

1 **Q. Please state your name, current professional position and business address**
2 **for the record.**

3 A. My name is Karl A. McDermott. I am currently the Ameren Distinguished
4 Professor of Business and Government at the University of Illinois Springfield
5 and a Special Consultant to National Economic Research Associates, Inc.
6 (“NERA”). My business address is 875 North Michigan Avenue, Suite 3650,
7 Chicago, Illinois, 60611.

8 **Q. Are you the same Karl A. McDermott that filed supplemental direct and**
9 **rebuttal testimony in Phase I of this docket?**

10 A. Yes.

11 **Q. Did you provide your qualifications to testify as part of your testimony in**
12 **Phase I?**

13 A. Yes. My qualifications were entered into the record in my Supplemental Direct
14 Testimony in Phase I (Exhibit RMP ___(KAM-1S).

15 **Q. What is the purpose of your testimony in this proceeding?**

16 A. I have been asked by Rocky Mountain Power¹ to respond to the testimony of Mr.
17 Charles E. Peterson on behalf of the Division of Public Utilities (“DPU Phase II
18 Exhibit 3.0”), Mr. Kevin C. Higgins on behalf of Utah Association of Energy
19 Users (“UAE Exhibit 1D.”), and Ms. Nancy L. Kelly on behalf of Western
20 Resource Advocates (“Kelly Phase II Dir. and Sur.”). Specifically I address the
21 lingering concern from Phase I that the proposed Energy Cost Adjustment

¹ Rocky Mountain Power is a division of PacifiCorp, however, for simplicity, my references to Rocky Mountain Power or the Company may denote PacifiCorp, PacifiCorp Energy, or another division, unless in figures or charts a specific publication source cites to a specific company name.

22 Mechanism (“ECAM”)² will cause Rocky Mountain Power to lapse in its
23 management of energy costs. I will also address the trends in design policy for
24 ECAMs by US public utility commissions.

25 **Q. Would you please summarize your conclusions?**

26 A. The ECAM mechanism proposed by Rocky Mountain Power conforms to good
27 regulatory practice and should be approved by the Utah Public Service
28 Commission (“UPSC” or “Commission”). Specifically,

- 29 • *Sharing of savings and losses of unrecovered net power costs is*
30 *unnecessary and largely inconsistent with US regulatory practice. A*
31 *prudence review is a more appropriate method to determine any*
32 *imprudently incurred costs, as opposed to any pre-defined sharing ratios.*
- 33 • *The concern over poor management incentives is unwarranted. A*
34 *prudence review and reconciliation as proposed by the Company is the*
35 *most effective incentive for management to procure NPC in a least cost*
36 *manner.*

37 **Sharing of Savings and Losses of Unrecovered Net Power Costs is Unnecessary and**
38 **Largely Inconsistent with US Regulatory Practice**

39 **Q. What issues are you responding to in this section of your testimony?**

40 A. I respond to DPU witness Mr. Peterson and UAE witness Mr. Higgins, (UAE
41 Exhibit 1D.13:278-15:322). Each proposed some form of sharing, although I will

² The ECAM is Rocky Mountain Power’s specific ratemaking proposal. These ratemaking mechanisms may be referred to as fuel clauses or fuel adjustment clauses (“FACs”). In this testimony, I will generally refer to this type of ratemaking mechanism as an ECAM.

42 focus on Mr. Peterson’s proposal, but my response applies equally well to Mr.
43 Higgins.

44 **Q. What is Mr. Peterson’s proposal for sharing costs?**

45 A. Mr. Peterson proposed three types of cost sharing under the Division’s preferred
46 ECAM design, (DPU Phase II Exhibit 3.0,12:258-13:276). The first sharing
47 mechanism proposed is a “deadband” of plus or minus two percent of the net
48 power costs (“NPC”) that are “in rates.” In Mr. Peterson’s view this is a “sharing
49 range” where there is zero percent sharing. (Id. 12:258) (I refer to the NPC “in-
50 rates” as the benchmark.)³ “Sharing” in this sense means that shareholders pay for
51 all costs up to two percent above the benchmark and customers pay for none.

52 The second sharing mechanism would address costs that exceed the
53 benchmark by greater than two percent but less than or equal to 30 percent. Under
54 this proposal Mr. Peterson would link the recovery of prudently incurred NPC to
55 target levels of purchased power, with the initial level of recovery at 70 percent.
56 (Id. 15:307-323)

57 Finally, Mr. Peterson proposes an “outer sharing band” that would apply
58 to all costs outside 30 percent of the benchmark. In this case, all actual costs
59 would be “shared.”⁴

³ The evidence provided by Mr. Duvall in Phase I indicates that in recent years the NPC forecast in general rate cases have been substantially less than actual NPC incurred. Therefore, although Mr. Peterson’s sharing mechanisms apply to actual NPC both above and below the benchmark, I will focus on the impact on shareholders if actual NPC are above the benchmark. However, it is also true that sharing mechanisms are detrimental to customers if actual NPC are below the benchmark.

⁴ Mr. Peterson also includes in his calculation of reconciled costs all revenue, from any source, less forecasted revenues, further muddying the ability of the utility to recover its prudently incurred costs.

60 **Q. What is your response to the sharing proposals?**

61 A. These proposals are completely unnecessary. For example, Mr. Peterson is
62 proposing that the Commission determine today that certain levels of purchase
63 power are imprudent in Rocky Mountain Power's portfolio in the future. What
64 Mr. Peterson fails to take into account is that the prudence review of Rocky
65 Mountain Power's NPC will address those issues when there is sufficient
66 information to determine if Rocky Mountain Power is relying too heavily on the
67 market. Indeed, Mr. Peterson appears to implicitly accept this criticism by
68 indicating that "the Company could still apply for the increase in the sharing
69 percentage if it can demonstrate that the higher level of FOTs is more in the
70 public interest in terms of least cost/least risk than having a lower percentage."
71 (Id. 15:320-323)

72 Mr. Peterson suggests that Rocky Mountain Power could put on a form of
73 a prudence defense to improve its ability to recover its prudently incurred costs.
74 But even if Rocky Mountain Power could show that it was prudently purchasing
75 power for customers and that its reliance on market purchases is in the public
76 interest, Mr. Peterson would allow Rocky Mountain Power to recover only 80
77 percent of its prudently incurred costs that were incurred in the public interest in
78 2015 and 90 percent by 2019. My general point that even prudently incurred costs
79 would be disallowed is true of any sharing proposal.

80 Further, Rocky Mountain Power would have no recourse under Mr.
81 Peterson's proposal to attempt to obtain an opportunity to recover all of its
82 prudently incurred costs between two percent and 30 percent of the benchmark

83 until 2015. This approach turns the fact-based inquiry into the prudent level of
84 costs on its head. Rocky Mountain Power could operate prudently in every aspect
85 of its operation and be rewarded by an arbitrary, i.e., not fact-based, disallowance
86 of costs.

87 **Q. Why do you claim that sharing proposals constitute an arbitrary**
88 **disallowance?**

89 A. It is arbitrary because it is not based on a cost foundation that is reasonable. As
90 was shown in the testimony in Phase I, NPC are volatile and unpredictable. This
91 causes the traditional approach of normalizing expenses in revenue requirement to
92 fail to allow for a reasonable opportunity to recover costs, (*See e.g.*, Supplemental
93 Direct Testimony of Karl A. McDermott). Now, if Mr. Peterson were to suggest a
94 benchmark that reflected changes in expected costs, such as some form of a
95 market index, that, at least, would begin to bring balance back to the system and
96 provide a less arbitrary ratemaking process. Relying, however, on the forecast
97 NPC in rates is arbitrary because the forecast will be wrong for all of the reasons
98 discussed in previous testimony (largely due to unpredictable market prices for
99 fuel and purchased power and unpredictability of loads, especially over short
100 periods of time).

101 Indeed, Mr. Peterson essentially proves this point in his test of the
102 accuracy of Rocky Mountain Power's forecasts. He concludes that the results of
103 his analysis illustrate either the "inherent unpredictability of NPC, or the poor
104 quality of the Company's forecasts." (DPU Phase II Exhibit 3.0, 30:674). It is not
105 credible to suggest that Rocky Mountain Power purposefully avoids improving its

106 forecasting methods as it has had every incentive to forecast its costs to the best of
107 its ability. Therefore, of Mr. Peterson's two explanations for the difference
108 between actual NPC and forecast NPC, it is difficult to come to any other
109 conclusion than NPC are inherently difficult to predict and therefore such costs
110 cause the normalization process to fail. As a result of this conclusion, the only fair
111 method of setting the prudent NPC that is currently before the Commission in this
112 docket is a prudence review of actual NPC. This is fair as it protects customers
113 from paying imprudent costs and protects the utility from arbitrary disallowances
114 of prudently incurred costs.

115 **Q. Would you please summarize Mr. Peterson's conclusion from his review of**
116 **ECAM mechanisms from around the country? (Id. 31:702-33:731)**

117 A. Mr. Peterson concludes that there are a wide variety of ECAM designs and that
118 many include so-called incentive mechanisms such as sharing rates and
119 deadbands.

120 **Q. Do you agree with Mr. Peterson's conclusions?**

121 A. Not entirely. While it is undeniable that some ECAMs include some of the
122 features that Mr. Peterson cites (i.e., deadbands, sharing, incentives), there is
123 considerably more agreement on the design approach than I think Mr. Peterson
124 implies. For example, sharing mechanisms are still relatively few even if one uses
125 Mr. Peterson's data from DPU Exhibit 3.8. This is also true for incentives as well
126 as deadbands.

127 Further, I have found that in an analysis of the sharing mechanisms, few
128 states utilize sharing rates as excessive as proposed by Mr. Peterson. Typically,

129 when a sharing mechanism is included in an ECAM the utility is at risk for 10
130 percent or less of its prudently incurred costs above the bench mark. This may
131 reflect several factors. For example, some regulators may believe that the utility
132 maintains some degree of control over these costs, even if the lion's share of NPC
133 is beyond the control of management. These sharing mechanisms may also reflect
134 an inherent bias against full recovery of costs, especially in the initial years of an
135 ECAM.

136 In a review of the evolution of ECAMs in what Mr. Peterson has termed
137 "Western States" I have found a trend toward narrowing the deadbands and
138 sharing rates over time (Exhibit RMP____(KAM-Phase II-2-1R). Indeed, in my
139 review of these mechanisms I could not find a single instance of a state moving to
140 a broader sharing rate over time. This provides strong evidence that regulators
141 that may have been initially skeptical of the ECAM process became less so over
142 time as mechanisms became better understood. This evidence suggests that Utah
143 can learn from other jurisdictions and not penalize the utility, even if only for a
144 short time, by disallowing prudently incurred costs. (I have testified to the value
145 of tracking prices and costs, for both customers and utilities, in my Supplemental
146 Direct Testimony in Phase I of this case.)

147 Further, I believe that Mr. Peterson has misconstrued or omitted data from several
148 of the ECAMs he reviewed. For example, Mr. Peterson cites to Florida Power and
149 Light (FPL) as providing support for his FOT incentive mechanism. Although I
150 understand his statement to be more of an analogy than a direct comparison,
151 nonetheless I do not see the FPL mechanism as supportive of Mr. Peterson's

152 proposal. The mechanism is significantly different than Mr. Peterson's FOT
153 incentive. First, the FPL sharing ratio Mr. Peterson cites applies only to the
154 incremental economy sales portion of NPC. That is, there is only a sharing of
155 revenues that provide upside benefits to the utility. Second, the FPL mechanism
156 provides for full recovery of fuel and purchased power costs. While there is a
157 reward/penalty incentive based on power plant availability, which is clearly an
158 operational issue, Mr. Peterson's proposed FOT incentive is not an operational
159 issue *per se*; rather it is a method to induce the utility to move toward a preferred
160 portfolio. Such an issue is more appropriately addressed in a portfolio review such
161 as an IRP or in the prudence review of NPC, not as a pre-condition on an ECAM.
162 Further Mr. Peterson's approach does not reward the utility for exceeding the
163 benchmark, which would make little sense in this context, and exposes the utility
164 to the risk of under recovery of prudently incurred costs even if the utility met Mr.
165 Peterson's proposed benchmarks. Therefore, it is difficult to characterize Mr.
166 Peterson's proposal as a true incentive mechanism as the very nature of the
167 benchmark he proposes, i.e., a favored level of market purchases in the utility's
168 portfolio, is fundamentally different than operating a power plant more efficiently.
169 For the Commission's convenience I have provided an update of Mr. Peterson's
170 survey with additional information (Exhibit RMP____(KAM-Phase II-2-2R). This
171 exhibit shows that full recovery of costs is more common than Mr. Peterson's
172 initial data suggests.

173 **Q. Are there any other relevant comparisons that can be made to provide**
174 **insight into the common policies toward ECAMs?**

175 A. Yes. Another relevant comparison is the set of utilities contained in the
176 comparable group used to estimate Rocky Mountain Power's return on equity
177 ("ROE"). Exhibit RMP____(KAM-Phase II-2-3R) lists the 22 comparable
178 companies used by Rocky Mountain Power, OCS, and DPU to proxy for the cost
179 of equity for Rocky Mountain Power's Utah operations. This exhibit describes the
180 type of sharing ratio, if any, incorporated in the mechanisms of each utility. As all
181 of these companies are holding companies as typically only the holding
182 company's stock is publically traded, I further reviewed each holding company to
183 determine the number of utilities held in each company in different jurisdictions.
184 There are a total of 47 operating companies (i.e., utilities) held in the 22 holding
185 companies. A summary of this exhibit is shown in Table 1. Nearly all of the
186 comparable companies provide full recovery of net power cost through their
187 power cost adjustment mechanisms. More to the point, of the 47 operating
188 companies that are included in either the DPU or the OCS's list of 22 holding
189 companies, only three operating companies (i.e., utilities) have cost sharing. Two
190 of these utilities are the only utility in the holding company (Idaho Power and
191 Portland General Electric) and one (Public Service of Colorado) has a sister utility
192 in the holding company (Northern State Power of Minnesota) that does not have
193 cost sharing as part of an ECAM. In two of three instances (Idaho Power and
194 Portland General Electric), the sharing rates (i.e., the costs allocated to
195 shareholders) are between five and ten percent nowhere near the sharing rates

196 proposed by Mr. Peterson and other parties in this case. In the other example,
197 Public Service of Colorado, a higher sharing rate has been implemented. There
198 are also three operating companies that have a deadband in place, but those
199 companies are all located in Wisconsin. This data supports the conclusion that the
200 most common approach, by far, to ECAM design allows for full recovery of
201 relevant costs.

Table 1: Summary of ECAMs for Comparable Groups

Full Recovery	41
Cost-Sharing	3
Deadband	3
Total	47

Source: Exhibit RMP___(KAM-Phase II-2-3R)

202 **The Concern Over Poor Management Incentives Is Misplaced**

203 **Q. What is the concern raised over management incentives?**

204 A. Mr. Peterson supports his proposed ECAM by claiming that management must
205 have “skin in the game” in order to motivate the utility to pursue least-cost, least-
206 risk procurement strategies (DPU Phase II Exhibit 3.0, 21:460-471). Ms. Kelly
207 and Mr. Higgins also raise the concern over a lack of incentives to minimize NPC.
208 (Kelly Phase II Dir, and UAE Exhibit 1D)

209 **Q. Do you agree with Mr. Peterson’s conclusion?**

210 A. No. The problem with this argument is that it assumes the Commission cannot
211 review the utility’s procurement decisions through resource acquisition
212 proceedings, a rate proceeding or in a *post hoc* prudence review of NPC. For
213 example, I understand that, whatever one’s interpretation of the Commission’s
214 role in the Integrated Resource Plan (IRP), data from the IRP can be used as

215 evidence in other proceedings to support claims concerning consistency of actions
216 with the IRP. Further, the Energy Resource Procurement Act requires a finding
217 that the acquisition of the resource is in the public interest, taking into account
218 factors such as lowest cost, risk, reliability and other factors the Commission
219 deems appropriate.⁵ In addition, the Major Plant Additions law required the
220 Commission to create administrative rules that apply to requests for alternative
221 ratemaking for large plant additions. These rules require, among other items, that
222 the utility show that the plant addition is prudent and the proposed addition is at
223 least as favorable as the resources in the IRP in terms of least cost and least risk. I
224 also understand the NPC is filed as part of these requests.⁶ All of these
225 proceedings allow the Commission room to evaluate the utility's approach to
226 resource acquisition with its implications for NPC. With this substantial oversight,
227 as well as the additional prudence review proceedings that will come with the
228 ECAM, it is difficult to conclude that the utility does not have "skin in the game."
229 Mr. Peterson seems to assume the Commission is not able to perform its statutory
230 charge in any type of proceeding and instead must substitute an arbitrary sharing
231 mechanism in place of a fact-based prudence determination.

232 Further, it is undeniable that prudence reviews provide utilities with a
233 strong incentive to act in a prudent manner. Utilities that do not act prudently are
234 at risk for disallowances. I provided several examples of disallowances in ECAM

⁵ Utah Code 54-17-302. *Also see: In the Matter of the Request of Rocky Mountain Power for a Waiver of the Solicitation Process and for Approval of Significant Energy Resource Decision*, UPSC Docket No. 08-035-35, (Report and Order, August 1, 2008).

⁶ Utah Code 54-17-302 and Utah Administrative Code R746-700-30. *Also see: In the Matter of the Application of Rocky Mountain Power for Alternative Cost Recovery for Major Plant Additions of the Ben Lomond to Terminal Transmission Line and the Dave Johnston Generation Unit 3 Emissions Control Measure*, UPSC Docket No. 10-035-13, (Report and Order, June 15, 2010).

235 proceedings in my Supplemental Direct Testimony in Phase I. Although some of
236 the witnesses in this case hypothesize that prudence reviews are not an effective
237 tool to motivate management to minimize NPC, the long use of ECAM
238 mechanisms in almost all other states and the prudence disallowance for which I
239 have provided examples indicate that this is an effective tool. It is difficult to
240 claim that the utility does not have “skin in the game” when its decisions are
241 reviewed after the fact in an ECAM filing. Indeed, after the fact reviews subject
242 utilities to regulatory risk, a risk factor well-known to the investment community.

243 To argue that the utility no longer faces risks of under recovery because it
244 has a prudence review as opposed to an arbitrary disallowance under a sharing
245 mechanism or without an ECAM oversimplifies the regulatory process. What
246 Rocky Mountain Power’s proposed ECAM does, however, provide the utility
247 with a way to manage its regulatory risk—by acting prudently, a standard that Mr.
248 Peterson has identified in his testimony. (Id. 21:461) By acting prudently, Rocky
249 Mountain Power has an opportunity, under its proposed ECAM, to recover its
250 reasonable NPC—an opportunity that Mr. Peterson would truncate in the name of
251 management incentives.

252 **Q. Mr. Peterson claims that under the ECAM proposal PacifiCorp shifts risk of**
253 **NPC recovery to ratepayers. (Id. 21:467-469 Also See UAE Exhibit 1D,**
254 **14:293-15:322) Is this a relevant concern for the design of the ECAM?**

255 A. No. Mr. Peterson and Mr. Higgins continue to argue that when customers pay
256 prudently incurred costs they are somehow burdened with “risk.” Unfortunately
257 for these witnesses paying the prudent cost is a part of the regulatory bargain.

258 Customers should pay the prudent costs companies incur to serve them—no more,
259 no less. The relevant question for the design of the ECAM is how one determines
260 the prudent costs to be recovered. Once we have determined that the traditional
261 normalization process can no longer identify the prudently incurred costs then the
262 actual prudently incurred costs should be the standard—not an arbitrarily
263 determined “sharing” of prudently incurred costs. Mr. Peterson suggests that
264 many commissions have protected ratepayers from risk shifting by implementing
265 sharing mechanisms, which a small percentage of utilities have; unfortunately
266 neither he nor Mr. Higgins provide any basis for the specific sharing ratios.
267 Indeed these witnesses cannot provide such support as any sharing of costs is,
268 almost by definition, arbitrary. I have further rebutted this “risk shifting” position
269 in my testimony in Phase I of this docket, and it should have no bearing on the
270 Commission’s decision on the design of the ECAM.

271 **Q. Several witnesses claim that ECAMs promote inefficiency (Kelly Phase II**
272 **Dir. Fnts. 7 and 8; UAE Exhibit 4D, 3:58, 11:228, 17:354) How do you**
273 **respond to this testimony?**

274 A. Ms. Kelly addressed the issue of ECAM incentive bias in both her August 4, 2010
275 Direct Testimony in Phase II, Part 2 and her August 10, 2010 Surrebuttal
276 Testimony in Phase II, Part 1. (Kelly Phase II Sur., 4:72-9:202) While I will
277 specifically address her Direct Testimony in Phase II, Part 2, my discussion will
278 be relevant to claims she makes in her Surrebuttal Testimony in Phase II, Part 1 as
279 well as the general claims of Mr. Higgins of an incentive bias. My response
280 concerning the issue of incentive bias is as follows:

281 First, Ms. Kelly cites Mr. Frank C. Graves' Phase I testimony for the
282 proposition that there is a "biasing-effects related to ECAMs." (Kelly, Phase II
283 Dir., 5:84-86) Mr. Graves, however, makes clear that these concerns rest in the
284 theoretical world and not the practical world of utility operations (Graves Reb.
285 Phase I, 27:436-441). In particular, Mr. Graves makes the salient point that the
286 alleged poor incentive from ECAMs do not arise from the pursuit of profit, as the
287 ECAM will not increase a utility's profit from modifying its behavior, but rather
288 from the "Quiet Life" of the monopolist. That is, ECAMs are alleged to create
289 slack in the utility's operations and thereby cause higher costs that are neither
290 beneficial to the utility (no additional profits from higher costs) or to customers
291 (higher prices). Mr. Graves, however, testifies that such concerns are misplaced,
292 overblown, and not particularly relevant given the ease with which regulators can
293 counteract any such inefficiency through relatively low cost administrative
294 procedures. (Id. 27:436-442)

295 Second, Ms. Kelly continues, as some witnesses did in Phase I of this
296 proceeding, to refer the Commission to academic articles that purport to show that
297 ECAMs are indeed deleterious to utility efficiency. While it is not my purpose
298 here to repeat my arguments in opposition to this claim from Phase I, I believe it
299 is useful to provide the Commission a summary of the articles laying out the
300 problems with the application of each to this proceeding and the decision
301 concerning the ECAM. I have provided this information in Exhibit
302 RMP___(KAM-Phase II-2-4R). It may also be worth, however, providing a
303 concrete illustration of one particular problem with the literature Ms. Kelly cites

304 suggesting that such literature is inapplicable to Rocky Mountain Power’s
305 proposed ECAM. For example, Ms. Kelly cites the work of Professors Kaserman
306 and Tepel from a 1982 study of fuel adjustment clauses. (Kelly Phase II Sur.,
307 8:170) The authors conclude from their statistical work, as Ms. Kelly notes, that
308 ECAMs cause higher costs. (Id.9:182-186) Yet Kaserman and Tepal are studying
309 a particular type of ECAM, namely one that is automatic in nature. That is, no
310 hearing is associated with the ECAM before rates go into effect. Indeed,
311 Kaserman and Tepel note that ECAMs that include a review process “are
312 equivalent to the no-clause regulatory regime in which output prices cannot be
313 adjusted without a formal review.” (Kaserman and Tepel, p. 693)⁷ The authors
314 therefore group those utilities with reviewed ECAMs with traditionally regulated
315 utilities for the purposes of the statistical analysis.⁸ As is well documented in this
316 case, Rocky Mountain Power’s proposed ECAM would have a reconciliation
317 review associated with it prior to allowing the adjustment surcharge to increase or
318 decrease and therefore the Kaserman and Tepel results do not apply to the
319 proposed ECAM.

⁷ Kaserman and Tepel cite a NARUC report for classification of “automatic” v. “non-automatic” fuel clauses. The NARUC report defines a clause as automatic based on the following test: “whether or not a formal hearing is held each time a utility requests a change in the adjustment surcharge.” “State Commission Regulation and Monitoring of the Fuel Adjustment Clause, Purchase Gas Adjustment Clause, and Electric and Gas Utility Fuel Procurement Practices,” NARUC, Washington DC, October 27, 1978, p.36.

⁸ In the time period for which nearly all the empirical research was completed i.e., 1970-1982, many states did not require a hearing for price changes under the ECAMs, and in some cases no review of the fuel costs was done until the next rate case. (*See e.g.*, NARUC *note 7*) Today nearly all ECAMs have some form of review either prior to the price change or on an annual basis with refunds required if utilities are found to have inflated the ECAM price. The exception to this practice is found in states with restructuring. Typically in these cases the prudence review is completed prior to entering into contracts for power and energy making after-the-fact prudence reviews unnecessary.

320 In sum, I conclude that the studies cited by the witnesses in this case are
321 largely inapplicable to the current proposal. There are several reasons for this
322 conclusion.

- 323 • Most of the empirical evidence for ECAMs utilized data from the 1970s.
324 As with the Kaserman and Tepel study noted above, these studies utilize
325 data on fuel adjustment charges that include automatic (i.e., without
326 review) pass-through of costs which is not what Rocky Mountain Power is
327 proposing. Those few studies that include more recent data focus more on
328 the effects of the competitive markets in providing incentives to improve
329 efficiency and relate those regulatory regimes to a competitive regime.
330 While some academic evidence appears to support the incentive bias
331 argument, taken as a whole, the evidence appears to be inconclusive as to
332 the incentive effects of Rocky Mountain Power's particular proposal.
- 333 • None of the studies explicitly take prudence reviews into account.⁹ This
334 reality of the regulatory process has an incentive influence that has been
335 lost in the generalization of the regulatory approach.
- 336 • Many of the modern regulatory mechanism such as integrated resource
337 planning, management audits, and other sophisticated monitoring
338 techniques either had not been implemented or were in the early stages of
339 implementation during the 1970s.¹⁰ Indeed, the tools available to
340 regulatory bodies to undertake these reviews have also changed
341 dramatically since the early 1980s. These tools include, among others,
342 ubiquitous use of information technology and instant access to
343 information. It is inconceivable that in today's environment a utility would
344 be able to choose a generation technology solely based on the existence of
345 an ECAM. Similarly, it would be difficult for a utility to hide the overuse
346 of fuel as such decisions are connected to generation decisions, and in
347 turn, integrated resource plans, which are filed and reviewed every other
348 year in IRP proceedings. (If parties are concerned about the IRP process
349 that should be addressed by the Commission in an IRP or other proceeding
350 and has little to do with whether the proposed ECAM is appropriate.)
- 351 • The purely theoretical articles do not adequately model the regulatory
352 process as most make simplifying assumptions that do not comport with
353 the regulatory structure as it is proposed for Rocky Mountain Power's

⁹ Recently, Ken Costello from the National Regulatory Research Institute, a frequent critic of cost tracking mechanisms, conceded that the concern over utilities exerting little effort to control costs occurs generally when a pass through of costs is allowed "with little or no regulatory oversight." See K. Costello. "How Should Regulators View Cost Trackers?" Washington, DC: National Regulatory Research Institute, 2009.

¹⁰ See e.g., R. Burns, et. al, "The Prudent Investment Test in the 1980s," NRRI-84-16, April 1985, Table 1-1 (shows that prudence cases were nearly unheard of prior to 1973-1984).

354 ECAM and therefore provide little insight into the type of proposal in this
355 case.

356 • Many of the authors make clear that the results of their studies, even if one
357 accepts that an incentive bias exists, should not suggest that ECAMs are
358 not appropriate policy as there may be other reasons e.g., lower
359 administrative costs and financial stability that would still lead a
360 regulatory body to accept ECAMs as reasonable policy tools.

361 **Q. Does this conclude your rebuttal testimony?**

362 A. Yes.