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**BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH**

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| In the Matter of the Application of Rocky Mountain Power for Approval of its Proposed Energy Cost Adjustment Mechanism | Docket No. 09-035-15<br><br>**UTAH OFFICE OF CONSUMER SERVICES' POST-HEARING BRIEF** |

In each phase of this proceeding, the Utah Office of Consumer Services has urged the Commission to reject Rocky Mountain Power's Application. The application for an energy cost adjustment mechanism (ECAM) relies upon overstated claims that load and power market trends are uneven. Its proposed solution is an untailored, all-inclusive adjustment mechanism that transfers the entire consequence of the expected variation to ratepayers. Both the Division of Public Utilities and Rocky Mountain Power propose inexact mechanisms that excuse Rocky Mountain Power from improved forecasts of net power costs in general rate cases, robust integrated resource planning, and regulatory oversight of the Company's hedging practices and procedures. Both are unstructured and undefined experiments that are not in the public interest.

The Commission chose, erroneously in the Office's opinion, to consider ECAM design proposals. Accordingly, the Office and other parties responded with evidence that Rocky Mountain Power's ECAM design proposal is unacceptably flawed. For an ECAM to result in just and reasonable rates, unlike Rocky Mountain Power's proposal, it must apportion risk equitably between ratepayers and shareholders and must enforce an efficiency incentive that equals or exceeds the incentive found in current law. An ECAM must also incorporate a purposeful consideration and supported resolution to issues that RMP's proposal disregards; the mismatch of hydro benefits and risks in the current inter-jurisdictional allocation method; non-compliant financial and physical hedging practices; potential over-reliance upon short-term power markets; and, a properly designed, effective cost sharing mechanism that also serves to motivate the utility to effectively manage or even reduce power costs.

When moving forward to Phase II, the Commission ordered: "In addition, we would like to see the two issues raised by the Office of Consumer Services addressed: namely, is the company's use of natural gas hedging and the level of and reliance on market energy affected by the use of an ECAM?" February 8, 2010 Report and Order. The compelling evidence on these issues demonstrates that an ECAM will improperly shift to ratepayers the risks of excessive reliance on market purchases, and that for the past four years, Rocky Mountain Power has engaged in unregulated and unexamined financial hedging transactions with no quantifiable benefit to ratepayers, but at a cost of hundreds of millions of dollars.

I. THE COMMISSION'S CRITERION FOR APPROVING AN ENERGY COST ADJUSTMENT MECHANISM HAS NOT BEEN MET.

The Commission ruled: "Phase I will address whether an energy cost adjustment mechanism, or ECAM, and its use in regulating RMP is in the public interest."[1] August 4, 2009 Scheduling Order. The Commission uses the phrase 'in the public interest' to define the threshold issue of whether an ECAM is necessary to establish just and reasonable rates and also, whether an ECAM is necessary to effectively regulate Rocky Mountain Power.

The Commission has not determined that an ECAM is in the public interest. In response to those presenting evidence that an ECAM was not in the public interest, the Commission stated: "[W]e do not believe the evidence presented precludes a conclusion that one could design an ECAM and use it consistent with the public interest." February 10, 2010 Report and Order. At the conclusion of the November 2010 hearings, Commission Chairman Boyer described the decision in Phase I this way:

> CHAIRMAN BOYER: Well, our idea was to – the first -- Phase I was to decide whether under any circumstances an ECAM could be in the public interest. And we decided, based on the evidence presented to us at that time, that possibly it could be. Transcript, November 2010, page 570.

Rocky Mountain Power's application for a ratemaking method that "could" "possibly" be in the public interest, because "one could design" and one could "use" an

[1] This is not a question of what 'is' is? In public utility regulation, a rate or other regulatory action is in the public interest only if it both protects utility investors from confiscatory rates and protects ratepayers from exploitive rates. *Stewart v. Utah Public Service Comm.*, 885 P.2d 759, 767 (Utah 1994) citing *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944).

ECAM "consistent with the public interest" falls far short of the proof required under long-standing Utah law defining the Commission's ratemaking proceedings. The Commission's decision must be based not upon possibilities, but upon economic and statistical analysis and comparisons of the type which can be committed to record and be available for analysis. *Utah Dept. of Bus. Regulation v. Public Serv. Comm.*, 614 P.2d 1242, 1247 (Utah 1980). The utility's strict burden to prove that rates are just and reasonable is not altered by Utah Code Ann. § 54-7-13.5 (West Supp. 2010). *Id.* at 1245. The Commission misapplied that burden when it concluded that an ECAM is in the public interest because the evidence did not preclude the possibility.

The Commission also stated: "The critiques show that it is not necessarily the use of an ECAM that presents the problems which parties raise but rather the inclusion or non-inclusion of specific elements in the construction of any particular ECAM." February 8, 2010 Report and Order. The evidence presented in Phase I was not so inconsequential to the public interest. What the Commission did not do in Phase I, and must do now, is objectively examine Rocky Mountain Power's rationale for proposing an ECAM, particularly the ECAM first proposed.

Beginning with the March 16, 2009 Application, Rocky Mountain Power relies solely upon complexities commonly encountered by electric utilities that justify and are managed in general rate case proceedings. Rocky Mountain Power complains about "[c]hanges in hydro conditions and wind generation, as wells as those caused by the dramatic global economic downturn in 2008 including changes in retail load, market prices, third party wheeling expenses and natural gas and coal fuel expenses."

Application ¶ 3. It also complains: "hydro and weather conditions, the timing of forced outages and the variability in the wholesale market prices for electricity and gas are not within the Company's control." Application ¶ 4. Based upon these allegations Rocky Mountain Power concludes: "the Company's net power costs ("NPC"), which currently represent approximately 30 percent of the Company's total Utah revenue requirement, are now subject to a much higher degree of volatility than they were in the past." Application ¶ 3.

Mr. Duvall best describes Rocky Mountain Power's solution to volatility. Mr. Duvall admits that in a general rate case, the Commission determines the rates that will recover prudently incurred costs and provides an opportunity to earn an authorized return. In between general rate cases, the Company manages 100% of the difference between actual revenues and actual costs. Rocky Mountain Power's proposal is that the ratepayers will pay 100% of those differences for 30% of the total revenue requirement. Transcript, November 2010, page 19 – 20.[2] Rocky Mountain Power calls this a symmetrically applied, proper matching of net power cost responsibility. Rocky Mountain Power refers to this as a fair allocation method to "restore the regulatory bargain." Transcript, November 2010, page 20 and 23. The evidence is that for 30% of the total revenue requirement, an ECAM truncates ratemaking to an after the fact review, as a practical matter based solely upon the information the utility provides.

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[2] Q. So it's the Company's proposal, however, to place a hundred percent of those ECAM differentials on ratepayers, is it not?
A. That's correct.

## II. ROCKY MOUNTAIN POWER HAS NOT OFFERED SUBSTANTIAL EVIDENCE THAT THERE IS ANY NEED FOR ALTERNATIVE REGULATION OF NET POWER COSTS OR THAT AN ENERGY COST ADJUSTMENT MECHANISM IS A CORRECT MEANS TO ADDRESS THE NEED IF ONE EXISTS.

The Division of Public Utilities supports “an ECAM in concept because the Company has been unable to earn its allowed rate of return for several years running. It is plausible that this is partly due to the net power costs being unexpectedly high.” Transcript, November 2010, page 302. In this regard, the Division also states that “power cost fluctuations may become large enough that the Company could be financially damaged if it were not able to reasonably recover costs from large fluctuations”, which the Division refers to as an “eventuality.” Transcript, November 2010, page 302 – 303.

Mr. Peterson for the Division, explained in his surrebuttal, page 19, line 405, that “[t]he primary concern of the Division is that under existing mechanisms, absent an ECAM, it is difficult for the Company to receive recovery retroactively,” or in other words, to manage the financial consequences of a crisis. Transcript, November 2010, page 373. However, the Division acknowledged, as it must, that no such crisis now exists and the most recent, approximately 10 years ago, was managed well by existing mechanisms. Transcript, November 2010, page 375.

Any evidence offered to support authorizing an ECAM should be weighed in light of the fact that since 2006, the Commission has four times, established rates that permitted recovery of prudently incurred costs and provided an opportunity to earn its authorized rate of return. ECAM proponents pass over the reasons why Rocky Mountain

Power does not recover its net power costs to conclude that an ECAM is the panacea to the symptoms of changing loads, markets and hydro conditions and therefore are a thorough substitute for a general rate case.

Rocky Mountain Power requests an ECAM because first, "customers should pay for prudently incurred net power costs," and second, "net power costs are large, volatile, unpredictable, and largely outside the control of the Company." Transcript, January 2010, page 13. Mr. Duvall explained it as follows:

> It's a hundred percent certain that any forecast will be wrong. Net power costs are driven by multiple simultaneous and differently correlated, volatile, and unpredictable components, including the weather, which affects temperature, wind, and rain, fuel and commodity pricing, the timing, magnitude, and duration of forced outages, both transmission forced outages and generation forced outages, and the economy as it affects customer loads. Transcript, January 2010, page 14.

In other words, within a rate effective period, net power costs are correlated to fluctuating demand for power and the price to produce or acquire it. While the magnitude of the fluctuation may be unanticipated, it is always expected. Given this fact, it is illogical to claim that the proposed ECAM is necessary to include net power costs in rates. And, the practical effect is to eliminate meaningful incentives for utility management to plan for and respond to the variations it knows will occur.

The admitted evidence demonstrates a number of reasoned but unexamined factors that explain Rocky Mountain Power's inability to accurately forecast net power costs for ratemaking purposes. These include the multi-state protocol rate cap and the absence of performance standards for market power reliance. Another issue that was raised but not properly explored is the role of using normalized prices for purchased power in ratemaking and planning models.[3] As Mr. Peterson testified: "Well, better forecasting would be one possibility. As I said a moment ago, it is kind of a mystery to me that the Company has been consistently under-forecasting for, it looks like eight or nine years in a row." Transcript, November 2010, page 318.

Rather than inquiring into the reasons net power costs are not accurately reflected in rates, Rocky Mountain Power instead proposes un-scrutinized, full cost reimbursement. This is contrary to fundamental ratemaking, which provides the utility a reasonable opportunity to earn its authorized return and to recover prudently incurred costs, including NPC, based on test period parameters. Failure of a utility to achieve the authorized earnings does not constitute a disallowance of prudently incurred costs. Rocky Mountain Power's actual return reflects the normal business risks and operation of economic forces with which its management is expected to cope. As Mr. Higgins states, "[i]n this fundamental sense, the setting of just and reasonable rates is decidedly distinct from simple cost reimbursement." Higgins, Direct Testimony Phase II, page 15.

## III. NO ENERGY COST ADJUSTMENT MECHANISM PROPOSED FOR COMMISSION APPROVAL WILL RESULT IN JUST AND REASONABLE RATES UNLESS AND UNTIL THE COMMISSION ACTIVELY REGULATES DOMINANT FACTORS THAT AFFECT RATES.

[3] If the Company is purchasing power during times that prices are routinely above the "normal" level used in its model, it would routinely result in higher net power costs. However, the Company is also making its planning decisions on the normalized prices used in its modeling. This is more evidence as to why planning practices must be examined if power cost recovery is to be changed.

Rocky Mountain Power proposes, and the Division agrees, to include in the ECAM all physical and financial electricity and natural gas hedging costs. Rocky Mountain Power's proposed ECAM operates on the base rates set by the revised protocol from Docket No. 02-035-04.[4] Rocky Mountain Power's recent application to amend the MSP continues the hydro-endowment for the benefit of the Pacific Northwest, but includes in the ECAM, net power cost differential due to hydro generation varying from normalized levels. Even Rocky Mountain Power refers to this as a mismatch, which it dismisses by stating: "To date, no party has identified any damage of allowing hydro in the ECAM, other than conceptually." Transcript, November 2010, page 26.

a. Hedging.

It is important to consider the magnitude of Rocky Mountain Power's hedging practices. Mr. Peterson testified that as a result of "swaps" net power costs in the 2008 rate case increased by $42 million. He further testified that: "Since 2006 through May 2010, the Company has paid out a net $173 million as a result of being on the wrong side of its electric and natural gas swaps." Transcript, November 2010, page 364; Peterson Direct Testimony, Phase II, page 5. Mr. Bird, for Rocky Mountain Power, testified that between January 2006 and May 2010, the spread between losses and gains from hedging was $1.1 billion, all without Commission approval of the practice. Transcript, November 2010, page 225, 227 – 228.

[4] It is not clear whether the Division agrees. Mr. Peterson, for the Division, admits that Rocky Mountain Power's ECAM proposal perpetuates the hydro-endowment in the current revised protocol, but that the Division is relying on a "side agreement" that no one has seen. Transcript, November 2010, page 363.

The swaps that Rocky Mountain Power intends to include in the ECAM, are defined by Mr. Duvall as “purely a financial deal” that provides no fuel or energy. Transcript, August 2010, page 29 – 30. Mr. Duvall admits that fixed for floating financial swaps have not been an issue before the Commission, nor has Rocky Mountain Power ever presented for Commission approval, its financial hedging policy or practices. Transcript, August 2010, page 33 and 38.

Mr. Wheelwright, for the Division, testified that since inception of the hedging program in 2006, it is used without the scrutiny or approval of regulators. Transcript, August 2010, page 161. He also testified that the Division, for some time, had been concerned about the amount and duration of the hedging program, about which there was a lack of understanding. Mr. Wheelwright admits that hedging transactions have not been determined to be in the best interest of the utility or ratepayers. Transcript, August 2010, page 152 – 153. He admits that in 2009 due to hedging, Rocky Mountain paid excess costs for natural gas roughly equal to 20 percent of the total net power costs. Transcript, August 2010, page 156. Yet, the Division recommends that the Commission include in an ECAM, the costs of a financial hedging program operating without regulatory scrutiny or approval, that has no guidelines for analysis or evaluation of program use or its results, that is not well understood or understood at all, because, “That’s the current program that’s in place today, yes.” Transcript, August 2010, page 159, 161.

In the face of its own reservations, the Division concedes that hedging costs may be included in an ECAM by stating: “[b]ut until we can understand the relationships between swaps and the physical hedges I'm not in a position to say that they should be excluded." Transcript, November 2010, page 366. The Division concedes their inclusion despite the fact that, in reference to a $1.1 billion swing in hedging gains and losses, Mr. Peterson testified: "Q. On page 6 to your direct testimony in this phase, at line 124, you stated: "The hedging losses are the result of the Company's own actions." Is that correct? A. Yes. The Company, by its own management choices, engages in hedging. And in particular, swaps." Transcript, November 2010, page 372 – 373. Merely excluding hedging from an ECAM does not remedy the underlying harm that it causes ratepayers. See Transcript, November 2010, page 364; Peterson Direct Testimony, Phase II, page 5. A thorough examination of these hedging practices is a necessary condition to any ECAM.

b. Inter-jurisdictional allocation.

On page 3 at line 57 of Mr. Peterson's Phase II direct testimony he states: "the division supports the resolution of this issue [rolled-in methodology] as a condition of implementing an ECAM and suggests that the Commission order the use of 'rolled-in' methodology for interstate allocation of the ECAM costs." At the November 2010 hearing, Mr. Peterson expanded the condition to include using rolled-in methodology to calculate base rates from which ECAM adjustments are calculated. Transcript, November 2010, page 362 – 363.

Unless and until there is a final Commission order requiring the use of rolled-in methodology for allocation of costs, including eliminating the hydro endowment preference, no ECAM of any design will result in just and reasonable rates.

## IV. CONCLUSION

Under current regulatory practices in Utah, Rocky Mountain Power bears 100 percent of the risk of deviation in net power costs in between rate cases. Rocky Mountain Power's proposed ECAM would simply reverse the risk and pass through 100 percent of changes in net power costs in between rate cases to customers. Rocky Mountain Power's claims that all net power costs are large, volatile and outside the utility's control have been demonstrated to be exaggerated or simply incorrect. The evidence does not establish a rational nexus between the net power costs in rates determined in a general rate case, and the factors that the utility contends prevent recovery of those costs.

Even if the Commission determines that an ECAM is necessary, its design and implementation requires a deliberate and sequential regulation of Rocky Mountain Power's hedging program that has greatly increased net power costs but has provided customers with no energy. Changing the recovery mechanism for net power costs also requires a deliberate and sequential examination of whether Rocky Mountain Power's planning decisions resulted in an appropriate level of reliance on market purchases, since the cost risks of such planning decisions would be shifted to consumers. A balanced ECAM will include risk sharing and in this case demands that cost allocation be rebalanced as a condition precedent to the design of the ECAM.

The public interest requires more than a concept and does not permit an experiment of ratemaking such as the Division proposes and as Rocky Mountain Power first proposed; one for which rules will be worked out later. Contrary to Mr. Peterson's testimony, Transcript, November 2010. page 369 – 370, there is a necessary connection between adopting an ECAM mechanism and the exact parameters that go into it. Because an ECAM will have an immediate impact upon rates, the substantive threshold and design issues raised by the Office and other parties must first be sequentially addressed and resolved.  Having merely a structure in place, leaving the details for later, is not enough.

RESPECTFULLY SUBMITTED this 16th day of December 2010.

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CERTIFICATE OF SERVICE

This is to certify that a true and correct copy of the above Post Hearing Brief was served upon the following by electronic mail sent on December 16, 2010:

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