be an acknowledgment or finding that an ECAM reduces the Company's risk and that it is appropriate to reflect such risk reduction in its allowed return on equity.

Of particular concern is the sharing of

hydro-related risk with Utah customers that would likely accompany an ECAM. Such a sharing of risk is inappropriate because Utah does not receive a proportionate benefit from the PacifiCorp hydro resource.

Although net power costs in grid reflects the benefits of a hydro system, these benefits are largely adjusted away from Utah pursuant to the MSP revised protocol.

While the full impact of the adjustment is mitigated somewhat by the MSP rate mitigation cap, this cap is not scheduled to be permanent. Even with the cap, Utah customers still pay a premium above the rolled-in revenue requirement. This premium is virtually entirely attributable to the removal of a substantial portion of the net benefit of the PacifiCorp hydro system from Utah's allocation of system costs pursuant to the revised protocol.

Because Utah does not receive a proportionate benefit from the hydro system, an ECAM that subjected Utah to hydro-related risks would be unreasonable, yet Rocky Mountain Power is not even willing to agree that hydro risk should not be borne by Utah customers in an ECAM, and even if the Company did agree with me on this point, I am not convinced

that removal of a hydro risk can be easily remedied through a design fix.

Rather, it seems to me that one of the unintended consequences of the MSP revised protocol is that it has made the applicability of an ECAM in Utah conceptually and practically more difficult than would otherwise be the case.

As a general proposition, an ECAM should not be considered unless the fuel and purchase power costs that would be recovered through an ECAM are subject to significant volatility, are largely beyond the control of management, and are substantial enough to have a material impact on the utility's revenue requirement and financial health between rate cases if they were to go uncovered.

In my testimony, I discussed my experience in Docket Number 08-035-38 in which I examine the impact on net power costs of using an updated forward price curve. In the updated analysis, the market cost of fuel for the Company's gas generating units have fallen by $77 million, yet net power costs have fallen only by $5.9 million due to the Company's strongly edged position.

I believe this experience provides very strong evidence that the Company is not subject to

fuel cost volatility sufficient to justify an ECAM. Based on the Company's fuel mix and hedging practices, I have concluded that the Company's cost structure is not sufficiently volatile to justify an induction of an ECAM at this time. Moreover, a future test period, which is being used by stipulation on the Company's current rate case in Utah, when taken in combination with the Company's aggressive hedging practices and frequent rate cases further diminishes any need or justification for an ECAM in Utah at this time. And that concludes my summary.

CHAIRMAN BOYER: Thank you, Mr. Higgins.

Commissioner Allen?

COMMISSIONER ALLEN: No.

CHAIRMAN BOYER: Mr. Campbell?

COMMISSIONER CAMPBELL: Just one. Is there the possibility that, with an ECAM, the Company would hedge less and thereby minimize costs?

THE WITNESS: I suppose with an ECAM there's the possibility that the Company would change its hedging practices. I don't know, necessarily, that that would result in cost minimization. I think that, quite frankly, the Company's hedging practices are the subject of its own docket. It's a rather

complex subject unto itself, and I would really reserve judgment as to what other hedging strategies might be preferred for the Company, other than the one it has now.

What I have concluded, though, is that the one it has now very materially covers the Company's fuel price risk. Whether another hedging policy or practice is desirable really remains to be seen, in my view.

CHAIRMAN BOYER: Mr. Higgins, you've heard the Company testimony that they have been under-recovering net power costs by approximately 40 million a year for the last several years. Is there a way, short of an ECAM, in lieu of an ECAM, in which they could recover those costs in a more timely fashion, assuming they're prudent?

THE WITNESS: Well, the -- looking at that question, I do think it's worthwhile to parse some of the facts behind that assertion. For example, if we look to the most recently-decided case that has fully run its course, which was the 07 docket, the Company did not come up short in its net power costs in that case.

If we look to the '06 docket which preceded that docket, there was no explicit net power costs

even adopted in that case. That case was settled. It was a $115 million sort of black box-type settlement that was adopted, and it was a case in which, as that period of time unfolded, we may recall that the Company had a power plant, Lakeside, that was scheduled to come online at a certain date, scheduled to come online in May, didn't come online until September until after the summer peak had occurred, so the Company was out there buying a lot of power to make up for the fact that its plant had not materialized, and so, to your question, Mr. Chairman, in a situation in which one is facing certain facts about why the utility may be under-recovering costs, there are mechanisms today that can be applied if there is a public interest to justify it. In particular, deferred cost accounting can be applied.

In the past, when the Company has had a substantial impact or substantial event, shall I say, that has caused it to incur extraordinary expenses that may have justified -- that may have impacted its financial well-being, it has the ability and had the ability to bring a deferred accounting case to the Commission, and so that mechanism is certainly available to the Company.

I did hear you ask earlier today about a mechanism in which there would be some sort of dead band involved, and extraordinary costs on either side of a dead band may be either recovered or returned to customers. That is a variation of an ECAM. Or you could do something like that pursuant to deferred accounting, I suppose, which was a part of your question.

I do think you could look at mechanisms like that, but it does -- it looks like there are -- there are ECAM-type mechanisms that have the kind of dead bands that you're referring to. For example, Puget Sound Energy in Washington has one. This utility, Rocky Mountain Power, has one in Wyoming. But those are design type of features.

CHAIRMAN BOYER: Thank you, Mr. Higgins, very much. You may sit down.

THE WITNESS: Thank you, Mr. Chairman.

CHAIRMAN BOYER: Mr. Evans, you don't have a witness, do you?

MR. EVANS: No, I don't, Mr. Chairman.

CHAIRMAN BOYER: Okay. Turning to Nucor Steel. No witnesses?

MR. MATTHEIS: We don't have a witness, either, your Honor. Thank you.

CHAIRMAN BOYER: I didn't read any testimony, but I could have overlooked it.

And now that brings us to Ms. Wolf.

MR. PROCTOR: And with your permission, Mr. Chairman, I'll assist Ms. Wolf.

CHAIRMAN BOYER: Oh, yes. Thank you, Mr. Proctor. That would be very nice.

ELIZABETH A. WOLF

called as a witness and sworn, was examined and testified as follows.

CHAIRMAN BOYER: Please be seated, and welcome.

DIRECT EXAMINATION

BY MR. PROCTOR:

Q Ms. Wolf, if you would state your name and on whose behalf you're appearing here today.

A My name is Elizabeth Wolf, and I'm appearing on behalf of Salt Lake Community Action Program.

Q What position do you hold with Salt Lake CAP?

A I'm utility ratepayer advocate at Salt Lake CAP.

Q How long have you been in that position?

A For -- approaching 13 years.

Q You have appeared before this Commission in the past in other cases?
A Yes, I have.
Q In this particular case, did you file written direct testimony on behalf of Salt Lake CAP?
A Yes.
Q And it's my understanding there were no exhibits to -- in addition to the direct testimony.
A That's correct.
Q Do you have any corrections or changes that you wish to make to that testimony?
A No, I do not.
Q And if I were to ask you today the same questions that were posed in the written testimony, would your answers remain the same?
A Yes.
MR. PROCTOR: I would move for the admission of the direct testimony of Elizabeth A. Wolf on behalf of Salt Lake CAP.
CHAIRMAN BOYER: Any objection to the admission of Ms. Wolf's prefiled direct testimony? It is admitted.
Q (BY MR. PROCTOR) Ms. Wolf, do you have a summary of your testimony, please?
A I do, yes. In my direct testimony,

submitted on November 16th, 2009, I recommended that the Public Service Commission not approve the establishment of an energy cost adjustment mechanism, or ECAM. To summarize my brief testimony, Salt Lake Community Action Program is concerned whether adopting an ECAM now promotes the appropriate balance between aligning utility incentives with the public interest.

These concerns include issues involving, one, how best to meet the short- and long-term resource needs of the Utah jurisdiction, including issues around demand side management, building resources, the types of resources, purchasing power, and the balance between addressing conflicting jurisdictional priorities.

Two, the complexity and ability to administer an ECAM within a regulatory environment that still requires frequent general rate cases to deal with the need for ongoing significant capital investment.

And three, the difficulty in designing an ECAM that would deal with the myriad of disparate issues that have been raised in this case.

And that concludes my summary.

CHAIRMAN BOYER: Thank you, Ms. Wolf.

Short and sweet.

Commissioner Allen, any questions?

COMMISSIONER ALLEN: No.

CHAIRMAN BOYER: And I don't, either. Thank you very much, Ms. Wolf.

THE WITNESS: You're very welcome.

CHAIRMAN BOYER: You may sit down. I think that we've now heard from all of the witnesses who filed testimony in this case. Now, the suggestion was made this morning that, because all parties have waived cross examination, it might be appropriate to hear, shall we say, legal arguments, at the conclusion of this hearing. How do the parties feel about that? That was Mr. Monson's suggestion. Would that be useful? Would it not be useful?

MR. MONSON: We'd like to do it still, and I think some parties feel like they'd like to not do it today. We'll do it at your pleasure.

CHAIRMAN BOYER: Mr. Dodge? Let me suggest one potential way of doing this would be to take a -- you know, a break, say an hour or something like that, come back at four-ish and hear brief arguments, and hopefully the arguments wouldn't be longer than the witnesses' testimony, and then we would still have time to hear from the public at five. That

would be one possibility.

MR. DODGE: If you do it that way, they will be brief, your Honor, so I support that.

CHAIRMAN BOYER: Would that be acceptable to the parties?

UNIDENTIFIED SPEAKER: Yes.

MR. PROCTOR: Oh, I think we'd need a half an hour and that ought to do it.

CHAIRMAN BOYER: Well, let's do that. Let's recess until -- shall we say four o'clock? Reconvene at four o'clock, hear brief arguments from counsel. Yeah, we'd have to limit the time if all eight of you are going to speak. You'd have to have like 7.5 minutes or something like that.

Okay. Let's do this: Let's come back at quarter to four and then give everyone about ten minutes. Does that sound good? Or if not good, at least if it's acceptable, we'll -- you don't have to take the full 7.5 minutes. Okay. We're in recess, then, until quarter to four.

(Recess, 2:50 p.m.)

(Reconvened, 3:47 p.m.)

CHAIRMAN BOYER: Okay. Let's go back on the record, and this is the time that we have determined to hear argument from counsel and, I

guess, one party, and we'll commence with Mr. Monson.

MR. MONSON: Thank you. One thing I haven't had time to do is to time myself. I'll try to be within your time frame.

There's no dispute in the evidence that the current system isn't working. Rocky Mountain Power has under-recovered its costs -- its net power costs by over $300 million over the past eight years. There's no dispute about that. We simply want customers to pay the actual costs prudently incurred in serving them, and we believe that is the way -- that's the definition of a just and reasonable rate, and we believe that would be appropriate.

Now, all parties to the case have essentially agreed that there's a three-prong test to determine if an ECAM is needed, and our evidence has clearly passed all three prongs of that test. The first one is, are costs large? Yes. No one disputes that. The second one is, are they volatile? In addition to these costs being large, if you look at Figure 5 in Mr. Graves' surrebuttal testimony, you'll see that they vary between plus 32 million above forecast to 308 million below forecast just in a period of four or five years, so, clearly, they -- they're very volatile.

We also have an interesting situation on volatility. We have some -- some of the intervenors say these costs are so volatile that you better not make ratepayers bear the risk of this volatility and acknowledge the volatility. Other intervenors say, "No, they're not volatile so you're not entitled to an ECAM."

I think when you consider the factors of both load and prices and the fact that these situations arise on the margin with gas plants that operate on the margin to replace renewable resources to fill gaps in our loads that you can't predict and are not predictable, these are clearly volatile costs, and I think if you look at any of the graphs in the testimony, you'll see they're volatile. They go like this, the prices and the volumes.

So the question then becomes -- well, and I think, also -- it's interesting we've had this debate, because every other state has, I think, gotten by this issue fairly easily. Every state that's looked at this issue has concluded these are volatile costs and they do pass the three-prong test.

So the third prong is, are they within the utility's control? And the issue here is hedging. Because of our hedging program, some of the parties

say, "Yeah, they're within our control. We can handle them." No one has challenged that we have a good hedging program. In fact, the Committee's -- the Office's witnesses said that we had a good program and we complied with it, and I think the purpose of that was to show we can hedge.

Well, that's true, we can hedge, and we do a good job, but we can't hedge the short-term variability and loads and prices that can't be predicted when you file a general rate case. And I don't think there's really much debate about that. And if you look at Mr. Graves' testimony, he demonstrates very clearly that the components of net power costs, particularly the net short-term sales and the gas purchases on the short term, cannot be hedged. If they could be hedged, we have a good hedging program and we would have done so, and we wouldn't be $300 million under-recovering for the past eight years.

The Company has no reason not to try to do the best job it can in covering those costs, and it hasn't been able to do it.

So there's some discussion about the EBA, the elimination of EBA. I think it's clear from the evidence that there have been substantial changes

since 1990 in the markets, in volatility, in the costs, the resources, and the mix of resources and the source of resources, but one thing hasn't changed.

Ms. Kelly said today that we are now in a short position where we were long in 1990. We're still a net seller of power, and Mr. Duvall's testimony makes that very clear. We are short on capacity, but we're long on energy, and that's why we have these long-term -- I mean, these sales and the sales volumes that we do. So that hasn't changed, either.

Okay. There were some concerns -- okay. So we pass the three prongs, so then you get to these concerns that were raised about adopting the program, and the main one seems to be the concern about incentives. Frankly, I don't understand that concern, because we only can earn a profit when we invest our funds in capital resources. If we simply buy power on the market, the best we can do is recover, dollar for dollar, our costs. We don't earn anything. So we have an incentive to invest.

We had some disincentives before the major plant addition statute was passed and before the Energy Resource Procurement Act was passed because

there were issues of regulatory lag and issues of future prudence review. Most of that was taken care of, so we don't have any disincentive to invest in capital resources, other than maybe we have a disincentive because we're under-earning so badly that we have a difficult time coming up with the capital to do so.

Another question that was raised is, could we fix this problem in some other way? And I thought it was very interesting to listen to Mr. Chernick's response to Chairman Boyer's question on that subject because, after going around and around, all he could say was we could do a better job of forecasting and we could get better models and we could do a better job.

The evidence is quite clear that because of all the moving parts and all the variability of them and their interrelationship, that we can't do better, and that's why ECAMs have been approved for 90 utilities throughout the country.

Another question is, are there enough regulatory hammers to deal with these issues? And we believe there are. Prudence reviews are a significant incentive to good action, but there's an element in this testimony from some of the parties

that there's a presumption, I guess, that the Company will act badly if it gets an ECAM.

First of all, that's the wrong legal presumption. The presumption is, that was stated very clearly in -- well, I should have written it down, but it's a United States Supreme Court case, Southwest Bell -- is that there's a presumption that management acts prudently, and that presumption was also adopted in WexPro, too, and the Commission doesn't intrude into management unless there's evidence that the utility has engaged in wasteful or grossly negligent practices, so there's a presumption that we'll act prudently.

But, more important than the presumption that we'll act prudently, we have ECAMs in four other states. We haven't changed our behavior because we've got an ECAM in these other states, and no one has questioned our prudence in those four other states.

There's a question about, how difficult will it be to review the prudence of our actions? Well, Questar Gas has a 191 account. It's been in place for over 30 years. It operates well. There are periodic filings, there's audits, there's reviews, and, as Commissioner Campbell noted in his

questions, it's actually made the process more transparent so that parties can get aware of it and get into it.

And by the way, there have been prudence reviews. There was a case in 1992 called a mega -- we call it the mega pass-through case. In that case the Committee challenged the Company's pass-through and said that there ought to be a hundred million dollar refund because the Company had not engaged in enough short-term spot market purchases and, instead, relied on long-term purchase contracts. I'm talking about Questar Gas. The Committee lost that case.

There was another prudence review in connection with the CO2 plant, as you may recall. The Committee won that case and there was a $30 million refund. So in the past 20 years there's been two major cases where there were prudence reviews. They weren't insurmountable or difficult, and the process works.

Okay. Beyond the issues and concerns, one thing that hasn't received a lot of attention is there's costs if we don't adopt an ECAM, and the first one is that ratepayers are currently not receiving the proper price signal for what the power they're buying costs them, and issues arose about,

well, maybe they wouldn't get it soon enough under the ECAM that we proposed. Well, that's a phase two issue, and we can change that if the Commission thinks it needs to be changed, but that's important. It's important that customers pay the fair cost of service.

Secondly, the Company hasn't been able to earn its rate of return. Hasn't even come really very close to earning its rate of return for many, many years, and it's largely attributable to this net power cost problem.

What's the effect of that? Well, some would say that the fact that the Company has changed hands three times in the last 20 years is a result of financial weakness on the part of the Company, but, more directly, the Company has engaged in a significant investment program involving a billion dollars a year of investment or more. The Company needs to be in a strong financial position. It needs to have access to capital markets, and it needs to have a good bond rating, and having an ECAM in place will assist in those things.

Commissioner Allen raised questions about a pilot program. We don't object to this being called a pilot program at all, as long as it's really an

ECAM where we do recover, through rate reconciliation, the actual cost of -- the actual prudently-incurred net power costs. We think, if you approve an ECAM, whether you call it a pilot program or not, you'll be able to continue to review it, continue to add features to it, but if you want to call it a pilot program, that's okay, because it's probably a pilot program, anyway.

Several issues were discussed about things like quicker price signals, reduction in return on equity. Those issues are all issues that don't need to be resolved right now and shouldn't be resolved right now. Some of them are phase two issues. Some are issues that will play out over time.

I want to also point out that in Idaho the Company applied for an ECAM approximately the same time they applied for an ECAM here. The filing in that case was simply the direct evidence. It was filed by the Company which all the parties claimed it was totally inadequate here in Utah. The parties were able to get together in Idaho and agreed on implementation of an ECAM in Idaho.

I think there is a good question, is what's so different about Utah? We've got every state that has rate-of-return-regulated utilities in it that are

vertically integrated has an ECAM except Utah. Are we that different? Are we that much smarter? I don't think so.

So, in conclusion, we'd respectfully request that the Commission issue an order, preferably a bench ruling, that having an ECAM could be in the public interest or is in the public interest and that we should move to phase two.

CHAIRMAN BOYER: Thank you, Mr. Monson.

Ms. Schmid?

MS. SCHMID: Good afternoon. The Division offers a middle ground in its testimony and recommendations. This Commission is scheduling orders to find phases for this docket, and we currently are at phase one, the stage where, as set forth in the Commission's August 4th, 2009 scheduling order, where the issue is whether an energy cost mechanism or ECAM and its use in regulating RMP is in the public interest.

The parties are not tasked, at this stage, with presenting and defending or taking apart a particular ECAM proposal. The question before the Commission today is one of public policy. Is an ECAM in the public interest? The Division has offered the Commission testimony directly addressing the public

interest issue, while it seems that other parties have focused more on the design of the Company's filed ECAM and polarized their positions as sort of an all-or-nothing proposal.

But at this phase, it doesn't have to be an all-or-nothing proposal. There's no need for the Commission to decide in this phase what a final ECAM should look like. The Commission now needs only to decide whether an ECAM can be in the public interest.

The Division has set forth -- or has put forth evidence that shows an ECAM can be in the public interest. The Division has also put forth criteria that it thinks an ECAM should follow to be in the public interest, and this is found in the testimony of Mr. Peterson.

He has five points. He says that an ECAM should not reduce incentives to provide -- for the Company to provide electricity at the lowest cost and least risk prudently possible, that an ECAM does not reduce incentives to the Company to reduce its load and prospective load with owned generation rather than through market purchases, that the mechanism does not unduly shift risk from the Company to ratepayers, that incremental power costs be offset by any incremental revenues before any additions are

made to a balancing account, that the mechanism only covers those costs that are truly outside of the Company's control and cannot be anticipated and/or significantly mitigated.

These are principles that the Division thinks can solidify and make an ECAM be in the public interest. These are not specific design criteria, but they are guiding principles.

The Division also notes that hedging and forecasting are important issues, and they have been raised by the parties. In the Division's opinion, these important issues can proceed through parallel proceedings.

The Commission can provide direction on hedging, and that can be used as a tool in phase two, if that's where the Commission decides to go, in designing the shape of an ECAM.

As part of that phase two, other tools can be implemented to meet issues regarding prudence review and evaluation of the ECAM. Those tools can include benchmarking, reviewing at specific milestones, and, if needed, implementation of a regulatory hammer in the design.

Note that if the Commission moves to phase two, it's not required blindly to accept whatever

proposal is put out. The Commission has the discretion to determine whether or not that specific proposal or proposals in phase two should be adopted; however, this phase is preliminary. We're deciding whether or not an ECAM can be in the public interest.

We've heard reference today to Questar's 191 account, and it seems wise, also, to look at Questar's recent conservation-enabling tariff, which the Commission recently implemented through a pilot program. The pilot program has promoted an open dialogue, permitted analysis and evaluation, and provided a forum for discussing the merits of that program.

If the Commission decides that an ECAM is in the public interest and then, after this, in a phase two, decides upon a particular form of ECAM, the Division recommends that it be adopted in a pilot program form so the same benefits can be received here.

The Division believes that an ECAM can be in the public interest, urges the Commission to move forward to phase two, and requests that the Commission, in its order moving this docket to phase two, provide some guidance on the principles that should be included in an ECAM design. The

Commission's decision today doesn't have to be all or nothing. Thank you.

CHAIRMAN BOYER: Thank you, Ms. Schmid.

Mr. Proctor?

MR. PROCTOR: Thank you, Mr. Chairman and commissioners.

It is true that customers should pay the actual costs prudently incurred by the utility providing service. The issue and operative word there, of course, is "prudent." There's no presumption that utility management utility generally is operating prudently. What happens is that in each case of a general rate case, just and reasonable rates are set, and in between rate cases, that utility is responsible for the greater expenses above rates and also gets to retain the greater revenues in excess of what was anticipated between rate cases. They're also given an opportunity to earn a return on the investment.

Since 2004, when I began to represent the Office formally, the Committee, and, in fact, some 24 years ago, 26 years ago, when I was representing Utah Power & Light, there was a continual complaint that, in particular with net power costs, the rates don't reflect actual costs and the Company can't earn its

authorized rate of return.

In this case, the Company insists that that's because there are, within net power costs, large, volatile, and, therefore, uncontrollable components. The Company's evidence does not establish that large, volatile costs are -- always mean it is uncontrollable. They lump it all together.

The fact of the matter is, as Ms. Kelly has quite ably pointed out, large costs, volatile costs, are controllable with the proper results, with the proper planning, with the proper methods, the proper models. Mr. Chernick does the same.

So, as to why it is that the net power costs or actual exceed rates, the Company does not provide any explanation other than, "Well, they're large, they're volatile, and, therefore, they're uncontrollable and we need an ECAM." We need to adjust the expenses in between rate cases.

The question, then, is why? Well, largely the answer is because every other state does it. Well, what the Company does not examine carefully is in those other -- for those other 90 utilities, and I speak now from the perspective of Utah, do they exist within a six-state service territory with six

different regulatory authorities? Are there divergent peaks? Is the utility or at least the customers of one part of that utility subject to a claimed hydro endowment, eliminating a benefit of inexpensive hydro power? Has there been in place a multi-state protocol to try to set rates to somehow counterbalance the imbalance that exists between the peaks and the resources available in one part of the territory versus another?

Is there a difference in the legislative environmental policy between Utah and other states, in particular, the emphasis upon renewable resources elsewhere? Is there available in Utah renewable resources, particularly as compared to those available in other states? Is there a divergent ratemaking standard? Are there states that affect Utah that are still using a historical test period? Are there states that have versions of ECAMs?

Is there a resource procurement policy that permits pre-approved cost recovery, as Utah does? Are there states that provide for the acquisition of major plants accompanied by pre-approved cost recovery, as in Utah? And is there a reliance to the same degree on market, and is there a hedging practice unapproved by the Commission that hedges to

the extent that Mr. Graves described in his testimony? The percentage he gave, I believe, is confidential, but it's a large one.

The response, then, from PacifiCorp is, "Provide us an ECAM." But PacifiCorp still does not discuss the drivers of the net power costs as Mr. Chernick described should be done. And, interestingly enough, whether or not they're recovering their net power costs is in dispute. Mr. Higgins testified that, as to the 2007 disparity, there is none, but, in fact, from the 2007 case, they are recovering their net power costs that were forecast in that particular case.

So the issue is, what is the appropriate balance necessary to accomplish the regulatory objectives? That's from your order defining what the question is in this phase one.

You also recognize that it is the Company's burden to prove that a change in ratemaking treatment for net power costs is upon the Company, but I want to point out another burden that the Company bears that is very relevant to this question. PacifiCorp has a monopoly, and as a monopoly Company, it has a duty to operate in such a manner as to give the customers the most favorable rate reasonably

possible. That's what Utah and the Utah Supreme Court calls a just and reasonable rate.

What that means is that PacifiCorp has an obligation to act prudently to control the controllable. Only if it establishes to the satisfaction of this Commission that it has taken all the steps necessary to, in fact, control the controllable, as Ms. Kelly points out in WRA, long-term planning, maybe even hour-ahead planning, not ten-minute-ahead planning, to control the controllable, only then, if there is a net power cost that is necessary to providing that service that is in response to large, volatile, and consistently uncontrollable costs whenever and every time it occurs, then an ECAM proposal should be considered, but PacifiCorp is a long ways from establishing that, under the present circumstances, it faces large, volatile, and consistently uncontrollable events that are uncontrollable whenever and every time they occur.

That's what's talked about by those other cases where the three elements include those -- you know, the final one being uncontrollable. With proper planning, proper model, proper methods, one can, in fact, address a number of issues. One can

anticipate changes, as Mr. Chernick explained in response to one of the commissioner's questions.

That obligation, the duty to provide the lowest, most favorable rate is a simple expression of the difference between a regulated monopoly and a nonregulated competitive business. The nonregulated competitive business can bet on the outcome. A regulated monopoly is not allowed to, nor is the regulated monopoly given a safe harbor if it does that incorrectly. That goes back to, you set just and reasonable rates, you live within them, you pay what's in excess, and you keep what is in excess.

So the regulated monopoly is expected to evaluate its forecasts, and then to make decisions based upon them with a philosophy that the Company maintains, whether it has developed it and it's approved by the Commission or whether it is imposed by the Commission, and I believe that at this point there's been a recognition that, with respect to the IRP process, for example, the Commission should impose teeth, some way to enforce it. That's to make certain that there are, indeed, true incentives, not for the customer service representative who is dealing with customers, not for the project manager who has a budget to live within, but senior

management and the Company as a whole.

That's where the incentive needs to be when one is directing the expenditure of 30 percent of the entire expenses for the utility, and that's in net power costs. That's the incentive that has to be preserved, and that's the incentives that are being discussed in the literature in any other cases, not the incentive of a person who is in charge of a small division in a plant to operate in the most effective, efficient way possible within the budget they're given. Rather, it deals with things such as hedging, such as the preparation of an IRP.

Those principles of utility ratemaking and utility operation are simply not considered by the ECAM that they proposed and asked you to accept, and it's for those reasons that the Office has taken the position that there are threshold duties that the utility is not performing or not performing well at this time that must be imposed upon them before one can consider the appropriate ECAM design to deal with those large and volatile, which are in every case, no matter when they happen, uncontrollable. Those are appropriate. The balance of the request is simply not.

So, as the Office has asked you to do, I'm

going to repeat, there are threshold issues that have to be decided. Other parties have raised them equally well. That's what we believe is appropriate in this case. No, it's not an up or down, but it's also not a, "Let's ignore the phase one and go immediately to phase two." You can't rely upon the outcome of phase two if what you're trying to do is see if something works.

What you do is lay the groundwork here for the requirements of any ECAM and see if, in fact, in phase two, when and if it is appropriate to consider, the Company can design one that meets your requirements, that it has within it a respect for the ratemaking and regulatory principles that are clearly established in this state. Thank you.

CHAIRMAN BOYER: Thank you, Mr. Proctor.

Ms. Smith?

MS. SMITH: May it please the Commission, thank you for the opportunity to offer oral argument on this very important issue. As I'm sure you're aware, Wal-Mart is a large retailer. It has more than 45 facilities in RMP's Utah service territory. These facilities include both store locations and distribution centers, and Wal-Mart is a large retail customer of RMP. Wal-Mart purchases approximately

180 million kilowatt hours annually from RMP.

Wal-Mart is also a leader in energy efficiency and deployment of demand-side management technology.

In the phase one portion of this proceeding, Wal-Mart's sponsored the testimony and exhibits of Steve W. Chriss, Wal-Mart's manager of state rate proceedings. In sum, Wal-Mart does not oppose this Commission's consideration of an appropriate ECAM proposal in the phase two of this proceeding, but Wal-Mart strongly cautions that the Commission consider the following two things: The extent to which the Company's approved rate of return can and should reflect the reduction in NPC risk, and that any ECAM design should improve the transparency of NPC rates and send price signals to customers so that they can have more informed consumption management decisions.

Wal-Mart advocates that rates be set based on a utility's cost of service. This produces equitable rates that reflect cost causation, send proper price signals, and minimize price distortions. Moreover, Wal-Mart advocates that, for net power cost rate design, that we should ensure that the collection timing better reflects when the utility

incurs the cost. More transparent fuel rates can drive more informed consumption management decisions, and this can provide customers the ability to understand their electricity rates in the context of broader energy markets.

Today several intervenors' witnesses have raised the issue of demand side management, and I appreciate this opportunity to offer a different conclusion. Price signals that drive the efficient use of energy, which, in turn, should drive increased implementation of demand side management measured at the customer level, thus, a central focus of any proposal, ECAM proposal, adopted by this Commission should be to send customers effective price signals.

Clearly, an ECAM that recovers fuel and purchased power costs on a timely basis would yield better price signals to customers, and these price signals would be driven by market and RMP system conditions, not by deferrals or large deferred account balances.

This forum today, as you well know, has gone beyond the policy question raised and has, additionally, allowed the parties to provide valuable feedback on RMP's initial proposal. Wal-Mart offers the following roadmap for a successful conclusion of

this proceeding: The Commission should consider all of the party feedback about what constitutes an ECAM mechanism that is in the public interest. The Commission should issue a phase one order that articulates the design features that RMP should include in a revised ECAM filing.

Phase two would then commence after RMP files its ECAM proposal with a proposal that conforms to the design features adopted by this Commission. Of course, these Commission-adopted design features should include an appropriate adjustment to the Company's approved rate of return to reflect the reduction in net power cost risk and, of course, more timely recovery of actual fuel costs.

Thank you for this opportunity.

CHAIRMAN BOYER: Thank you, Ms. Smith.

Ms. Mandell?

MS. MANDELL: Thank you very much.

An ECAM is not in the public interest, most fundamentally because it creates perverse incentives for the utility. An ECAM creates a bias away from resources that the Company's own studies show are best able to manage risk, namely, energy efficiency and renewables.

An ECAM creates a bias towards resources

that are a higher cost and higher risk, such as fossil fuel-based resources and short-term market purchases.

Ms. Kelly's testimony provides compelling evidence that an ECAM does influence resource choices that are against the public interest. She provides hard data, rather than hyperbole, involving looking at portfolio choices in the 2008 IRP and the performance metrics associated with portfolio choices that demonstrate the Company already has a bias against resources that lower the risks that we've been discussing in this docket.

Secondly, she provided -- another example is, when you look at wind, the Company's own studies show that wind resources reduce upper tail risk and lower expected costs and the Company already has a bias towards not choosing those resources, an ECAM exacerbates those management choices away from lower risk choices.

Now, additionally, the Company has not demonstrated need in this docket. What Ms. Kelly discusses and has shown is that the Company does have control over the risks that are discussed in this case through long-run resource planning. The Company can make choices to invest in resources that mitigate

risks. They can -- and they can control the risks.

Ms. Kelly discussed three major risks facing the Company now, wholesale market prices, natural gas price volatility, and the risk of the costs of CO2 rate federal legislation.

All those risks can be controlled through proper long-run resource decisions that are in compliance with the Company's own modeling and choices.

Now, there are additional reasons that an ECAM is not in the public interest. An ECAM shifts risks away from those best able to manage the risks and towards those most unable to manage the risks, and, again, Ms. Kelly's testimony goes to the -- goes to hard data and the Company's own testimony to demonstrate in a compelling manner that that's an inappropriate shifting of risks.

And, lastly, an ECAM is not in the public interest because of the risks of climate change. By creating perverse incentives, the Company is motivated to make choices that are not best for avoiding the physical and environmental impacts of climate change, and those risks are real, and the ECAM is contrary to the best interests of the public in that regard.

So, in conclusion, the Company has not met its burden of proof in this docket to demonstrate need and to demonstrate that an ECAM is in the public interest.

I have to add, if the Commission does decide to go to a phase two, WRA strongly recommends that the Commission do a very thorough examination of the IRP process to make sure that it's well aligned and that the Company's choices are in the public interest, the long-range choices are in the public interest and are towards resources that are less risky and less costly. Thank you.

CHAIRMAN BOYER: Thank you, Ms. Mandell.

Mr. Dodge?

MR. DODGE: Thank you, Mr. Chairman.

I'd like to begin by respectfully disagreeing with Mr. Monson in his statement that no -- there's no dispute that the current system is not working or that the Company has under-recovered its net power costs by hundreds of millions of dollars. We don't believe any such showing has been made in this case.

The 300 or so million dollars in net power costs, the delta between what the Company claims its net power costs were and what it claims it recovered

in rates, that number fails to account for the effect of a number of things; for example, it includes the effects of the 2001 energy crisis. They go back to the 2001 case. It fails to account for delayed Lakeside startup, as Mr. Higgins testified to. It fails to account for rate case settlements. Many -- most of those cases were settled, and in settlements, as the Commission knows, there's often a tradeoff between one set of costs for another. Net power costs were not resolved carefully by the Commission in litigated proceedings in those dockets.

Indeed, in the one docket where it was litigated, they didn't suffer a loss. That was the one year where they didn't have under-recovery of their net power costs, so you cannot conclude from the evidence they presented that the net power costs have been under-recovered by anywhere near the level that they claim.

It also fails to account for the fact that many of those cases were their historical test periods. It also fails to account for hedging issues; A, the possibility that in some of those years there were no hedging activities. I don't know that, but I don't believe that's been demonstrated. But B -- and, again, here I will disagree with

Mr. Monson. I don't believe everyone here agrees that the Company's hedging strategy is good. It may be good, from the Company's perspective, at reducing costs, but it's probably pitifully poor from the customer's perspective -- excuse me, of reducing revenue recovery risk, but it's poor, from the ratepayer perspective, of capturing the downside when market prices drop. They only hedged against their upside risk and not against the customer's downside risk.

Those kinds of issues need to be carefully looked at. I don't know of any client that I represent that hedges a hundred percent of its -- nearly a hundred percent of its fuel prices.

So it fails to account for hedging policies and practices that may not be consistent with ratepayer interests, in particular.

ECAMs are typically justified based upon fuel volatility. No one disputes that there's fuel volatility, but make no mistake about it. Fuel price volatility is not the driving issue in this case. They've hedged against the fuel price volatility almost completely. The risks that they proposed to shift to ratepayers in this docket include weather-related risks, to the extent they haven't

already shifted those through weather normalization practices, outage-related risks, production plant-related risks, in other words, their resource portfolio selection-related risks, and hydro risks.

And, as Mr. Higgins pointed out, that one is particularly galling, given that Utah does not get a commensurate share of hydro upside or benefits, and yet the proposal is to shift the hydro risk to Utah ratepayers.

Those are the kind of risks we're talking about. I understand why the Company doesn't want to bear those. Who does want to bear risk? The problem is, they're paid to take those sorts of risks. It's only if they can demonstrate that those risks are uncontrollable through any other means and that they have a significant deleterious impact on their potential to earn, their ability to earn, that we should even be talking about it, and I don't believe the evidence has demonstrated that.

Now, in pushing for an ECAM, the Company wants to rely dramatically -- to dramatically increase the level on after-the-fact prudence review. That kind of review is simply ineffective as compared to the incentive of self-interest. Whenever we can rely upon self-interest, that is the most reliable

method of incenting someone to do what's right. Today the Company has the incentive -- again, other than with respect to the hedging practices I talked about -- the incentive to minimize net power costs because it's in their own self-interest in between rate cases.

It is an ineffective substitute to say we would do after-the-fact prudence review. It's incredibly difficult to prove. It's incredibly difficult to find witnesses who can step back into the shoes of management at the time the decision was made, demonstrate what decision should have been made, and demonstrate the results of that in a rate case. In fact, it's almost never successful.

Regulating by exemption, as has been proposed here today, is no substitute for reliance on one's own financial self-interest, particularly in the context like here where the Company has unparalleled access to information and data relevant to that kind of an information.

Now, again, the Company is paid to take the kind of risks that we've been talking about, and yet they want to reduce those. They want to shift all of those risks to ratepayers and they want to resist any notion of reducing their ROE for it.

It's very difficult, as we've encountered in other dockets before this Commission, to identify the precise results of risk shifting to ratepayers, and yet the Commission acknowledges it happens, but if you can't demonstrate it precisely, if you can't use a mathematical or econometrical model to show it, then many here reject it, and then you just have to punt and leave the ROE basically where it would be.

It's not fair to ratepayers to systematically shift risk to them away from the utility and yet not -- and not, at the same time, systematically reduce the ROE.

The fact that there may be ECAMs in other states, I submit, is not relevant here, and I would submit this state has done it fairly well. Rates are fairly low here, both gas and electric rates. The utilities are relatively healthy. A man reputed to be the most brilliant investor of our century bought the thing, obviously doesn't believe that this is a poorly-regulated entity.

There are ways other than ECAMs to deal with these issues, and I submit that many of the states that have ECAMs wouldn't adopt them today if they were facing the issue today. We had an ECAM or an EBA. The Company convinced us to get rid of it at

a time prices were starting to decline, not surprisingly, but on the proper basis that they have the ability to manage the risk, let them take the risk.

I submit that if many Commissions today faced this, they would look at new tools available to utilities, like hedging future test periods, and other means of managing risk, and choose that rather than an ECAM because of the incentive-damaging aspects and the risk-shifting aspects of an ECAM.

And then I'd like to address the issue of incrementalization -- probably a new word. Mr. Higgins has testified to this in other dockets. A utility will incrementally move, every time it can, to reduce its risk without reducing its return. In this state, we have moved to future test periods, and I note here that it's interesting. The utility wants the benefits of the future test period, i.e., bringing capital costs in earlier. They don't want the risks of the future test period, i.e., their apparent inability to project some of their usage or cost numbers correctly. You either have a future test period or you don't, in my view. We gave them one. If we're going to keep it, they should live with it, or let's return it to a historical test

period.

In addition to a future test period, they got a pre-approval statute, they got a single-item ratemaking statute. They are now hedging that significant ratepayer cost, I would submit, for shareholder benefits, and all of those are not enough.

Now, an ECAM -- and I guarantee you if an ECAM gets adopted, what's the next thing they'll be saying? They now need an incentive to do demand side and energy efficiency, and we saw that with Questar, and Kevin Higgins pointed out, they wouldn't be here complaining about that if we just left the fuel price risk on the Company like it was once there.

Ratepayers can be incrementally damaged, if you will, by shifting risk from one to the other, and if there's not a commensurate reduction in the cost to the ratepayer of return on capital or capital costs, then that's a one-sided proposition that's not fair to ratepayers.

In closing, I'd like to concur with the Committee -- or the Office, excuse me. I submit that, unlike some, I do not believe the only issue before this Commission is, is there any conceivable circumstance under which an ECAM might be in the

public interest? We have a specific ECAM before us. This is an adjudicated proceeding. You are dealing with -- if this Commission cannot determine from the testimony or does not determine that it's in the public interest to adopt that with some tinkering, I submit it's inappropriate to move on. It's not appropriate to simply say, "Let's go see if we can devise something." It isn't our job to devise something. It's the utility's job to devise something that is in the public interest.

And I concur with the Office, that before moving forward into a phase intended to design an ECAM, that the Commission should first deal with the difficult issues of hedging standards and practices, market reliance and MSP or market -- well, excuse me, MSP, meaning the issue that Mr. Higgins addressed, the unfairness of shifting hydro risk without either returning the rolled in or doing something else to align risk and reward there, and last, resource planning, as Commissioner Campbell pointed out, the lack of teeth in the resource planning process, if that's going to be relied upon. All of those things, I think, are prerequisites to moving into a design phase for an ECAM. Thank you.

CHAIRMAN BOYER: Thank you, Mr. Dodge.

Mr. Evans?

MR. EVANS: Thank you, Mr. Chairman. Appreciate the opportunity and the invitation to offer oral argument. We have not presented a witness in this docket and, honestly, after having heard oral argument, I think there's nothing that we can add that would assist the Commission in arriving at its decision, so we will waive our oral argument. Thank you.

CHAIRMAN BOYER: Okay. Thank you, Mr. Evans.

Is it Mr. Mattheis?

MR. MATTHEIS: Yes, sir. Thank you, your Honor. I'll be very brief. Nucor appreciates the opportunity to offer comments. We don't believe that the Company has met its burden of demonstrating that an ECAM would be in the public interest at this time, for the reasons very ably summarized by WRA, UAE, and the Office, and with that said, I won't burden the record any further. I appreciate it, and thank you very much.

CHAIRMAN BOYER: Thank you. Thank you for joining us.

Ms. Wolf, do you wish to make any statement?

MS. WOLF: No, thanks.

CHAIRMAN BOYER: Okay. She indicates no. At least the record does reflect that. Okay. Very well. We'll be now in recess until five o'clock when we will hear from members of the public. Ms. Murray, are you going to help us again, as you normally do? Thank you so much. We'll see you then.

(Whereupon the taking of the hearing was concluded at 4:39 p.m.)

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STATE OF UTAH   )
)   ss.
COUNTY OF SALT LAKE   )

I, RENEE L. STACY, Certified Shorthand Reporter, Registered Professional Reporter and Notary Public for the State of Utah, certify:

That the foregoing transcript, consisting of Pages 1 to 205, was stenographically reported by me at the time and place hereinbefore set forth; that the same was thereafter reduced to typewritten form, and that the foregoing is a true and correct transcript of those proceedings.

I further certify that I am neither counsel for nor related to any party to said action nor in anywise interested in the outcome thereof.

IN WITNESS WHEREOF, I have subscribed my name and affixed my seal this 19th day of January, 2010.

____
RENEE L. STACY, CSR, RPR
Notary Public in and for the
County of Salt Lake, State of Utah

My Commission Expires:

November 9, 2011