Steven S. Michel
Western Resource Advocates
409 E. Palace Ave. #2
Santa Fe NM 87501
505-820-1590
Attorney for Western Resource Advocates

Sophie Hayes (12546)
Utah Clean Energy
1014 2nd Ave.
Salt Lake City, UT 84103
801-363-4046
Attorney for Utah Clean Energy

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

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

PREFILED REBUTTAL TESTIMONY OF NANCY L KELLY

Phase II, Part 2

ON BEHALF OF

WESTERN RESOURCE ADVOCATES

AND

UTAH CLEAN ENERGY

September 15, 2010

1 **I. INTRODUCTION**

2 **Q: Please state your name, employer and present position.**

3 A: My name is Nancy L Kelly. I am employed by Western Resource Advocates (WRA) in
4 its Energy Program as a Senior Policy Advisor.

5 **Q: Have you previously filed testimony in this docket?**

6 A: Yes. On behalf of WRA, I filed Direct Testimony on November 16, 2009 and Surrebuttal
7 Testimony on January 5, 2010 in Phase I of this docket. On behalf of WRA and Utah
8 Clean Energy (UCE) I filed Direct Testimony on June 16, 2010 and Surrebuttal
9 Testimony on August 10, 2010 in Phase II, Part 1. On behalf of both organizations I filed
10 Direct Testimony in Phase II, Part 2 on August 4, 2010.

11 **Q: On whose behalf are you submitting rebuttal testimony today?**

12 A: WRA and UCE.

13 **Q: What is the purpose of your testimony?**

14 A: My primary purpose in providing testimony today is to respond to the direct testimony of
15 Mr. Charles E. Peterson of the Division of Public Utilities (Division) filed August 4,
16 2010. The main issue I wish to address is whether the ECAM design as proposed by Mr.
17 Peterson is in the public interest. In addition, I will discuss the revenue adjustment
18 mechanisms as proposed by the Division, the Office and UAE. Finally I will address the
19 performance standards proposal of Mr. Maurice Brubaker for the Utah Industrial Energy
20 Consumers (UIEC).

21 **II PUBLIC INTEREST CRITERIA**

22 **Q: Do you believe the Division's ECAM design as proposed by Mr. Peterson is in the**
23 **public interest.**

24 A: No. The Division's proposal does not address the long-run planning bias that WRA and
25 UCE believe to be a flaw in Rocky Mountain Power's proposed ECAM design.
26 Significantly, the Division's ECAM proposal does not meet the conditions the Division
27 first identified "must be satisfied before it would support a power cost adjustment
28 mechanism."[1]

29 **Q: What are the criteria the Division first proposed as necessary to approve an ECAM**
30 **as in the public interest.**

31 A: The Division's conditions include the following: "(1) that the mechanism does not reduce
32 Company incentives to provide electricity to customers at the lowest cost and least risk
33 prudently possible; (2) that the mechanism does not reduce incentives to the Company to
34 cover its load, and prospective load growth, with owned generation rather than through
35 market purchases; (3) that the mechanism does not unreasonably shift risk from the
36 Company to ratepayers; (4) that incremental power costs be offset by any incremental
37 revenues before any additions are made to a balancing account; (5) that the mechanism
38 only covers those costs that are truly outside of the Company's control and cannot be
39 anticipated and/or significantly mitigated."[2]

---

[1] Phase I, Peterson Direct, at 85-86, November 16, 2009.
[2] Peterson Direct at 76-84, August 4, 2010.

40 **Q: Do you agree with the Division's criteria?**

41 A: Yes, I generally agree with all five conditions.

42 For an ECAM to be in the public interest, management incentives, to operate the current
43 system efficiently and to acquire the mix of resources that best manages risk over the
44 long run, should not be reduced. Therefore, I fully agree with condition one. And, I also
45 agree in concept with what I understand the intent of condition two to be, that is, to
46 protect customers from one type of long-run planning risk: the risk associated with the
47 potential volatility of front office transactions (FOT).[3] I would note that this second
48 condition appears to be a subset of the first, in that covering load with short-term market
49 purchases rather than owned generation or long-term power purchase agreements can
50 increase risk; however, I would also note that meeting this condition, alone, does not
51 necessarily coincide with significantly reducing risk. As I discuss below, the issue is
52 with the choice of replacement resources. Some "owned" resources will reduce risk and
53 address uncertainty better than others.

54 I also agree with condition three that an ECAM should not "unreasonably" shift risk from
55 the Company to ratepayers. Only management has the ability to manage the multiple
56 risks of current operation and to manage the risks of the future through wise resource
57 selection. I also agree that incremental revenues should offset incremental power costs
58 before any additions are made to a balancing account. This is a matter of simple fairness.

[3] Early in this decade, both Utah customers and PacifiCorp shareholders paid the consequences of PacifiCorp not heeding this risk in the late 1990's as it prepared for a world in which it feared load loss and stranded cost. See Order on Stipulation issued May 1, 2002 that resolved three open dockets: Docket No. 01-035-23, Docket No. 01-035-29, and Docket No. 01-035-36.

59 Finally, I also generally agree that the mechanism should only cover costs that are truly
60 outside of management's control.

61 **Q: Does the Division's proposed ECAM meet the five conditions it identified in Phase 1**
62 **of this proceeding as necessary to win its support?**

63 A: No. The Division's ECAM proposal meets only one of the five. The Division's ECAM
64 design appropriately credits revenues against cost before additions are made to the
65 balancing account. None of the others are met, as explained below.

66 ***Efficient System Operation and Long Run Planning Incentives***

67 **Q: Q: Please describe the design component Mr. Peterson proposes to address the long-**
68 **run planning disincentive "to provide electricity to customers at the lowest cost and**
69 **least risk prudently possible."**

70 A: The Division proposes a symmetrical 2% dead band and a 70%/30% sharing mechanism.
71 Within the 2% dead band, if actual net power costs exceed net power cost in rates, the
72 Company is responsible for 100% of the above forecast cost. If actual net power costs are
73 below net power costs in rates within the 2% dead band, the Company keeps the entire
74 difference.

75 Outside of the dead band, whenever actual net power costs exceed 2% of net power costs
76 in rates, customers are responsible for 70% of the costs through the ECAM and the
77 Company for 30%. And, if actual net power cost are below net power cost in rates by
78 more than 2%, the Company keeps 30% of the difference and 70% is returned to
79 customers through the ECAM.

80 **Q: How does Mr. Peterson conclude this design mechanism addresses operational**
81 **efficiency and long-run planning disincentives?**

82 A: Mr. Peterson states "the 2 percent dead band and the 70 percent sharing percentage
83 continue to put significant sums at risk for stockholders to potentially absorb. These in
84 turn should motivate management to continue to pursue a lowest-cost, least-risk
85 strategy."

86 **Q: How do you respond?**

87 A: To begin with, I am surprised by the phrase "continue to pursue a lowest-cost, least-risk,
88 strategy." This contradicts positions the Division has taken in the IRP process and does
89 not reflect the expressed concern in Mr. Peterson's testimony that the Company is relying
90 too heavily on FOTs and not enough on owned resources. It certainly does not reflect the
91 content of the Commission's IRP orders over the years.

92 Second, while I agree that a strong sharing mechanism is essential if the Commission
93 decides to move forward with an ECAM, I do not think a dead band and sharing
94 mechanism meet the criteria that management incentives not be reduced. First, by
95 shifting the risk of 70% of actual net power costs in excess of forecast from shareholders
96 to customers, management incentives are reduced. Shareholders are at risk for less.
97 While continued responsibility for 30% of the costs is a positive component and should
98 help incent operational efficiency, this is certainly not as strong an incentive as
99 shareholders held responsible for 100% of net power cost deviations from net power cost
100 in rates between rate cases.

101 In addition, as I discussed in my August 4 testimony, while a 30 percent sharing
102 percentage might help incent operational efficiency, it is less likely to have a positive
103 effect on the acquisition of resources that best manage risk and uncertainty into the
104 future.

105 Finally, the Division proposes reducing these sharing bands if the Company reduces FOT
106 as a percentage of peak load. This will further reduce the incentive to operate the current
107 system efficiently, and as I discuss below, while it's intended purpose may be to reduce
108 one type of long-run planning risk—the price variability associated with short term
109 wholesale power purchases—the proposal may have the unintended consequence of
110 shifting one type of planning risk for another without actually reducing the riskiness of
111 the Company's overall resource acquisition strategy.

112 ***Owned Generation Versus Short Term Market Purchases***

113 **Q: Please describe the design component Mr. Peterson proposes to assure that an**
114 **ECAM "does not reduce incentives to the Company to cover its load, and**
115 **prospective load growth, with owned generation rather than through market**
116 **purchases."**

117 A: Mr. Peterson proposes tying sharing band percentages to front office transaction targets.
118 If the Company meets a 2015 and a 2020 target, the sharing percentage would increase,
119 first to 80/20 in 2015, and then to 90/10 in 2020. Mr. Peterson indicates that the purpose
120 is to incent the Company to reduce reliance on short-term market purchases to meet
121 projected load by increasing customers' share of costs.

122 **Q: How does Mr. Peterson determine the FOT targets?**

123 A: The FOT targets are defined as a percentage of system peak load. Mr. Peterson bases the
124 targets on PacifiCorp's 2010 Business Plan as contained in the *2008 IRP Update*. The
125 2015 target matches the Company's plan exactly. The 2020 target is set 1% lower than
126 FOT included in the Business Plan.

127 **Q: Please describe the process that produced the 2010 Business Plan.**

128 A: PacifiCorp decision makers began with the 2008 IRP portfolio, eliminated 482 MW of
129 wind, 121 MW of Class 1 and Class 2 DSM, 46 MW of distributed generation, 43 MW of
130 CHP, and 35 MW of geothermal and delayed segments of the Gateway Energy
131 transmission project by two years. The wind acquisition schedule was altered to add the
132 remaining wind late in the period. In addition 115 MW of capacity upgrades were
133 removed. The capacity expansion model was then used with a new load forecast to
134 optimize gas resources and front office transactions. [4]

135 **Q: Were stakeholders involved in the development of the 2010 Business Plan?**

136 A: No. However, the Commission requested comments on the Business Plan. Both WRA
137 and UCE responded to the request for comments. Our comments are attached as exhibits
138 to my June 16 testimony in this docket.

139 **Q: Did the Company provide risk analysis for the 2010 Business Plan portfolio?**

140 A: No.

[4] See Exhibit NLK-1 attached to Nancy Kelly Direct, Phase II, Part 1, June 16, 2010.

141 **Q: Did you form a conclusion regarding the relative risk of the 2010 Business Plan**
142 **portfolio as compared to the 2008 IRP Portfolio?**

143 A: I did. I concluded it was more risky. It removed the resources that manage risk and
144 uncertainty, DSM and renewables, and replaced them with additional gas and market
145 purchases which are risky.

146 **Q: Assuming you agreed that incenting the Company through increased sharing bands**
147 **tied to targets is a good approach for addressing long-run planning risk, do you**
148 **agree with how these targets were determined?**

149 A: No.

150 **Q: How do you respond to Mr. Peterson's claim that the criterion that the ECAM not**
151 **reduce management incentives to cover its load, and prospective load growth, with**
152 **owned generation rather than through market purchases has been met?**

153 A: First, I would observe that Mr. Peterson appears to recognizes that an ECAM reduces
154 management incentives to meet system load with owned resources. Otherwise the
155 Division would not have proposed "incenting" the Company to reduce it's short-term
156 market reliance with increasing sharing bands.

157 Second, the risk profile of the resource acquisitions that would be replacing FOTs matters
158 to the overall level of system risk. Replacing one risky resource with another does not
159 lower system risk, it simply shifts risk from one risky resource to another. So, the
160 success of the FOT targets lies in PacifiCorp's choice of replacement resources.

161 For example, if limiting FOTs would increase PacifiCorp's acquisition of low-risk
162 resources, like energy efficiency and renewables, whose costs are for the most part
163 understood at the time of acquisition, system risk would be reduced. However, if
164 PacifiCorp replaces FOTs with natural gas resources, one risky resource is being replaced
165 by another. The full cost of gas resources are not known at the time of acquisition, but
166 depend on the cost of natural gas over the life of the facility.

167 Given that an ECAM already incents the acquisition of natural gas resources since the
168 risky component of gas-fired plants, the unknown fuel costs over the life of the plant is
169 passed through to customers through the ECAM, it is more likely that PacifiCorp will
170 acquire gas resources to replace FOTs than that it will acquire energy efficiency and
171 renewable resources. Therefore, I do not believe that FOT targets will significantly
172 reduce system risk. They are more likely to shift Company resource acquisition from one
173 risky resource to another.

174 **Q: What do you conclude regarding the Division's proposal to tie sharing percentages**
175 **to FOT targets?**

176 A: Given that FOT targets are unlikely, in and of themselves, to be successful in addressing
177 long-run planning biases, tying the sharing percentage to these targets will not reduce
178 system risk.

179 It is my opinion that if targets are to be used, they must include energy efficiency and
180 renewable resource acquisition targets as well as limits on FOT.

181 Finally, I would also observe that this docket does not appear to have the necessary
182 record for determining appropriate FOT limits, energy efficiency targets, or renewable
183 targets. As discussed below, WRA and UCE support opening a new docket to investigate
184 appropriate risk-mitigating measures, including FOT limits and renewable energy and
185 energy efficiency targets before implementation of any ECAM.

186 ***Risk Shifting from Company to Ratepayers***

187 **Q: What design component does Mr. Peterson propose to assure that the Division's**
188 **ECAM proposal does not "unreasonably shift risk from the Company to**
189 **ratepayers?"**

190 A: None that I am aware of.

191 **Q: Does the Division's proposal shift risk from PacifiCorp to ratepayers.**

192 A: Yes. Outside of the dead band 70% of the risk is shifted to customers, which could be
193 increased to 80% in 2015 and then to 90% in 2020.

194 **Q: Do you have any additional comments regarding the shifting of risk from**
195 **shareholders to customers?**

196 A: The shifting of risk from shareholders to customers is at its heart an issue of fairness.
197 Customers do not have ability to manage risk; they can only respond to price after the
198 fact. If the system has been prudently planned to reduce risk and address uncertainty
199 over the long-run through wise resource acquisition, or if the resource types incented by
200 an ECAM were risk-reducing, shifting risk would be less of an issue. However, given the
201 long history of suboptimal planning as evidenced through past Commission IRP orders, it

202 is unfair to shift to customers the risk of the current system—which is the result of past
203 planning decisions—without at the very least assuring that risk and uncertainty will be
204 managed through wise resource acquisition in the future.

205 **Q: What do you propose?**

206 A: WRA and UCE maintain that an ECAM cannot be in the public interest without
207 addressing the issue of long-term planning incentives and risk mitigating strategies.
208 Therefore, if the Commission determines to move forward with an ECAM, WRA and
209 UCE would support opening a docket to examine risk-mitigating strategies in general.
210 The Office has recommended that prior to the implementation of any ECAM, the
211 appropriate levels of FOTs and natural gas hedging should first be addressed. WRA and
212 UCE feel that appropriate FOT levels and natural gas hedging are appropriately
213 categorized as risk-mitigating strategies, along with energy efficiency and renewable
214 energy. We would expect that issues in this new docket would include the evaluation of
215 energy efficiency and renewable resource targets as risk mitigating measures in addition
216 to evaluating FOT limits and natural gas hedging.

217 ***Revenue Adjustment***

218 **Q: Please describe the design component Mr. Petersen proposes to assure that**
219 **incremental power costs are offset by incremental revenues before additions are**
220 **made to a balancing account.**

221 A: I describe the Division's proposal and discuss competing Revenue Adjustment proposals
222 in Section III.

223 **Q: Does the Division's ECAM proposal meet its fourth criterion?**

224 A: Yes.

225 *Costs Outside of the Company's Control*

226 **Q: What does Mr. Peterson say regarding the Division's condition that "the Company**
227 **should only recover those costs that are outside of the Company's control and**
228 **cannot be anticipated and/or significantly mitigated?"**

229 A: He indicates that the Division has backed away from this criterion. The Division had
230 originally considered examining individual cost items and including or excluding them
231 based on the criterion. However, Division staff became concerned that including some
232 costs and not others could introduce perverse incentives and decided against that
233 approach.

234 **Q: Do you agree that treating some costs one way and other costs another can cause**
235 **perverse incentives?**

236 A: Yes. This is how an ECAM causes perverse long-run planning biases. Variable cost
237 recovery is treated one way (recovered through an ECAM), and fixed cost recovery is
238 treated another (recovered through a ratecase). The result is a bias in favor of resources
239 whose costs are more variable than fixed, while resources whose costs are more fixed
240 than variable are disincented. So, FOTs and natural gas resources are incented;
241 renewables and energy efficiency are disincented.

242 **Q: Does the Division's ECAM proposal meet its fifth criterion?**

243 A: No.

244 *Public Interest Conclusion*

245 **Q: What is your overall conclusion regarding the Division's ECAM proposal?**

246 A: The Division's ECAM proposal has met only one of the five pubic interest conditions set
247 forth by the Division. Therefore, based on its own criteria, the Division's ECAM
248 proposal is not in the public interest.

249 **III REVENUE ADJUSTMENT MECHANISM**

250 **Q: In your direct testimony filed August 4, 2010, you supported a revenue adjustment**
251 **mechanism as part of an ECAM design. Is this still your position?**

252 A: Yes.

253 **Q: Did other intervenors support a revenue adjustment mechanism?**

254 A: Yes. The Division, the Office, and UAE all support some type of revenue adjustment.
255 The Division's ECAM proposal aligns actual revenues received to forecast revenues and
256 credits this amount against net power costs. UAE proposes, and the Office appears to
257 support, a more limited revenue adjustment similar to a mechanism used in Idaho. Both
258 Mr. Higgins and the Office would credit revenues from load growth that occurs outside
259 the test year. Both include only the revenues associated with the fixed cost recovery of
260 generation and transmission.

261 **Q: Do you have an opinion regarding whether a revenue adjustment mechanism should**
262 **be limited to load growth that occurs outside of the test year or whether it should**
263 **true actual revenues to forecast revenues whether or not the ECAM recovery period**
264 **is within the test year?**

265 A: Yes. If actual net power costs are to be trued to forecast net power costs through an
266 ECAM, then it is only fair that actual revenues be trued to forecast revenues and credited
267 against net power costs.

268 As an illustration, a particularly hot summer season within the forecast test year may
269 require the Company to burn more fuel and undertake a higher level of power purchases
270 than was included in the net power forecast such that actual net power cost exceeds base
271 net power cost. These costs would be tracked for recovery through the ECAM.
272 However, as loads increase, retail sales to customers increase. These sales are revenues
273 to PacifiCorp. So, the Company also receives revenues in excess of forecast revenues.
274 The additional revenues received from customers should be credited against the
275 additional power costs whether revenues were received within the forecast test year or
276 not. For consistency and fairness, if actual costs are trued to forecast costs, actual
277 revenues should be trued to forecast revenues.

278 **Q: Would you limit revenues to margins arising from revenues intended to recover**
279 **fixed generation and transmission costs only, as Mr. Higgins proposes and the**
280 **Office appears to support?**

281 A: No. Total revenue is set to recover many other fixed cost components in addition to
282 generation and transmission costs. When loads exceed forecast, the Company is

283 recovering revenues on these fixed cost components in excess of forecast as well as on
284 generation and transmission. These revenues should also be netted against net power
285 cost.

286 **IV. PERFORMANCE STANDARDS**

287 **Q: Have you reviewed the testimony of UIEC witness Mr. Maurice Brubaker?**

288 A: Yes, I have.

289 **Q: Please describe the performance standards Mr. Brubaker recommends if the**
290 **Commission adopts an ECAM in Utah.**

291 A: Mr. Brubaker has proposed that RMP's eligibility for ECAM recovery be dependent
292 upon the Company's performance of several selected generating facilities and operating
293 coal mines. If the Company fails to meet the performance targets set by Mr. Brubaker, it
294 risks non-recovery unless it shows that it acted prudently.

295 **Q: Does WRA support UIEC's recommendation that the Commission adopt**
296 **performance standards for Rocky Mountain Power's proposed ECAM?**

297 A: No, WRA does not support the performance standards proposed by UIEC. However, let
298 me begin by saying that I agree with the concerns Mr. Brubaker has raised with respect to
299 an ECAM and the perverse incentives it creates.

300 **Q: Why do you disagree with performance standards as a method of incenting**
301 **operational efficiency?**

302 A: There are several reasons. The first concern I have with UIEC's approach is that it adds a
303 great deal of complexity to the mechanism. Not only are the performance targets
304 somewhat arbitrary (the coal targets are based on historical performance while the wind
305 target is based upon representations of the Company), but non-performance, without a
306 demonstration of prudence, requires a determination of resulting excess costs. This is a
307 very difficult determination that could require hypothetical re-dispatching of RMP's
308 system during various presumed hours of underperformance.

309 The second concern I have is that the performance standards can create unintended
310 consequences. For example, some of the performance targets can be met or not
311 depending upon circumstances beyond RMP's control. Wind output in a particular
312 season is something RMP can do little to control. Similarly coal mine output may be
313 beyond operator control. To tie RMP's recovery to the vagaries of weather creates a
314 disincentive for an environmentally beneficial resource such as wind power. At the same
315 time, the performance requirements can create an incentive to run coal plants even when
316 other factors might dictate that those units be ramped down or shut down for
317 maintenance.

318 The final concern I have is that the performance targets apply selectively to only a few
319 resources: coal, coal mining, and wind. Mr. Brubaker provides no explanation for
320 excluding gas generation and purchases from his performance criteria, or, for that matter,
321 any other power source. Certainly, RMP's procurement and operation of its other

322 sources of power bears on the Company's power costs. To include performance penalties
323 for some power sources but not others creates an incentive toward those sources whose
324 cost recovery is not at risk from under-performance.

325 **Q: Is there a better way to address the concerns expressed by UIEC?**

326 A: Yes. A simple sharing mechanism, that puts the Company at risk for 30 percent of all of
327 its power costs, does a better job of addressing the important goals of UIEC's
328 performance targets without picking winners and losers and creating a complicated
329 adjustment mechanism. Strong sharing bands should assist in incenting operational
330 efficiency.

331 **V. SUMMARY AND CONCLUSION**

332 **Q: Please provide your overall conclusion.**

333 A: At the end of Phase I, WRA concluded: "given the benefits of a normalized approach, the
334 perverse incentives that an ECAM would introduce, and the shifting of the risk of
335 fluctuating net power costs from management to those least able to manage such risks, an
336 ECAM is not in the public interest."

337 In that same process, the Division established five conditions that must first be met for an
338 ECAM to win its support, and identified issues with the Company's expressed need and
339 ECAM design. However, the Division expressed faith that it could address the failings of
340 the Company's ECAM through its own ECAM design and recommended a second phase
341 to address shortcomings in the Company's proposal.

342 WRA and UCE have reviewed the Division's ECAM proposal and evaluated it using the
343 Division's recommended criteria. Neither the Division's proposed ECAM nor the
344 Company's proposed ECAM meet the public interest criteria set forth by the Division.
345 WRA and UCE maintain that without risk mitigating measures, including energy
346 efficiency and renewable energy targets, an ECAM cannot be in the public interest.

347 If the Commission determines to adopt some ECAM design, WRA and UCE recommend
348 that the ECAM not be implemented until appropriate risk-mitigating measures have been
349 identified and established through a separate docket. At the very least, these risk
350 mitigating measures would include energy efficiency and renewable resource targets as
351 well as front office transaction limits.

352 Finally, WRA and UCE recommend that any ECAM design credit all revenues received
353 by the Company in excess of forecast revenues against net power costs. In order to
354 incent operational efficiency we recommend strong sharing bands that keep the Company
355 at risk for no less than 30% when actual net power costs exceed forecasts. We oppose the
356 use of performance standards.

357 **Q: Does this conclude your testimony?**

358 A: Yes it does.