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BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

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

PREFILED DIRECT TESTIMONY OF KEVIN C. HIGGINS

PHASE II

The Utah Association of Energy Users ("UAE") hereby submits the Prefiled Direct Testimony of Kevin C. Higgins in this docket on Phase II design issues.

DATED this 4th day of August, 2010.

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

I hereby certify that a true and correct copy of the foregoing was served by email this 4th day of August, 2010, on the following:

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BEFORE

THE PUBLIC SERVICE COMMISSION OF UTAH

Direct Testimony of Kevin C. Higgins

on behalf of

UAE

Docket No. 09-035-15

Phase II

August 4, 2010

DIRECT TESTIMONY OF KEVIN C. HIGGINS

Introduction

Q. Please state your name and business address.

A. My name is Kevin C. Higgins. My business address is 215 South State Street, Suite 200, Salt Lake City, Utah, 84111.

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

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

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

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

Q. Are you the same Kevin C. Higgins who testified on behalf of UAE in Phase I of this proceeding?

A. Yes, I am.

Q. Please describe your professional experience and qualifications.

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

Prior to joining Energy Strategies, I held policy positions in state and local government. From 1983 to 1990, I was economist, then assistant director, for the Utah Energy Office, where I helped develop and implement state energy policy. From 1991 to 1994, I was chief of staff to the chairman of the Salt Lake County Commission, where I was responsible for development and implementation of a broad spectrum of public policy at the local government level.

Q. Have you previously testified before this Commission?

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

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

A. Yes. I have testified in approximately 110 other proceedings on the subjects of utility rates and regulatory policy before state utility regulators in Alaska, Arkansas, Arizona, Colorado, Georgia, Idaho, Illinois, Indiana, Kansas, Kentucky, Michigan, Minnesota, Missouri, Montana, Nevada, New Mexico, New York, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, Texas, Virginia, Washington, West Virginia, and Wyoming. I have also filed affidavits in proceedings at the Federal Energy Regulatory Commission.

A more detailed description of my qualifications is contained in Attachment A, attached to my direct testimony in Phase I of this docket.

Overview and Conclusions

Q. What is the purpose of your testimony in this Phase II of the proceeding?

A. My testimony addresses the Energy Cost Adjustment Mechanism ("ECAM") proposed by Rocky Mountain Power ("RMP"); in my testimony I propose various design modifications should an ECAM be adopted in the State of Utah.

Q. Before proceeding with your Phase II recommendations, please summarize your Phase I conclusions and recommendations regarding the adoption of an ECAM in the RMP Utah jurisdiction.

A. As I explained in my Phase I testimony, I do not believe that adoption of an ECAM for RMP in Utah is in the public interest in light of all relevant considerations. As a form of single-issue ratemaking, an ECAM 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 the utility to customers, and reduced economic incentives for the utility to undertake demand-side management actions.

An ECAM should not be considered unless the 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 unrecovered.

Based on the Company's fuel mix and hedging practices, I concluded in Phase I of this proceeding that RMP's cost structure is not sufficiently volatile to justify adoption of an ECAM at this time. In addition, the use of a future test period to set base rates, currently being used to set RMP's base rates in Utah, when taken in combination with RMP's aggressive hedging practices and frequent rate case filings, further diminishes any need or justification for an ECAM in Utah at this time.

Q. Have the conclusions you offered in Phase I of this proceeding changed since the time you presented them?

A. No. I do not believe that RMP has carried its burden of proof to demonstrate that its proposed ECAM, or any other proposed ECAM, is in the Utah public interest under existing circumstances.

Q. Please summarize your Phase II recommendations.

A. If an ECAM is adopted in Utah, then I am recommending several changes to RMP's proposal to address several significant deficiencies:

(1) RMP's proposal does not provide for any risk-sharing between the Company and customers. Instead, RMP's proposed ECAM would simply pass through 100 percent of changes in net power cost ("NPC") in between rate cases to customers. This type of 100 percent cost pass-through seriously reduces RMP's incentive to manage its fuel and purchased power costs as well as it would manage them if the Company remained fully responsible for the energy cost risk. To remedy this problem and provide a more equitable balance between customer

and shareholder interests, I recommend adoption of a 70/30 sharing mechanism in which 70 percent of the difference between Base NPC and Actual NPC[1] is allocated to customers and 30 percent is allocated to RMP.

(2) In determining the appropriate amount of any ECAM revenue requirement, the incremental margins attributable to load growth should be credited to customers as an offset. RMP's Idaho ECAM recognizes such a credit, but the Company's Utah ECAM proposal does not. If an ECAM is adopted in Utah, then I recommend the inclusion of a load growth adjustment factor, the value of which would be multiplied by each MWH of Utah load change that occurs relative to the test-period load used for setting rates in the most recent general rate case, but is applicable only to ECAM measurement periods that occur after the close of that test period. The resulting product is then credited against the ECAM balancing account and is subject to the 70/30 sharing mechanism. If the ECAM becomes effective before the conclusion of the next general rate case (in 2011), I recommend that the load growth adjustment factor be set equal to $28.43 per MWH.

(3) RMP's ECAM proposal subjects Utah to hydro-related risk, despite the fact that the Company's current jurisdictional cost allocation methodology, the MSP Revised Protocol, removes the entire benefit of low-cost west-side hydropower from Utah's allocated costs, and the MSP rate mitigation cap currently in place charges Utah a premium that is entirely attributable to the

[1] As used here, Base NPC and Actual NPC are identical to the usage in RMP's filed case, and are described more fully later in my testimony.

removal of a substantial portion of the net benefit of the PacifiCorp hydro system from Utah's allocation of system costs. If an ECAM is adopted in Utah, I recommend that as a condition of such adoption, inter-jurisdictional costs allocated to Utah should be set based on the Rolled-in Allocation Methodology, which apportions to Utah a system hydro benefit that is proportionate to Utah's load. With this change, the system hydro benefits credited to Utah would be consistent with the system hydro risk allocated to Utah through an ECAM.

(4) I disagree with RMP's proposal that the ECAM balancing account earn the Company's most recently approved rate-of-return. Rather, it is more appropriate for the carrying charge to reflect RMP's cost of debt.

(5) I concur with RMP's proposal to utilize an annual measurement period for the purpose of establishing the ECAM adjustor amount. I also concur with the rate design proposal presented by RMP witness William R. Griffith that would differentiate any ECAM adjustor charge by voltage and time-of-day, as applicable.

(6) UAE's application for a deferred accounting order for incremental revenues from sales of Renewable Energy Credits ("REC") should not be addressed in this docket, but rather should be analyzed on its own merits as part of setting rates in the next rate case proceeding. It is not necessary for an ECAM to be adopted, or for an ECAM that recognizes REC revenues to be adopted, in order to obtain a reasonable outcome for customers on this matter. At the same time, it

would be preferable for incremental REC revenues to be included in an ECAM than to not be recognized as a credit to customers at all.

(7) The adoption of an ECAM would reduce RMP shareholder risk, all other things being equal. Consequently, the adoption of an ECAM should result in a lower authorized return on equity than would otherwise obtain.

<u>RMP's Proposal</u>

Q. What is the basic principle behind the operation of an ECAM?

A. Generally, an ECAM identifies a base level of fuel and purchased power costs that are included in current rates, which in Utah, is generally equivalent to the NPC that are included in rates pursuant to a general rate case proceeding. When going-forward fuel and purchased power costs deviate from the base level, an ECAM provides an adjustor charge to recover (or refund) some or all of that differential. In some regimes, the differential is measured prospectively (i.e., using forecasted fuel and purchased power prices) with a subsequent true-up to actual. Alternatively, the differential can be measured on a cost deferral basis, in which the deviation between base fuel costs and actual fuel costs for a given period is tracked and recovered in a subsequent period. This latter approach is being proposed by RMP in this proceeding. Typical periods of measurement for the purpose of establishing an adjustor rate can be monthly, quarterly, or annually. In the case at hand, RMP has proposed an annual measurement period for the purpose of establishing the adjustor amount, although the dollar value of the cost deferrals is measured (i.e., tracked) on a monthly basis.

Q. Please describe the design of the ECAM being proposed by RMP.

A. As explained in the direct testimony of RMP witness Gregory N. Duvall, the base level of RMP's fuel and purchased power costs ("Base NPC") would be established in a general rate case proceeding, using all components of NPC as defined in the Company's general rate cases and modeled by the Company's production dispatch model GRID. The total Company monthly NPC would then be divided by the monthly normalized MWH load (used in determining NPC) to express the costs on a per-unit basis.

Going forward, the per-unit Base NPC would be compared to the actual per-unit fuel and purchased power costs ("Actual NPC"), which would be adjusted to be consistent with the Company's production dispatch model, to remove prior period accounting entries, and to include applicable Commission-adopted adjustments reflected in the most recent general rate case. On a monthly basis, RMP would compare (per-unit) Actual NPC to (per-unit) Base NPC. Any differences in the system per-unit cost would be multiplied by actual Utah MWH load in that month and the product deferred in a balancing account. The monthly under- or -over-recovery would accumulate in the balancing account and earn interest at the Company's most recently approved rate of return on rate base in Utah. At the conclusion of each one-year measurement period, an ECAM adjustor charge (proposed Schedule 94) would be levied to recover (or refund) the amount that has accumulated in the balancing account.

Q. What specific FERC accounts would be included in this calculation as proposed by RMP?

A. As proposed by Mr. Duvall, Base NPC and Actual NPC would include amounts typically booked to the following FERC accounts:

Account 447 – Sales for resale, excluding on-system wholesale sales and other revenues that are not modeled in GRID;
Account 501 – Fuel, steam generation; excluding fuel handling, start up fuel/gas, diesel fuel, residual disposal and other costs that are not modeled in GRID;
Account 503 – Steam from other sources;
Account 547 – Fuel, other generation;
Account 555 – Purchased power, excluding BPA residential exchange credit pass-through if applicable; and
Account 565 – Transmission of electricity by others.

Q. If the Commission were to approve an ECAM in Utah, are you supportive of RMP's proposed design?

A. No. There are various aspects of RMP's proposal that are deficient. Of serious concern, RMP's proposal does not provide for any risk-sharing between the Company and customers. An additional shortcoming is that RMP's approach does not provide any offsetting credits to customers associated with the incremental margins earned from load growth.

In addition, RMP's ECAM proposal subjects Utah to hydro-related risk, despite the fact that the Company's current jurisdictional cost allocation methodology, the MSP Revised Protocol, removes the entire benefit of low-cost west-side hydropower from Utah's allocated costs, and the MSP rate mitigation cap currently in place charges Utah a premium that is 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. Adopting an ECAM mechanism that forces Utah to share in the risks of west-side hydro resources under the current inter-jurisdictional cost allocation method would be fundamentally unreasonable.

I also disagree with RMP's proposal that the ECAM balancing account earn the Company's most recently approved rate-of-return. Rather, it is more appropriate for the carrying charge to reflect RMP's cost of debt.

I will address each of these shortcomings in RMP's approach in greater detail below, and recommend specific remedies to these design problems should the Commission conclude that an ECAM should be adopted in Utah.

Q. Are there particular design aspects of RMP's proposal that you support, should an ECAM be adopted in Utah?

A. Yes, in particular, I concur with RMP's proposal to utilize an annual measurement period for the purpose of establishing the ECAM adjustor amount. I also concur with the rate design proposal presented by Mr. Griffith that would differentiate any ECAM adjustor charge by voltage and time-of-day, as applicable. Finally, I do not object to RMP's basic proposal to measure the difference between Base NPC and Actual NPC on a per-unit basis, as described above in my testimony.

Benefit and Risk Sharing

Q. Please address the issue of benefit and risk sharing in an ECAM.

A. Under current regulatory practices in Utah, RMP bears 100 percent of the risk of deviation in NPC in between rate cases. RMP has argued that it is unfair and unreasonable for it to bear all of this risk. RMP's proposed ECAM would simply reverse the risk and pass through 100 percent of changes in NPC in between rate cases to customers. This type of 100 percent cost pass-through seriously reduces RMP's incentive to manage its fuel and purchased power costs as well as it would manage them if the Company remained fully responsible for the energy cost risk. It is axiomatic that when a firm stands to gain or lose from its cost management decisions, as RMP does today, the pursuit of its economic self-interest gives it a powerful incentive to perform well in managing its costs. I strongly recommend against adoption of an ECAM design that removes this natural economic incentive.

Q. But aren't energy costs largely outside a utility's control?

A. Absolutely not. These energy costs are completely out of the customers' control, but not of the utility. Utilities are not mere passive bystanders when it comes to managing power costs. Every hour of every day, utilities need to be managing the dispatch of their systems to achieve minimum costs, subject to the reliability constraints under which they operate. This requires a sophisticated approach to managing utility-owned resources, as well as conducting a large volume of transactions – purchases and sales – throughout the year. For example, the NPC currently in Utah rates was derived by modeling the effects of over 8 million MWH of sales and over 2 million MWH of purchases in hourly balancing markets, with balancing sales occurring during 8,752 hours of the year and balancing purchases occurring during 6,231 hours of the year; collectively, these transactions extend across six market hubs.[2] The depth and breadth of this around-the-clock dispatch and balancing requirement is so extensive that it is inadvisable for regulators to rely solely on after-the-fact prudence audits to ensure sound utility cost-management performance; rather it is far preferable to harness the natural economic self-interest of the company to incentivize desired behavior.

Q. Are there other aspects of managing NPC that are important besides optimizing system dispatch?

A. Yes. In addition to hourly dispatch, RMP enters into numerous transactions throughout the course of the year that impact NPC, such as short- and long-term purchases and sales and fuel procurement. For example, RMP/PacifiCorp transacted for more than 21 million MWH of long-term, intermediate-term, and short-term purchases, and 14 million MWH of exchanges in 2009, consummated in over 265 transactions. The Company also made over 22 million MWH of long-term, intermediate term, and short-term sales in 2009, conducted in over 150 transactions.[3] It is critical that RMP have the proper incentives for these transactions to produce the greatest possible net benefit to customers. This incentive is most efficiently implemented by a regime in which

[2] Docket No. 09-035-23, Exhibit GND-1, and associated GRID run June 2010 (Gold)_2009 05 29 Net Power Cost Report.
[3] PacifiCorp FERC Form 1, pp. 310-11. Transaction count and MWH exclude out-of-period adjustments.

RMP bears, or at least significantly shares in, the benefits and risks of its decisions.

In addition to creating the proper incentives for RMP's interactions with other parties, incentives play an important role with respect to the Company's own operations. For example, it is important for RMP to schedule plant maintenance in a manner that takes into account the impact on NPC, e.g., by avoiding outages when replacement power is likely to be most expensive. Absent an ECAM, the benefits and costs of deviations from NPC in rates are absorbed by RMP; thus, currently, the Company has the incentive to take proper account of NPC when scheduling outages. However, a regime in which 100 percent of NPC deviations are passed through to customers removes the Company's natural economic incentive to properly consider the impact on NPC in its operations.

Q. What is your recommendation for a reasonable risk/benefit-sharing arrangement between RMP and customers if an ECAM is adopted in Utah?

A. I recommend adoption of a 70/30 sharing mechanism in which 70 percent of the difference between Base NPC and Actual NPC is allocated to customers and 30 percent is allocated to RMP. This sharing ratio still shifts the substantial majority of responsibility for recovering NPC deviations on customers, but it meaningfully aligns Company and customer interests through shared benefits and costs. Under this type of sharing arrangement, if per-unit NPC increases over the base amount, 70 percent of the increment would be recoverable from customers, but RMP would also be responsible to absorb 30 percent of this deviation.

Similarly, if RMP is able to reduce per-unit NPC below the base amount, say, through increased off-system sales margins, RMP would retain 30 percent of this benefit, while customers would receive the remaining 70 percent of the benefit. Taken on the whole, if an ECAM is adopted, I believe this weighting strikes a reasonable balance between customers and shareholders.

Q. If NPC is prudently incurred, why should a utility be required to absorb any portion of increased costs?

A. It is very important to distinguish here between setting rates in a general rate case proceeding and the establishment of a single-issue cost recovery mechanism, such as an ECAM. Rates established in a general rate case should be set at a level that provides the utility a reasonable opportunity to earn its authorized return and to recover prudently-incurred costs, including NPC, based on test period parameters. However, once rates are set, except for certain extraordinary circumstances that may give rise to deferred accounting treatment, the utility is expected to operate within the framework of those approved rates, and its management is expected to cope with normal business risks and the operation of economic forces.[4] Failure to achieve the authorized earnings does not constitute a disallowance of prudently-incurred costs. Rather, rates are set to give the utility the opportunity to earn its authorized return and to fully recover prudently-incurred costs, but it is up to the utility to manage its business to

[4] See for example, Report and Order, In the Matter of the Investigation into the Reasonableness of Rates and Charges of PacifiCorp, dba Utah Power & Light Company. Docket No. 97-035-01, March 4, 1999 at 47-48.

achieve (or even exceed) this objective. In this fundamental sense, the setting of just and reasonable rates is decidedly distinct from simple cost reimbursement.

If an ECAM is adopted, presumably the Commission will have determined that the current ratemaking structure in Utah, in which RMP absorbs the full benefit or burden of deviations from NPC in rates (and is compensated for that risk through the level of its authorized return on equity), requires modification to reduce RMP's exposure to this risk. In reducing RMP's risk, however, it is hardly necessary to migrate to the far end of the ratemaking spectrum to a regime in which costs are simply reimbursed through a 100 percent pass-through. RMP's risk can be substantially reduced (and customer risk increased) relative to the status quo through an ECAM rate design in which risks and benefits are shared. Such a model does not constitute a disallowance of prudently-incurred costs. Rather, base rates already provide for full recovery of prudent test period costs, and allowance is made through the ECAM for additional recovery (or refund) of a portion of cost deviations from the approved baseline level: recovery that otherwise would have been entirely precluded (but for those extraordinary circumstances warranting deferred accounting treatment).

Q. Are risk and benefit sharing provisions used in ECAMs in other states?

A. Yes. A table summarizing some of these provisions is presented in UAE Exhibit 1.1D (KCH-1). Of note, RMP has agreed to sharing provisions in both Wyoming and Idaho.

Q. Please describe the sharing mechanism in place in RMP's service territory in Idaho.

A. In Idaho, RMP has agreed to a sharing mechanism that is similar in structure to what I have described above, except that the customer allocation is weighted at 90 percent and the Company allocation is weighted at 10 percent. This sharing agreement was adopted as part of a stipulation filed with the Idaho Public Utilities Commission in July 2009.[5]

Q. Please describe the sharing mechanism in place in RMP's service territory in Wyoming.

A. In Wyoming, RMP agreed to a graduated sharing mechanism with several tiers. The first tier, associated with NPC deviations equal to +/- $40 million on a total Company basis, constitutes a "deadband" in which 100 percent of cost or benefit deviations is allocated to RMP. The second tier, associated with the next +/- $60 million of NPC deviations (beyond the $40 million deadband), is allocated 70 percent to customers and 30 percent to RMP. The third tier, associated with the next +/- $100 million of NPC deviations (beyond the $100 million of the first two tiers), is allocated 85 percent to customers and 15 percent to RMP. And the final tier, associated with all NPC deviations beyond the $200 million of the first three tiers, is allocated 90 percent to customers and 10 percent to RMP.

The current Wyoming ECAM (called "PCAM") is scheduled to sunset by March 31, 2012. RMP is proposing to replace the current Wyoming design with

[5] Idaho Public Utilities Commission, Case No. PAC-E-08-08.

one that is similar to the Company's Utah proposal, but with a sharing provision that is weighted 95 percent to customers and 5 percent to RMP.

Q. Given the various sharing mechanisms used in other states, why do you support a 70/30 sharing mechanism?

A. The issue at hand is the need to find the proper balance to ensure sufficient management incentive to control costs, as well as to take into consideration the magnitude of change that is reasonable if Utah is to migrate from a status quo in which the sharing weighting is 0 percent customer and 100 percent RMP. I believe a 70/30 mechanism should be sufficient to accomplish that purpose if an ECAM is adopted. This degree of sharing is comparable to the sharing that RMP accepted in Wyoming when measured at an annual NPC deviation (from Base NPC) of $265 million (Company-wide). At NPC deviations less than $265 million, RMP's cost (or benefit) share in Wyoming is greater than 30 percent; at NPC deviations greater than $265 million, RMP's cost (or benefit) share is less than 30 percent.

Q. What is your assessment of incorporating a deadband into the sharing design?

A. A deadband can be useful in that it avoids the imposition of an ECAM adjustor charge if the deviation from Base NPC fails to reach a threshold of a given materiality. In essence, it provides for a continuation of the status quo (i.e., 100 percent of NPC deviations allocated to RMP) over a pre-specified range. The ECAM is then limited to instances of significant divergence from Base NPC. In my opinion, this structure has considerable merit. However, in the interest of simplicity, I have not explicitly proposed a deadband for application in Utah at this time, although I am not averse to incorporating one into the design of a Utah ECAM, if an ECAM is adopted by the Commission.

Q. Can you provide an example of how your sharing mechanism would work?

A. Yes. I have provided a comprehensive example of how my proposed ECAM design works in UAE Exhibit 1.2D (KCH-2). For comparison purposes, I have also provided an example of how RMP's ECAM design works using the same input assumptions in UAE Exhibit 1.3D (KCH-3). UAE Exhibit 1.2D (KCH-2) also includes the operation of the load growth adjustment factor discussed in the next section of my testimony.

<u>Load Growth Adjustment Factor</u>

Q. How should load growth be considered in the context of an ECAM?

A. There are two aspects of load growth that should be understood in the context of an ECAM: NPC recovery and recovery of incremental margins.

Let's start with NPC recovery. Because RMP is proposing to measure the difference between Base NPC and Actual NPC on a per-unit basis, i.e., $/MWH, and then multiply this difference by the actual amount of Utah load in the ECAM measurement period, the measurement and recovery of NPC will automatically be adjusted for load growth. No further adjustment is needed on this score. (On the other hand, if Base NPC and Actual NPC were specified in total dollars – instead of $/MWH – it would be necessary to adjust Actual NPC for changes in system load, to avoid levying an ECAM adjustor charge on customers that was attributable purely to an increase in NPC resulting from system load growth.)

Now, let us consider recovery of incremental margins that occurs with load growth. If an ECAM is adopted, it is highly likely that the difference between Actual NPC and Base NPC will be measured during periods that occur after the close of the test period(s) used for setting rates, which includes the determination of Base NPC. Load growth beyond the close of the test period provides new margins (i.e., sales revenue minus variable costs) that add to utility earnings. If deviations in NPC are recovered through an ECAM for periods beyond the close of the test period, it would be appropriate to also recognize incremental margins from load growth as an offset to the ECAM-related costs recovered by the utility.

Q. Please explain why this is appropriate.

A. It is a matter of basic fairness to customers. If the utility is allowed to recover deviations in NPC for measurement periods beyond the test period on a single-issue basis, it is important to recognize that a jurisdiction with an increasing load, as is typically the case with Utah, will be providing the utility with incremental margins that were not taken into account during the test period. Therefore, in determining the appropriate amount of any ECAM revenue requirement, the incremental margins attributable to load growth should be credited to customers as an offset. This adjustment is necessary to equitably balance customer and utility interests in a single-issue ratemaking context.

Q. Is there precedent for recognition of such margins?

A. Yes. For example, in Idaho, RMP recognizes a credit for incremental generation-related margins from jurisdictional load growth as part of its Idaho ECAM.

Q. What is the current margin credit in RMP's Idaho ECAM?

A. Currently, RMP recognizes a credit of $17.48 per MWH for each MWH of growth in Idaho load relative to the test period used in setting base fuel cost (i.e., Base NPC). The amount of this credit is calculated as the difference between system production-related costs reflected in Idaho rates and NPC-related expenses (excluding wholesale margins), divided by system retail sales. The resulting quotient measures the generation-related margins contributed by incremental load on a per-MWH basis.

Q. What load growth adjustment factor are you recommending for application to Utah if an ECAM is adopted?

A. If an ECAM is adopted in Utah and becomes effective before the conclusion of the next general rate case (in 2011), I recommend inclusion of a load growth adjustment factor of $28.43 per MWH. The calculation of this factor is derived in UAE Exhibit 1.4D (KCH-4). It is calculated using the same methodology that RMP employs in Idaho, except that my proposal also includes incremental margins earned on transmission plant. My calculation uses RMP cost data from the most recently completed Major Plant Additions case, Docket No. 10-035-13.

Q. How is the load growth adjustment factor used in the determination of an ECAM adjustment charge?

A. The load growth adjustment factor is multiplied by each MWH of Utah load change that occurs relative to the test-period load used for setting rates in the most recent general rate case, but is applicable only to ECAM measurement periods that occur after the close of that test period. The resulting product is then credited against the ECAM balancing account and is subject to the 70/30 sharing mechanism.

As I noted above, I have provided an example of how the load growth adjustment factor would work in UAE Exhibit 1.2D (KCH-2). Note that in the example, I have used an annual growth rate of 2.5 percent relative to the pro-forma test-period load (July 2009 to June 2010) used in setting base rates. I made this assumption to provide a meaningful illustration of the impact this adjustment would have on the ECAM using a typical Utah growth rate. The 2.5 percent growth rate is representative of the MWH sales growth rates that RMP uses for Utah in the Company's IRP. [6]

Q. What is the annual impact of your recommended load growth adjustment assuming a 2.5 percent load growth rate for Utah?

[6] See PacifiCorp 2008 IRP, Table 5.2, p. 71.

A. Prior to the 70/30 sharing, it produces a credit to customers of approximately $15.2 million per year. After taking account of the 70/30 sharing, it produces a credit of approximately $10.7 million per year.

Q. What portion of your recommended load growth adjustment factor is comprised of generation-related margin contributions and what portion is transmission-related?

A. As shown in UAE Exhibit 1.4D (KCH-4), $20.12 /MWH is generation-related and $8.31/MWH is transmission-related.

Q. Why do you recommend inclusion of transmission-related margins in the load growth adjustment factor?

A. Load growth from any customer class will provide a significant increase to utility margins for transmission service that was not taken into account during the test period; if customers are to be subject to an ECAM adjustment, it is reasonable to recognize these margins as a credit against the ECAM balance.

Q. Why are you recommending that the load growth adjustment factor be applied only to ECAM measurement periods that occur after the close of the test period used to set rates in the last general rate case?

A. The purpose of the adjustment factor is to account for the effects of load growth over time; thus, it is appropriate to begin applying it in the first month following the close of the test period used to set Base NPC in a general rate case. The adjustment is not intended to correct or true up the test period load forecast. For this reason, in my illustrative example, I first apply the adjustment in July

2010, because the test period in the most recently concluded general rate case ended June 2010.

Q. Should the test period utilized in a Major Plant Addition filing be used to delineate the start of the period in which the load growth adjustment factor applies?

A. No. As demonstrated in RMP's first Major Plant Addition filing, the test period used in that filing was different from the test period used to set rates in the prior general rate case proceeding, but the loads were assumed to be unchanged from the test period used in the previous general rate case. The application of the load growth adjustment factor should not be delayed until the close of the test period of a Major Plant Additions case, because the test period used in such a case, by construction, will likely ignore the effects of load growth.

Q. Are you proposing that the load growth adjustment factor should be applied symmetrically, such that the ECAM balancing account would increase if load declined?

A. In my view it would be equitable for the adjustment to be applied symmetrically.

<u>Hydro-Related Risk</u>

Q. Please explain how adoption of an ECAM would transfer hydro-related risk to Utah customers.

A. RMP/PacifiCorp has access to substantial hydro resources, located primarily in the western side of the Company's system. Generally, hydro resources are significantly less expensive than other resources on the Company's system.

Base NPC is established in GRID assuming "normal" water conditions based on median hydro levels. However, a poor water year might require the Company to make more off-system purchases or operate more expensive generation facilities to replace reduced hydro production. Currently, in Utah, the risk of increased Actual NPC due to deviations from a normal water year is absorbed by RMP. But with an ECAM, any increased (or decreased) cost associated with deviations from a normal water year would be passed on to customers. This higher (or lower) cost would be captured in the ECAM and passed through to Utah customers, thereby exposing them to hydro-related risk.

Q. Do you believe the transfer of hydro-related risk to Utah customers is appropriate?

A. No, not under the inter-jurisdictional cost allocation methodology currently used to allocate system costs to Utah, the MSP Revised Protocol. The transfer of hydro-related risk to Utah customers is inappropriate under the MSP Revised Protocol because Utah does not receive a proportionate benefit from the PacifiCorp hydro resource under that allocation method. Although net power cost in GRID reflects the benefits of the hydro system, the MSP Revised Protocol removes the large majority of these benefits from Utah through a revenue adjustment. This occurs in each Utah rate case through a calculation known as the "embedded cost differential," which extracts from Utah customers the net benefits of west-side hydro resources, thereby increasing Utah's revenue requirement.

The impact of this adjustment is mitigated somewhat through the application of the MSP rate impact cap, which sets the Utah revenue requirement equal to the lower of the MSP Revised Protocol amount (plus a premium of 0.25 percent) or the amount of the Rolled-in Allocation Methodology plus a premium of 1.0 percent. In the latter case, the 1.0 percent premium charged to Utah customers is entirely attributable to the removal of the net benefit of PacifiCorp's west-side hydro system from Utah's allocation of system costs (pursuant to the MSP Revised Protocol). Consequently, even when the MSP rate mitigation cap is in effect, Utah does not receive a proportionate benefit from PacifiCorp's hydro system. Because Utah does not receive a proportionate benefit from the system hydro resources under the current inter-jurisdictional cost allocation method, it would not be reasonable to adopt an ECAM that fully exposed Utah to hydro-related risks without also modifying the inter-jurisdictional cost allocation method to reflect a commensurate hydro benefit to Utah. Simply put, Utah should not be fully exposed to the hydro risk unless Utah also receives a proportionate hydro benefit.

Q. What is your recommendation for addressing hydro-related risk if an ECAM is adopted in Utah?

A. If an ECAM is adopted in Utah, as a condition of such adoption and for at least as long as an ECAM remains in effect, inter-jurisdictional costs allocated to Utah should be set based on the Rolled-in Allocation Methodology, which apportions to Utah a system hydro benefit that is proportionate to Utah's load. With this change, the system hydro benefits credited to Utah would be consistent with the system hydro risk allocated to Utah through an ECAM.

Q. When should the change to Rolled-in be implemented?

A. It appears to me that the Commission has three alternatives to consider. The first alternative applies if an ECAM is adopted that recovers deferred NPC dating to February 2010, as proposed by RMP; in this circumstance, it would be reasonable to make an adjustment to the ECAM balancing account to credit to customers the 1.0 percent premium embedded in Utah base rates approved in Docket No. 09-035-23. My understanding is Utah law prescribes that an ECAM can only be adopted in conjunction with a general rate case proceeding; if an ECAM is approved that recognizes deferrals starting in February 2010, presumably the Commission would be adopting the ECAM in conjunction with the prior rate case, Docket No. 09-035-23. In such an instance, the 1.0 percent premium in rates should be credited to customers in the ECAM balancing account to maintain synchronization between Utah's exposure to hydro risk in the ECAM and the recognition of hydro benefits in Utah rates.

This adjustment, of course, would only be a one-time event; for all subsequent rate cases, so long as an ECAM was in effect, base rates would be set using the Rolled-in Allocation Methodology without a premium.

Q. How would the amount of the credit be calculated?

A. It would equal 1.0 percent of the monthly base revenues paid by Utah customers, coincident with the months in which an NPC deferral is recognized for inclusion in the ECAM balancing account

Q. What is the second alternative?

A. The second alternative would be to postpone any accruals to the ECAM balancing account until the start of the rate-effective period of the next general rate case, with base rates in that case established using the Rolled-in method. Deviations in NPC prior to that date would not be eligible for recovery (or refund). This approach would also ensure synchronization between Utah's exposure to hydro risk in the ECAM and the recognition of hydro benefits in Utah rates.

Q. What is the third alternative?

A. The third alternative is to recognize deferred NPC dating to February 2010, as proposed by RMP, but to delay application of the Rolled-in Allocation Methodology to base rates until the next general rate case. In my view, this alternative is sub-optimal in that it expressly allows for a period in which Utah customers are fully exposed to hydro risk without receiving a proportionate hydro benefit.

Q. How should your recommendation to switch to the Rolled-in Allocation Methodology be viewed in light of the Commission's prior consideration of the MSP Revised Protocol?

A. The MSP Revised Protocol and the MSP rate mitigation cap (in conjunction with the use of the Rolled-in methodology) were conditionally approved by the Commission on December 14, 2004 in Docket No. 02-035-04. These mechanisms for determining Utah revenue requirements were recommended to the Commission as part of a multi-party Stipulation. UAE is a party to that Stipulation and I testified in support of its approval.

As I testified in 2004, the "Reservation of Rights" section at the end of the Stipulation was critical to UAE's support of the MSP Revised Protocol. That section makes it clear that neither support of the MSP Revised Protocol nor execution of the Stipulation will bind or be used against a party in the event that unforeseen or changed circumstances cause continued use of the MSP Revised Protocol to produce unjust or unreasonable results.

In 2004, when the Stipulation was filed and conditionally approved, there was no ECAM in Utah. In my opinion, the adoption of an ECAM subjecting Utah customers to hydro-related risk is a materially-changed circumstance, and I believe the continued use of the MSP Revised Protocol to determine Utah's allocated share of system revenue requirements in conjunction with an ECAM would produce unjust and unreasonable results; consequently, as I discussed above, I am recommending that if an ECAM is adopted in Utah, then Utah's allocated share of system revenue requirements should no longer be based on the MSP Revised Protocol (and rate mitigation cap), but should be determined by the Rolled-in Allocation Methodology without a premium.

Independently from the ECAM proceeding, the going-forward applicability of the MSP Revised Protocol has been the subject of heightened interest in Utah in recent months. In its Order in Docket No. 09-035-23, issued October 19, 2009, the Commission reminded parties that its approval of the Stipulation in Docket No. 02-035-04 was conditional, and the Commission emphasized that "[i]f the projected savings to Utah in the later years, which substantially offset the increases in the early years, do not materialize, we may reconsider the further use of the Stipulation." [Order at 1] The Commission went on to raise the following question:

> We would like to know if the continued use of the 2004 Stipulation mechanisms to set Utah revenue requirement does and will produce results in Utah which are just, reasonable, and in the public interest. Per the terms and conditions of the Revised Protocol, our staff raised this issue with the MSP Standing Committee on September 9, 2009, and suggested a schedule for addressing the issue. Our intent today is not to hinder the development of a long term solution to the issue in MSP, but rather to make certain the rates we set in Docket No. 09-035-23 are just and reasonable. [Order at 2]

Subsequently, in the Commission's November 9, 2009 Order staying the October 19, 2009 Order, the Commission reiterated that, "Although constrained by the time remaining in this docket, we intend to have inter-jurisdictional allocation issues addressed and the reasonableness of any allocation established prior to our approval of any future changes in RMP's rates." [Order at 2]

My recommendation to utilize the Rolled-in Allocation Methodology for Utah if an ECAM is adopted is not intended to be a comprehensive discussion of all going-forward issues pertinent to the MSP Revised Protocol, but rather is a specific recommendation within the framework of the ECAM proceeding. While adoption of my recommendation in this ECAM proceeding might appear to have implications for MSP discussions among representatives of PacifiCorp's jurisdictions, it is not intended to preclude or preempt a new, negotiated MSP resolution among those parties. Rather, my recommendation is tied to RMP's voluntary pursuit of an ECAM; thus, my recommendation is more akin to the adoption of the MSP rate mitigation cap in the 2004 Stipulation, which governs inter-jurisdictional cost allocation to Utah, in co-existence with the MSP Revised Protocol among the signatory states.

Q. As a party to the Utah MSP Stipulation dated June 28, 2004, in Docket 02-035-04 and as a party that supported ratification of the Revised Protocol in that docket, UAE agreed to work in good faith to address interjurisdictional issues being considered by the MSP Standing Committee. Has UAE done so?

A. Yes. UAE, along with a number of other Utah participants, has actively monitored and participated in MSP Standing Committee activities over the past several years to address, among other things, concerns of Utah parties regarding continued application of Revised Protocol in Utah. In addition, UAE has informed the MSP Standing Committee that adoption of an ECAM in Utah would constitute a changed circumstance that would cause it to conclude in good faith that Revised Protocol would no longer produce just and reasonable results for Utah, and that UAE intends to propose in this docket that adoption of any kind of ECAM should be conditioned upon simultaneous adoption of the Rolled-in Allocation Methodology for all interjurisdictional cost allocation ratemaking purposes in Utah.

<u>Carrying Charge on ECAM Balancing Account</u>

Q. What carrying charge has RMP proposed to be applied to any ECAM balancing account?

A. As stated by Mr. Duvall, RMP is proposing that the ECAM balancing account earn the Company's most recently approved rate-of-return.

Q. Do you agree with this proposal?

A. No. The proposed ECAM adjustor charge is designed to pay off each year's balancing account accrual in twelve months – a relatively short period of time. Consequently, there is no need for an equity component to be included in the carrying charge applied to the balance; rather, it is more appropriate for the carrying charge to reflect RMP's cost of debt. Arguably, RMP's cost of short-term debt could be used for this purpose. A reasonable middle-ground alternative is to use the cost of long-term debt, consistent with the carrying charge of 5.98 percent approved in this docket (and Docket No. 10-035-14) for any deferred NPC or REC revenues that may be approved by the Commission.[7]

[7] Docket Nos. 09-035-15 and 10-035-14, Report and Order on Deferred Accounting Stipulation, July 14, 2010 at 5-6.

<u>Time Period for ECAM Measurement</u>

Q. What time period has RMP proposed for measuring the ECAM balancing account for the purpose of setting an ECAM adjustor charge?

A. RMP has proposed an annual measurement period for the purpose of establishing the ECAM adjustor charge, although the dollar value of the NPC deferrals would be measured (i.e., tracked) on a monthly basis.

Q. Do you concur with this proposal?

A. Yes. Because deviations from NPC are likely to fluctuate during the course of the year, if an ECAM is adopted it is preferable to set the ECAM adjustor charge on an annual basis. Administratively, it makes little sense to set a positive adjustor charge to recover positive NPC deviations for one part of a year, only to follow it with a negative adjustor charge for a subsequent part of the year if the deviations were to reverse for that subsequent portion of the year.

Q. What calendar period is RMP proposing for ECAM measurement?

A. RMP is proposing that the annual ECAM measurement period run from October 1 to September 30. The annual ECAM balance to be recovered would be presented on December 15 and the ECAM adjustor charge would take effect the following February 1.

Q. What is your assessment of this aspect of RMP's proposal?

A. I have no recommendation regarding the use of a particular calendar period. I suggest that the Commission select a period that is most administratively convenient for the parties tasked with reviewing RMP's filing.

I note that in the example calculation I present in UAE Exhibit 1.2D (KCH-2), I used the October 1 through September 30 period proposed by RMP, simply for consistency with the Company's proposal. I also note that use of this calendar period in the example requires that the inaugural ECAM adjustor charge be based on a partial-year ECAM balancing account, which I illustrated in my example for the sake of consistency with the Company's proposal.

<u>Rate Design: Time of Day and Voltage-Differentiated ECAM Adjustor Charges</u>

Q. What has RMP proposed with respect to rate design for the ECAM adjustor charge if an ECAM is adopted?

A. As described by Mr. Griffith, RMP is proposing that the ECAM adjustor charge (proposed Schedule 94) be applied as an equal cents-per-kWh rate, after adjusting for voltage level losses, for all tariff schedules, except time-of-day Schedules 6A, 8, 9 and 9A. For Schedules 6A, 8, 9 and 9A, there would be separate on-peak and off-peak ECAM adjustor charges for the periods from May through September and for the periods from October through April; the ECAM adjustor charge would be shaped proportionately to follow the base energy rates for these time-of-day schedules, while the overall cents-per-kWh amount for each of these schedules would be equal to the cents-per-kWh amount applicable to the non-time-of-day tariff schedules, after adjusting for voltage level losses.

Q. What is your assessment of the rate design features proposed by Mr. Griffith?

A. I agree with Mr. Griffith's proposal to shape the ECAM adjustor charge by time-of-day to reflect the shape of the base energy charge for time-of-day-billed rate schedules, as it is consistent with maintaining the underlying price signals in the rate design. I also strongly support differentiating the charge based on voltage of service.

Q. Why should an ECAM adjustor charge be differentiated by voltage level?

A. An ECAM adjustor charge should be differentiated by voltage for the same reasons that base rates reflect voltage differences: customers taking service at higher voltages incur fewer line losses. Consequently, higher voltage customers require fewer kilowatt-hours of generation at input to meet a given level of energy consumption delivered to their meters. The ECAM adjustment charges for customers should be designed to reflect these line loss differences. I note that RMP's ECAM adjustor charge in Idaho is differentiated by voltage; I support the application of the same design concept in Utah if an ECAM is adopted.

<u>Deferral of Renewable Energy Credits</u>

Q. Briefly describe the nature of Renewable Energy Credits.

A. RMP is able to sell the renewable energy "attributes" associated with the generation output of certain renewable generation facilities such as wind, geothermal, and small hydro plants. These attributes have value to other utilities that are required to procure specified amounts of renewable energy pursuant to state statutes and regulations. When these attributes are sold in the marketplace, the exchanged product has come to be known as RECs or Green Tags. Because REC sales are made using assets that are paid for by customers, the revenues from REC sales are appropriately treated as a revenue credit against the revenue requirement recovered from customers in a rate case.

Q. In its application for an ECAM, did RMP seek to include REC revenues in the ECAM balancing account?

A. No. REC revenues are recorded in Account 456, Other Electric Revenue. This account is not among those proposed by RMP for inclusion in the ECAM.

Q. Are you familiar with UAE's application for a deferred accounting order for incremental REC revenue filed in Docket 10-035-14?

A. Yes, I am.

Q. How does UAE's application for a deferred accounting order relate to the rate design of an ECAM?

A. There is no direct or necessary relationship. In my opinion, UAE's application for a deferred accounting order should be addressed on its merit as part of setting rates in the next rate case proceeding. My view is that incremental REC revenues should be credited to customers as an offset to rates irrespective of whether an ECAM is approved.

Q. Do you agree with the assertion in UAE's application that RMP has experienced an increase in REC revenue, over and above what is recognized in Utah rates, that was unforeseeable and extraordinary?

A. Yes. 2009 was a year in which REC values soared to unprecedented levels. The magnitude of change in the amount of REC revenues was certainly extraordinary and the change was not foreseeable to parties who were not directly involved in the negotiations that led to the tremendous run-up in the price of the RECs that RMP sold to others.

Consider that on November 12, 2009, RMP filed rebuttal testimony in Docket No. 09-035-23 in which the Company stated that for purposes of the rate case, $18.5 million represented a reasonable level of its system-wide REC revenues for the test period ending June 2010.[8] The Commission's Report and Order in that docket, dated February 18, 2010, utilized that value in setting Utah rates. However, 2009 actual system-wide REC revenues had turned out to be $50.8 million.[9] And by March 18, 2010, RMP had stipulated in Wyoming to system-wide REC sales of $84.4 million for Calendar Year 2010, with a provision for a true-up. Projections in excess of $80 million had been proposed a full month earlier by parties to the Wyoming case.[10] In a matter of weeks, the Company's projections for REC sales grew by orders of magnitude as the Utah rate case was being concluded. In my view, the case for deferred accounting treatment of the incremental REC revenues is compelling; this sequence of events provides strong background in support of this view.

[8] Rebuttal testimony of Steven R. McDougal, pp. 5-6.
[9] Attachment 2.12.b to RMP Response to UAE 2.12.b.
[10] Wyoming Docket No. 20000-352-ER-09. "Stipulation and Agreement," filed March 18, 2009. See also direct testimony of Denise Kay Parrish on behalf of the Office of Consumer Advocate and direct testimony of Kevin C. Higgins on behalf of Wyoming Industrial Energy Consumers.

I note that UAE's proposed deferred accounting treatment, if approved, would only recoup for customers that portion of incremental REC revenues that are booked starting February 22, 2010. The surge in REC revenue values realized by RMP in 2009 will be retained in full by the Company.

Q. If an ECAM is approved, should REC revenues be included?

A. Not necessarily. As I stated above, given the extraordinary and unforeseeable circumstances surrounding the surge in RMP's REC revenues around the time of the conclusion of the prior Utah rate case, RMP's incremental REC revenues should be credited to customers as an offset to rates irrespective of whether an ECAM is approved.

If an ECAM is adopted, I believe it is still preferable for the matter of incremental REC revenues to be considered on its own merit in a ratemaking docket. That is, it is not necessary for an ECAM to be adopted, or for an ECAM that recognizes REC revenues to be adopted, in order to obtain a reasonable outcome for customers on this matter. At the same time, it would be preferable, of course, for incremental REC revenues to be included in an ECAM than to not be recognized as a credit to customers at all.

<u>Impact on Authorized Return on Equity</u>

Q. If an ECAM is adopted, should there be some reflection of this in the level of the utility's authorized return on equity?

A. Yes. Return on equity includes a component that compensates shareholders for risk. The adoption of an ECAM would reduce this risk, all other things being equal. Consequently, the adoption of an ECAM should result in a lower authorized return on equity than would otherwise obtain.

Q. Does this conclude your direct testimony?

A. Yes, it does.