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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	**Post-Hearing Brief of Utah Clean Energy** Docket No. 09-035-15

INTRODUCTION

Utah Clean Energy (UCE) submits this post-hearing brief pursuant to the request of the Public Service Commission of Utah (Commission) at the completion of the hearing in this docket, held November 1 and 2, 2010. This brief provides a review of Utah Clean Energy's positions in this docket and supportive evidence.

An energy cost adjustment mechanism (ECAM) cannot be in the public interest without risk-mitigation measures designed to address 1) the disincentive effect of an ECAM on procuring energy-efficiency and renewable resources, which mitigate both market and climate change risk, and 2) the incentive effect of an ECAM to acquire risky resources, such as short-term market purchases and fossil fuel. Additionally, the Company's ECAM cannot be in the public interest unless it provides for significant sharing of risks and rewards to incentivize appropriate management of risk and net power costs.

The Company's proposed change in the method of cost recovery of net power costs must serve the public interest. If there is potential harm to the public from adopting an ECAM, that harm should be mitigated through design or other measures. Therefore, if the Commission decides an ECAM is needed, the ECAM must be designed to serve the public interest, and mitigation measures should be established to address any concerns not rectifiable through ECAM design.

ARGUMENT

I. If the Commission adopts an ECAM, it should establish risk mitigation measures, such as strengthened resource planning or targets for energy efficiency and renewable energy.

Throughout Phase II of this docket (the only phase in which Utah Clean Energy participated), Utah Clean Energy's interest in the Company's proposed energy cost adjustment

mechanism has been that if an ECAM is adopted, the Commission should establish measures to ensure that energy efficiency and renewable energy—resources whose fuel-free attributes mitigate fuel and carbon risks and reduce net power costs—are not forsaken for fuel or purchased power. WRA and Utah Clean Energy proposed a 70/30 sharing mechanism to counteract an ECAM's potential disincentive to manage, control, and reduce net power costs, but there is no other specific ECAM design component that mitigates the planning and input bias created by an ECAM. Therefore, if the Commission approves an energy cost adjustment mechanism, no matter the design, the Commission should establish risk mitigation measures, such as strengthened resource planning, or targets for energy efficiency and renewable energy.

IRP planning studies show energy efficiency and renewable resources mitigate risk; nevertheless, the Company continues to prioritize resources its IRP planning studies indicate are more risky, including short term market transactions and gas-fired generation. Direct Testimony of Nancy Kelly, Phase II, Part 1 8-9; Rebuttal Testimony of Nancy Kelly, Phase II, Part 2 5:87-91, 8:141-145. Ms. Kelly testified,

> The results of the 2008 IRP planning studies demonstrate that an energy efficient and renewables heavy portfolio, Portfolio 8, is the least-cost, risk-adjusted portfolio. It ranked first in expected cost, first in risk adjusted PVRR, and first using weighted performance measures chosen by the public process participants. However, PacifiCorp did not choose this portfolio as its preferred portfolio. Instead, the Company selected Portfolio 5 with half the amount of wind, less geothermal, less distributed generation, and less DSM. Portfolio 5 included more front office transactions and more gas-fired generation than Portfolio 8. Direct Testimony of Nancy Kelly, Phase I 11:14-21.

This preference for fuel and purchased power resources, over resources that mitigate market, gas price, and environmental compliance risks, is problematic and not in the public interest. "This strategy, as has been shown by IRP planning studies, is risky." Surrebuttal Testimony of Nancy Kelly, Phase I 9:180-81. Although the Commission acknowledged the

Company's latest IRP, "acknowledgement does not guarantee favorable ratemaking treatment of future resource acquisition decisions." Report and Order 58, *In the matter of the Acknowledgment of PacifiCorp's Integrated Resource Plan*, Docket No. 09-2035-01, April 1, 2010.

Ms. Kelly's testimony, since the first phase of this docket, has provided compelling evidence that an ECAM does influence resource choices. Although an ECAM creates a bias against resources that manage risk—energy efficiency and renewable resources—ECAM design cannot fully mitigate planning biases. The Office testified that "a sharing mechanism does not fully address planning incentives." OCS-5 Gimble 7:184-85.

An ECAM affects incentives due to the near guaranteed cost recovery for fuel and purchased power. As Ms. Kelly testified,

> Unless short-term wholesale purchases and natural gas are excluded from PacifiCorp's ECAM, which would nullify the Company's purpose in requesting an ECAM, the bias created will strengthen PacifiCorp's incentive to meet customer's growing resource needs with natural gas fired resources and to use short-term wholesale electricity purchases to meet capacity requirements. Direct Testimony of Nancy Kelly, Phase II, Part 2 3:45-49.

Mr. Peterson concurred, "[S]ince [the Company] can get full recovery or potentially full recovery in—under their scenario, that those would be the items that they would tend to do. They would be incented to, you know, *make short-term purchases rather than engage in long-term contracts and planning* . . . because of the certainty or near certainty of recovery." Tr. (Peterson) 370-71 (emphasis added).

It is well established in the record that an ECAM reduces the risk of fuel and purchased power resources for the company. However, it does not eliminate the risks; it shifts the risks of resource decisions onto consumers. Mr. Gimble testified that the pass-through of costs permitted by an ECAM would "expose customers to the price risk associated with the Company's previous

resource planning and procurement decisions." OCS-5 Gimble 10:292-95. Therefore, a mechanism that eases cost recovery for and thereby incentivizes fuel and purchased power resources is not in the public interest unless risk mitigation measures are established to counteract incentives toward increased risk—risk that is assigned to customers through the ECAM.

The Company proposes to shift risk onto consumers, even though the Company is in a better position to mitigate those risks, through prudent resource planning. Company witnesses agreed that customers have minimal control over net power costs. Indeed, their "control" is limited to a reduction in usage. Tr. (Duvall) 144:19-24. Mr. Bird testified that it was the Company's job to manage risk: "I am not aware that customers have any control [of net power costs], other than their representation in a rate case setting. I think my reaction to the general comment I think I heard you say, you know, risks should be managed by those who have the best ability to manage them. And that is the Company's job." Tr. (Bird) 251-52.

The Company is responsible to manage and mitigate risks through long-run planning. Mr. Bird testified that managing net power costs is a matter of managing the risks of the entire portfolio: "[I]n terms of managing our net power cost risks . . . We believe it's critical, because it's correlated and interrelated within our entire portfolio risk management. The proper and intelligent way to manage those risks is on a portfolio basis." Tr. (Bird) 241:5-12.

If the "proper and intelligent way" to manage risks to consumers is on a portfolio basis, and if risks are to be shifted to consumers through an ECAM, it follows that the Company should have accountability when it comes to long-term resource planning. Ms. Kelly explained,

> [B]eacuse an ECAM will shift significant risks to consumer—risks customers are in no position to mitigate—the Commission will need to establish mitigation measures to accompany the ECAM in order to make the whole ECAM in the public interest.

> Resource planning and acquisition is not, as Mr. Duvall seems to suggest, irrelevant to the ECAM, because adoption of an ECAM would change the utility's resource acquisition incentives. Therefore, resource acquisition is a threshold issue for creating an ECAM that is in the public interest. Surrebuttal Testimony of Nancy Kelly, Phase II, Part 1 17:350-357.

If the Commission decides to implement an ECAM, it should adopt rules, regulations, or practices to address risk mitigation measures, including FOT levels, hedging programs, and long-run planning. Risk mitigation measures, including proper levels of FOTs, hedging programs, and long-run planning cannot fully be addressed through ECAM design. *See* OCS-5 Gimble 11:305-312. However, since investigating ECAM designs was the particular purpose of Phase II of this docket, the Commission should open a new docket to investigate ECAM risk mitigation measures, external to ECAM design; relevant and important issues must still be addressed to ensure that an ECAM is in the public interest.

II. A significant sharing mechanism is necessary for an ECAM to be in the public interest.

If resource planning issues are addressed and mitigated, other ECAM design components can mitigate other sources of potential harm from an ECAM sufficiently to be in the public interest. A significant risk/reward sharing mechanism is a necessary design component.

A. The design of any ECAM adopted by the Commission should include a 70/30 sharing mechanism in addition to a prudence review.

Utah's Energy Balancing Account statute requires that an energy balancing account become effective only after a finding by the Commission that the account is in the public interest and for recovery of prudently-incurred costs. Utah Code Ann. 54-7-13.5(2)(b). The Company has the ability to manage several aspects of net power costs, and thereby has the ability to incur both prudent and imprudent costs through the consequences of its discretion. A 70/30 sharing mechanism provides an important incentive for the Company to control and even reduce net

power costs. The 70/30 sharing mechanism provides a direct financial incentive to promote operational efficiency, by requiring the Company to continue to bear some share of the risk that it currently does, whereas a prudence review is less likely to be effective. Imprudence is a difficult and costly case to make, requiring much regulatory time and many resources.

During the Phase II, Part 2 hearing, a number of Company witnesses testified of the Company's ability to affect its net power costs. Company witnesses agreed that the following cost items affecting net power costs could be affected by Company discretion: capital investment activities (Nov. 1-2 Tr. 122:9-13); the price paid or received for front office transactions (Nov. 1-2 Tr. 127:3-17); resource acquisitions (Nov. 1-2 Tr. 127-28); energy efficiency (Nov. 1-2 Tr. 128:21-25); plant maintenance and plant outages (Nov. 1-2 Tr. 129: 5-9, 230-231); fuel procurement costs (Nov. 1-2 Tr. 129:18-21, 229-230); fuel transportation costs (Nov. 1-2 Tr. 130:13-19); and plant dispatch and associated costs (Nov. 1-2 Tr. 231-32). Although the Company has argued that net power costs are outside its control, the Company nevertheless is able, through its actions, to affect net power cost components, and thereby increase or decrease net power costs.

Sharing bands provide incentives to reduce, control, or manage net power costs. Indeed, it provides that the company will benefit by 30% if it effectively reduces net power costs; therefore, the Company benefits more from an ECAM with a sharing mechanism than it does from an ECAM without a sharing mechanism when it manages and reduces net power costs.[1]

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[1] The following hypothetical situation illustrates how the Company can benefit from an ECAM with sharing bands by managing net power costs:
Q. Ms. Kelly, you were asked about why WRA is not supporting an ECAM because of the notion or the claim, if you will, that an ECAM would incentivize renewables. Let's assume the Company doesn't have any renewables in its system and has an estimated fuel expenditure for a given year, okay? What happens to the Company's fuel expenditure expectations or actual expenditures if the Company then adds a renewable resource?

The sharing mechanism in an ECAM design mirrors the between-rate-case incentives to manage and reduce net power costs that exist without an ECAM. *See* Phase II, Part 2 Surrebuttal Testimony of Nancy L. Kelly, WRA and UCE Exhibit II.2-1.0SR, ln. 54-107 (providing an example of how the 70/30 sharing would work in a hypothetical example).

The proposed 70/30 sharing mechanism is not arbitrary, but provides a reasonable threshold of materiality to ensure sufficient management of net power costs. Without an ECAM, the Company assumes 100% of the risks and benefits of its net power cost forecast between rate cases. Instead of wholesale reversal of risk from the utility to customers, the 70/30 sharing mechanism reserves a significant portion of risk (and benefit) for the Company in order to incentivize the efficient management of net power costs. Mr. Peterson testified that "the intent of the sharing band is to give enough incentive to management that they—that the Company has *significant* dollars at risk that they will maintain the mode of patience that they now have to operate as efficiently as possible, because they are still putting *substantial* shareholder funds at risk." Nov. 1-2 Tr. (Peterson) 376:8-14 (emphasis added).

Mr. Higgins testified and explained that a 70/30 sharing mechanism provides both a "reasonable threshold of materiality" to incentivize sufficient management of net power costs and a more reasonable customer impact:

A. It goes down.
Q. And in the absence of an ECAM what happens to the Company's earnings when those fuel costs go down?
A. They keep, they keep it in between rate cases.
Q. Okay. And if there is an ECAM and the Company adds renewables and lowers its fuel costs, what happens to its earnings? If there's an ECAM without any sharing. Does the Company get an earnings benefit from that?
A. No.
Q. And if there is a sharing mechanism does the Company then get some earnings benefit from reducing fuel costs?
A. Yes.
Nov. 1-2 Tr. (Kelly) 565-66.

> Rocky Mountain Power's proposed ECAM would simply pass through 100 percent of changes in net power costs in between rate cases to customers. This type of 100 percent cost pass through seriously reduces the Company's incentive to manage its fuel and purchase power costs as well as it would manage them if the Company remained fully responsible for the energy cost risk. To remedy this problem, as well as to provide an 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 net power cost and actual net power cost is allocated to customers, and 30 percent is allocated to Rocky Mountain Power. I believe this weighting establishes a reasonable threshold of materiality 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 the status quo, in which the sharing weight is effectively 0 percent customer and 100 percent Rocky Mountain Power. This 70/30 weighting also bears some general correspondence to the sharing provisions the Company agreed to in Wyoming in 2006. Nov. 1-2 Tr. 505-06.

The 70/30 sharing mechanism is important both in terms of providing the Company with effective operational incentives, but also in terms of not completely reversing risk allotment from shareholders to consumers. In other words, shifting risk to consumers from zero percent to 70 percent has a more gradual rate impact than shifting customer risk from zero to 100 percent.

The evidence shows that a 70/30 sharing mechanism is a more effective incentive than a prudence review. A prudence review establishes a lower threshold than a financial incentive to control net power costs. As was made clear in the Phase II, Part 2 hearing, there is a significant distinction between working proactively "to get the best possible result from every action taken" and "not behaving unreasonably and getting caught." Nov. 1-2 Tr. (Higgins) 507:5-22.

The record is unclear and inconsistent about how a prudence review currently works and is anticipated to work with an ECAM. *Cf.* Nov. 1-2 Tr. (Duval) 132-34 *with* Nov. 1-2 Tr. (Bird) 238-39. A prudence review, as proposed by the Company, is insufficient to assure the public interest is met because it has not been shown that a prudence review is an effective substitute for the self-disciplining force of financial responsibility.

The 70/30 sharing mechanism would function to align Company interests with the public interest in incentivizing management to operate efficiently. A 70/30 sharing mechanism would incentivize the company to "police itself in the first instance" because a significant ratio of shareholder funds is at stake. Nov. 1-2 Tr. (Peterson) 413-14. On the other hand, a prudence review provides no guidelines, standards, or requirements for the company to maintain or reduce net power costs.

CONCLUSION

If the Commission decides an ECAM is needed, the ECAM must be designed to serve the public interest, and mitigation measures should be established to address any concerns not rectifiable through ECAM design.

RESPECTFULLY SUBMITTED this 16th day of December, 2010.

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