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BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application of Rocky Mountain Power for Authority to Increase its Retail Electric Utility Service Rates in Utah and for Approval of Its Proposed Electric Service Schedules and Electric Service Regulations	**Docket No. 09-035-23**

PREFILED SURREBUTTAL TESTIMONY OF KEVIN C. HIGGINS

[REVENUE REQUIREMENT, COST OF SERVICE, RATE SPREAD]

The UAE Intervention Group ("UAE") hereby submits the Prefiled Surrebuttal Testimony of Kevin C. Higgins on revenue requirement, cost of service and rate spread issues.

DATED this 30th day of November, 2009.

/s/ _____
Gary A. Dodge,
Attorneys for UAE

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served by email this 30th day of November, 2009, on the following:

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BEFORE

THE PUBLIC SERVICE COMMISSION OF UTAH

Surrebuttal Testimony of Kevin C. Higgins

on behalf of

UAE

Docket No. 09-035-23

[Revenue Requirement, Cost of Service, Rate Spread]

November 30, 2009

SURREBUTTAL TESTIMONY OF KEVIN C. HIGGINS

INTRODUCTION

Q. Please state your name and business address.

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

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

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

Q. Are you the same Kevin C. Higgins who previously filed direct and rebuttal testimony in this proceeding on behalf of UAE?

A. Yes, I am.

OVERVIEW AND CONCLUSIONS

Q. What is the purpose of your surrebuttal testimony?

A. My surrebuttal testimony responds to the following issues:

(1) Various net power cost matters discussed in the rebuttal testimony of RMP witness Gregory N. Duvall;

(2) New information presented in RMP's rebuttal testimony regarding rate spread; and

(3) Various cost-of-service issues discussed in the rebuttal testimonies of RMP witnesses C. Craig Paice and Scott D. Thornton, DPU witnesses Jonathan Nunes and Joseph Mancinelli, and OCS witness Paul Chernick.

Q. What are the primary conclusions of your surrebuttal testimony?

A. I offer the following primary conclusions:

(1) I accept Mr. Duvall's correction to my adjustment to system net power costs for the updated forward price curve dated June 30, 2009. This correction reduces my adjustment to system net power costs to $(1,667,878).

(2) I find Mr. Duvall's response to my arguments concerning intra-hour and inter-hour wind integration costs to be unpersuasive; therefore, I continue to recommend adoption of the adjustments to the Company's wind integration costs presented in my direct testimony.

(3) Based on RMP's correction to its cost-of-service study presented in its rebuttal filing, I have modified my proposed rate spread to tighten the bandwidth to +/- 0.5 percentage point on either side of the system average rate increase (excluding special contracts). I have also modified my recommendation relative to the proposal in my direct testimony by moving Residential and Schedule 8 customers to the uniform percentage increase and moving Schedule 6 customers to a below-average increase. UAE's surrebuttal rate spread is presented in Tables KCH-SR1, 3, 4, and 5, corresponding to the various revenue changes being recommended by parties to this docket. Alternatively, I continue to believe that an equal percentage revenue change for all rate schedules would be reasonable.

(4) I acknowledge that the approach used by RMP to allocate income tax expense by class appears to comport with the Commission orders cited by Mr. Paice in his rebuttal testimony. However, I believe the allocation approach is conceptually incorrect and inconsistent with the approach adopted in a recent Questar Gas Company case. I respectfully suggest that the Commission should adopt the methodology change that it approved for Questar Gas Company's class cost-of-service study in Docket No. 07-057-13. I recommend that this change be extended to RMP's cost-of-service studies, so that the interpretation of class relative rates of return will be consistent across dockets, in addition to more accurately reflecting class relative rates of return.

(5) I continue to recommend that the Commission order RMP to correct its depiction of Utah class cost of service such that distribution cost of service does not vary between the Rolled-in and MSP cap revenue requirements. The approach suggested by Mr. Paice in response to my critique of RMP's treatment of the MSP rate mitigation cap would not produce reasonable results for cost-of-service purposes. Instead, it is preferable to treat the MSP rate mitigation cap as an adjustment to the generation expenses allocated to Utah, as described in my direct testimony.

(6) While the correction in the Company's rebuttal cost-of-service study has significantly reduced the problematic "gap" between Utah jurisdictional load and Utah class load, it has not eliminated it. I continue to maintain that this issue

requires further analysis, including reconsideration of the Company's decision to cease calibrating class loads to jurisdictional loads.

(7) Mr. Nunes misconstrues the purpose of the sensitivity analysis presented in my direct testimony, which tested whether measurement error was potentially causing significant shifts in cost-of-service responsibility assigned to census-measured classes (Schedules 8 and 9). Indeed, RMP's rebuttal correction to its cost-of-service study significantly reduced the cost allocations to Schedules 8 and 9, which is entirely consistent with the results of my sensitivity analysis and confirms that my concern was valid. Mr. Nunes' comments on my sensitivity analysis should be disregarded.

(8) Utah jurisdictional load factor is not 72% as indicated by Mr. Mancinelli, but is no greater than 59.2%, and is probably somewhere in the vicinity of 55%. Thus, if the Average and Excess Demand method were used to allocate costs in Utah, the demand-related costs allocated to classes based on energy would be in the range of 55-59%, rather than 72% as indicated by Mr. Mancinelli.

(9) I do not agree with Mr. Mancinelli's suggestion that the Commission establish a working group to discuss, identify, and recommend the appropriate cost classification for various kinds of generation resources within the PacifiCorp system. I believe the Commission and Utah parties have already given significant time and attention to these classification issues and the Commission has consistently held that 75% demand/ 25% energy is the appropriate basis for

allocating production costs to classes in the Utah jurisdiction. I am not persuaded that re-arguing the classification issue among the interested parties in a working group would be a productive expenditure of time and money. Instead, I believe effort would be better directed to investigating the load measurement discrepancies that remain unresolved in the Utah jurisdiction.

NET POWER COSTS

Response to Gregory N. Duvall

Q. What aspects of Mr. Duvall's rebuttal are you addressing?

A. I respond to Mr. Duvall's rebuttal testimony regarding the application of the updated forward price curve dated June 30, 2009; wind integration costs; and RMP's proposed adjustment to its direct case for higher BPA charges.

Q. Please begin by responding to Mr. Duvall's rebuttal testimony regarding the updated forward price curve that you utilized in your direct testimony.

A. In my direct testimony, I recommended using an updated forward price curve dated June 30, 2009 to set net power costs. On page 6 of his rebuttal testimony, Mr. Duvall provides corrections for certain items omitted in my adjustment. The result of Mr. Duvall's corrections is that my adjustment to system net power costs for the updated forward price curve is reduced to approximately $(1.7) million.

Q. Do you accept Mr. Duvall's correction?

A. Yes.

Q. Do you have any other comments on this issue?

A. Yes. In offering his correction, Mr. Duvall stated that UAE failed to present its adjustment in a fair and accurate manner. In response, I note that the instructions RMP provided UAE in discovery for performing this calculation were vaguely worded with respect to the items that Mr. Duvall states were omitted. In the future, clearer documentation for performing this calculation would be helpful.

Q. Turning to wind integration costs, what is your response to Mr. Duvall's rebuttal testimony on this subject?

A. Mr. Duvall responds to my arguments concerning both intra-hour and inter-hour wind integration costs on pages 36-40 of his rebuttal testimony.

RMP's intra-hour wind integration expense is based on the Company's claim that it needs 295 MW of incremental reserves to provide intra-hour regulation support to its wind fleet. In my direct testimony, I agreed that it is appropriate to include the cost of incremental reserves needed for RMP to "regulate up" in response to reductions in intra-hour wind generation output. However, I argued that there should be no incremental costs assigned to retail customers when RMP "regulates down" in response to increases in wind generation that occur within the hour, because backing down units to accommodate greater wind output does not require the Company to carry incremental reserves. Therefore, I removed 74 MW of reserves that RMP had included for "regulating down."

Mr. Duvall replies to my argument to remove reserves for "regulating down" as follows:

> When wind output is increasing, the Company must reduce other generation output in a manner that it would not have otherwise to operate the system in an economic manner. This may involve decreasing hydro generation to inefficient levels or ramping up out of the money resources so they can be ramped back down while the wind ramps up. These costs are not already being recovered from customers because they are not included in GRID. [1]

This strikes me as a very tortured rationale to justify the significant charges RMP is seeking to levy on customers to accommodate intra-hour *increases* in wind output. We need to bear in mind what is supposed to be happening when RMP is "regulating down." Wind output is increasing during the hour, and the Company is backing off its most expensive resources in its dispatch stack, similar to what occurs when load drops during the hour. Mr. Duvall offers no explanation as to why incremental reserves would be needed to perform this activity. Further, it is not at all clear how the gyrations described by Mr. Duvall above translate into a need for additional reserves, which is the form in which RMP is seeking to recover intra-hour wind integration costs.

In summary, I find Mr. Duvall's response to my argument concerning intra-hour wind integration costs to be unpersuasive.

Q. What is your response to Mr. Duvall regarding inter-hour wind integration costs?

A. RMP assumes that all inter-hour wind integration occurs through market sales and purchases. As I discussed in my direct testimony, from a MWh

[1] Rebuttal testimony of Gregory N. Duvall, p. 40, lines 869-874.

standpoint, "planned" inter-hour wind integration sales must equal "planned" inter-hour wind integration purchases – otherwise the underlying MWh modeled in GRID would be incorrect for determining net power cost. In the absence of knowledge about when they would occur, such offsetting sales and purchases would produce a net incremental energy cost of zero but for RMP's assumption that it will pay $0.50/MWh above market for every inter-hour purchase and that it will sell at $0.50/MWh below market for every inter-hour sale. This transactional premium applied to the total volume of projected inter-hour wind integration purchases and sales constitutes 100 percent of the cost of RMP's proposed inter-hour wind integration cost.

In my direct testimony, I disputed the inclusion of these costs, pointing out that RMP's analysis fails to consider that the Company's calculation of intra-hour wind integration costs assumes that 295 MW of incremental reserves will be carried for this purpose. I argued that these reserves are able to provide a dual function of supporting both intra-hour and inter-hour wind integration.

Mr. Duvall replies that my argument amounts to double-counting, stating: "Reserves that are meant to cover forced outages need to remain available for that purpose and cannot be also used to provide for [inter]-hour variations in wind generation." [2]

Q. What is your response to this argument?

[2] Ibid., p. 38, lines 820-823. Mr. Duvall's statement referenced *intra*-hour variations in wind, but it is clear from the context of his statement that he meant *inter*-hour variations.

A. Mr. Duvall does not respond to my argument on its merit. I am not double-counting, as I do not propose that reserves needed for forced outages be used for inter-hour wind integration. Rather, my argument is based on the 295 MW of incremental reserves that RMP assumes will be needed for intra-hour wind integration (or alternatively, the 221 MW of incremental reserves required after reserves claimed for "regulating down" are removed). This reserve is incremental to the 5 percent operating reserve "to cover forced outages" for wind resources that RMP assumes in calculating net power cost.

In carrying these incremental reserves, RMP will be able to respond to changes in inter-hour wind forecasts without having to rely exclusively on market transactions. For instance, if wind output suddenly drops, this incremental reserve is available to provide the required intra-hour increase in supply ("regulating up"). In planning for the next hour, the Company will then take account of the fact that its wind output has fallen, and the need for intra-hour regulating reserves in the next hour has fallen along with it. This means a portion of the intra-hour reserves that customers are already paying for can be available to support inter-hour wind integration for the next hour. The upshot is that RMP's management of inter-hour wind integration should not depend exclusively – or even necessarily significantly – on market transactions when some portion of the 221-295 MW in incremental reserves is also available for this purpose. As the entirety of the Company's claimed inter-hour wind integration cost is derived from assumed transactional premiums on purchases and sales, the elimination of the assumed exclusive

dependence on the market for inter-hour wind integration also eliminates this claim.

In summary, for Utah ratemaking, the Company's attempt to introduce inter-hour wind integration costs represents a new category of costs. RMP's claim for recovering these alleged costs fails to consider that the Company's claim of intra-hour wind integration costs assumes a substantial increase in reserves that can provide a dual function of supporting both intra-hour and inter-hour wind integration. Mr. Duvall's response to this argument does not address the argument on its merit. The Company bears the burden on this issue and has not met it. Therefore, I continue to recommend that the Commission adopt my proposal to adjust net power costs to remove the Company's claim for inter-hour wind integration costs.

Q. What are your comments on RMP's proposal to adjust its direct case to recover increased BPA charges?

A. On page 7 of his rebuttal testimony, Mr. Duvall acknowledges that the Company's rebuttal net power cost should reflect OCS's Adjustment E.13, which updates BPA's wind integration charge to reflect the final decision in BPA's rate case. According to Mr. Duvall, this change results in a reduction in system net power cost of approximately $1.5 million. At the same time, Mr. Duvall states that the rebuttal net power cost should also reflect the new prices of the BPA peaking contract and the Grant County purchase contract, both of which were made available by BPA on the same day as its final decision on revised wind

integration charges. According to Mr. Duvall, this update increases system net power cost by approximately $8.0 million. Over $7.9 million of this proposed increase is associated with the BPA peaking contract.

On the one hand, the comparable treatment of these changes in BPA prices proposed by Mr. Duvall appears reasonable. At the same time, the fact that BPA was seeking a rate increase for its peaking contract (along with wind integration charges) was known (or knowable) to RMP at the time the Company filed its rate case (even though the final decision was not yet known). In its February 2009 Wholesale Power Rate Initial Proposal, BPA calculated an Average System Cost ("BASC") of $41.90/MWh. Rather than using this projected price in the calculation of the peaking contract price in a manner consistent with its use of BPA's projected wind integration charges, RMP appears to have prepared its direct case using the Fiscal Year 2009 BASC of $33.00/MWh. Thus, the Company's proposed rebuttal update to reflect the final price of $40.42/MWh appears to be a correction of its own oversight in its initial filing.

Q. What do you recommend?

A. All things considered, I believe RMP's correction is accurate and should probably be accepted, unless it is inconsistent with the Commission's policy or practice for allowing a party to correct omitted or inaccurate information from its own direct testimony that inures to its benefit. At a minimum, it strikes me as reasonable for the increase in BPA peaking contract prices to be used to offset the

reduction in BPA wind integration charges, in light of the fact that these two price changes were determined by the same seller on the same date.

RATE SPREAD

Q. What new information is presented in RMP's rebuttal testimony regarding rate spread?

A. In its rebuttal filing, RMP made a significant correction to the inputs used in its cost-of-service study. In direct testimony, UIEC witness Maurice Brubaker and I independently criticized the inputs used in RMP's cost-of-service study presented in RMP's direct case. Our criticisms emphasized the significant discrepancy between the jurisdictional load allocated to Utah in the jurisdictional allocation model relative to the sum of Utah class loads used in the cost-of-service study. As shown in Table KHC-5 in my direct testimony, there was a very material "gap" between these two measures of 9.6% for the test period. In response to this issue, RMP reevaluated and corrected its method for aligning historical hourly load research data with the projected class usage on the monthly forecasted peak days. This correction is described in the rebuttal testimony of C. Craig Paice and Scott D. Thornton.

As a consequence of this correction, there are significant changes in the Company's cost-of-service results. Of note, consistent with the arguments presented by Mr. Brubaker and me, the correction demonstrates that the initial RMP study produced unreasonable revenue deficiencies for Schedules 8 and 9.

Also of note, the revised analysis shows that Residential customers are not over-recovering, as previously indicated.

Given the new results of the Company's rebuttal cost-of-service study, RMP witness William R. Griffith has proposed a new rate spread that he applies to RMP's revised proposed revenue requirement increase of $55 million (excluding special contract customers). In his rebuttal rate spread, Mr. Griffith moves the proposed percentage increase for Residential and Schedule 8 customers to the uniform system increase, while retaining a 1.0 percentage point above-average increase for Schedule 9 and Schedule 10. His proposed increase for certain Lighting rate schedules also remains 1.0 percentage point below the system average.

Q. What is your assessment of Mr. Griffith's rebuttal rate spread?

A. Generally, I agree with the direction of his proposed rate spread. However, I believe it is appropriate to tighten the range of proposed increases to +/- 0.5% on either side of the average retail increase. In addition, I believe it is appropriate to recognize a below average increase for Schedule 6 of 0.5%.

A comparison of RMP's proposed rebuttal rate spread and my proposed rate spread are presented in Table KCH-SR1, below.

Table KCH-SR1

Comparison of RMP Rebuttal Spread and UAE Surrebuttal Spread @ $55 Million Revenue Increase

		RMP Rebuttal Recommended Spread		UAE Recommended at RMP Rebuttal Increase	
Class	Schedule	($000)	(%)	($000)	(%)
Residential	1,3	$21,992	3.85%	23,541	4.13%
GS – Large	6,6A,6B	$15,719	3.85%	$14,138	3.47%
GS – 1 MW+	8	$4,521	3.85%	$4,840	4.13%
GS – High Voltage	9,9A	$7,739	4.85%	$7,132	4.47%
Irrigation	10,10TOD	$531	4.85%	$490	4.47%
GS – Small	23	$3,941	3.86%	$4,217	4.13%
Other	Various	$517	3.05%	$602	3.55%
Total Retail		$54,961	3.97%	$54,961	3.97%

Q. Why do you believe it is appropriate to tighten the bands on either side of the average percentage rate increase relative to RMP's proposal?

A. In my direct testimony I supported the Company's proposed bandwidth of +/- 1.0 percentage point on either side of the average percentage increase, despite my strong misgivings concerning the inputs used in the cost-of-service study, based in part on the magnitude of the variations in the class results. RMP's rebuttal cost-of-service study shows these variations to be significantly reduced, particularly with respect to the Schedule 9 and Residential classes. Indeed, when the Company's presentation of class relative rates of return is corrected to reflect calculated income taxes (as discussed in my direct testimony), the variation in returns across classes is even closer than in the Company's rebuttal results, as shown in Table KCH-SR2, below.

Table KCH-SR2

Comparison of Class Earned Returns – Income Taxes Allocated vs. Calculated

EARNED RATE OF RETURN BY RATE CLASS – RMP DEPICTION (ALLOCATED)

Schedule No.	Description	Earned Return on Rate Base	Earned Rate of Return Index
1	Residential	7.62%	1.00
6	Gen. Service – Large	8.45%	1.11
8	Gen. Service - + 1 MW	7.77%	1.02
7,11,12,13	Street & Area Lighting	17.68%	2.31
9	Gen. Service – High Voltage	5.98%	0.78
10	Irrigation	3.26%	0.43
15	Traffic Signals	6.69%	0.88
15	Outdoor Lighting	43.82%	5.74
23	Gen. Service – Small	8.67%	1.13
25	Mobile Home Parks	7.63%	1.00
SpC	Customer A	2.63%	0.34
SpC	Customer B	-1.85%	-0.24
SpC	Customer C	9.22%	1.21
Total	Utah Jurisdiction	7.64%	1.00

Data Source: Exhibit RMP _____ (CCP-3R).

EARNED RATE OF RETURN BY RATE CLASS – UAE DEPICTION (CALCULATED)

Schedule No.	Description	Earned Return on Rate Base	Earned Rate of Return Index
1	Residential	7.56%	0.99
6	Gen. Service – Large	8.13%	1.06
8	Gen. Service - + 1 MW	7.73%	1.01
7,11,12,13	Street & Area Lighting	13.11%	1.72
9	Gen. Service – High Voltage	6.81%	0.89
10	Irrigation	4.78%	0.63
15	Traffic Signals	6.94%	0.91
15	Outdoor Lighting	32.66%	4.28
23	Gen. Service – Small	8.40%	1.10
25	Mobile Home Parks	7.58%	0.99
SpC	Customer A	4.37%	0.57
SpC	Customer B	1.95%	0.26
SpC	Customer C	8.92%	1.17
Total	Utah Jurisdiction	7.64%	1.00

Q. Are there additional reasons to support a tightened bandwidth?

A. Yes. The correction to RMP's initial cost-of-service study results, in combination with the class load measurement concerns raised in this case, demonstrates that RMP's cost-of-service analysis is a work in progress, underscoring the importance of using informed judgment in interpreting its results. Even though the Company's rebuttal correction removes a significant portion of the gap between jurisdictional costs allocated to Utah and the sum of class loads, the remaining unexplained gap is still of concern. I remain troubled by the implications of the Company's decision several years ago to cease calibrating class loads to jurisdictional loads. These factors, in combination with the results of RMP's rebuttal correction, strongly suggests that a cautious approach should be taken in differentiating class rate increases. In my view, this warrants a tighter bandwidth.

Q. In light of your discussion above, what is your opinion of spreading rates using an equal percentage change for all rate schedules?

A. In my rebuttal testimony, I stated that such a rate spread was in the range of reasonable outcomes. In light of the discussion above, the argument in favor of an equal percentage approach is strengthened. In my opinion, both the tighter bandwidth I proposed above and an equal percentage approach are reasonable.

Q. In your direct testimony, you recommended a revenue apportionment approach for spreading revenue changes that differ from the Company's

proposed revenue change. Do you continue to recommend that this approach be applied to your "tighter bandwidth" rate spread proposal?

A. Yes. I continue to recommend that the approach described on pages 42-43 of my direct testimony be used for spreading revenue changes that differ from the Company's proposed revenue change. This approach is illustrated in UAE Exhibit 1.1SR (KCH-1.1SR) using my recommended rate spread applied both to RMP's surrebuttal revenue increase of $55.0 million and DPU's initially-proposed revenue increase of $8.5 million. The results of this rate spread applied to a revenue increase of $8.5 million is presented in Table KCH-SR3, below.

Table KCH-SR3

UAE Surrebuttal Rate Spread @ $8.5 Million Revenue Increase

Class	Schedule	UAE Recommended at DPU Direct Increase ($000)	(%)
Residential	1,3	$4,362	0.76%
GS – Large	6,6A,6B	$517	0.13%
GS – 1 MW+	8	$897	0.76%
GS – High Voltage	9,9A	$1,748	1.09%
Irrigation	10,10TOD	$120	1.09%
GS – Small	23	$782	0.76%
Other	Various	$36	0.21%
Total Retail		$8,461	0.61%

Q. Have you also calculated your recommended rate spread approach to DPU's rebuttal revenue change of $(0.9) million?

A. Yes, I have. These results are presented in Table KCH-SR4, below.

Table KCH-SR4

UAE Surrebuttal Rate Spread @ $0.9 Million Revenue Decrease

Class	Schedule	UAE Recommended at DPU Supp. Decrease ($000)	(%)
Residential	1,3	$495	0.09%
GS – Large	6,6A,6B	($2,230)	(0.55%)
GS – 1 MW+	8	$102	0.09%
GS – High Voltage	9,9A	$662	0.41%
Irrigation	10,10TOD	$45	0.41%
GS – Small	23	$89	0.09%
Other	Various	($79)	(0.46%)
Total Retail		($915)	(0.07%)

Q. What are the results of your recommended rate spread approach applied to OCS's initial recommended revenue change of $(5.9) million?

A. These results are presented in Table KCH-SR5, below.

Table KCH-SR5

UAE Surrebuttal Rate Spread @ $5.9 Million Revenue Decrease

Class	Schedule	UAE Recommended at OCS Decrease ($000)	(%)
Residential	1,3	($1,559)	(0.27%)
GS – Large	6,6A,6B	($3,689)	(0.90%)
GS – 1 MW+	8	($321)	(0.27%)
GS – High Voltage	9,9A	$85	0.05%
Irrigation	10,10TOD	$6	0.05%
GS – Small	23	($279)	(0.27%)
Other	Various	($139)	(0.82%)
Total Retail		($5,896)	(0.43%)

Summary of UAE Rate Spread Surrebuttal

Q. Do you have any summary comments to offer on the subject of rate spread?

A. Yes. In this surrebuttal testimony, I have modified my proposed rate spread to tighten the bandwidth to +/- 0.5 percentage point on either side of the

system average rate increase (excluding special contracts). I have also modified my recommended spread relative to the proposal in my direct testimony by moving Residential and Schedule 8 customers to the uniform percentage increase and moving Schedule 6 customers to a below-average increase to reflect the corrections in RMP's rebuttal cost-of-service analysis. I have also concluded that, in light of the correction presented in RMP's rebuttal cost-of-service analysis, as well as the concerns expressed in this proceeding regarding load measurement issues, an equal percentage revenue change for all rate schedules would also be reasonable.

COST OF SERVICE

Response to C. Craig Paice

Q. What aspects of Mr. Paice's rebuttal testimony are you addressing?

A. I am addressing two topics that Mr. Paice discussed in his rebuttal: (1) allocation of income tax expense to customer classes; and (2) the treatment of the MSP rate mitigation cap for class cost allocation.

Q. What is your response to Mr. Paice on the topic of allocation of income tax expense to customer classes?

A. In my direct testimony, I pointed out that in RMP's depiction of class cost of service at current revenues, the Company *allocates* income tax responsibility to customer classes based on each class's allocated share of rate base. I noted that this is a non-standard and inaccurate depiction; at *current revenues*, the income

tax expense for a given class should be *calculated* based on the operating revenue for return produced by that class. The Company's approach distorts relative rates of return at current revenues: the relative return ratio is overstated for classes earning above the average return and it is understated for classes earning below the average return.

In his rebuttal, Mr. Paice cites prior Commission decisions in Docket Nos. 79-035-12 and 97-035-01, in which the Commission concluded that income taxes should be allocated based on relative rate base.

I acknowledge that the approach used by the Company appears to comport with the prior Commission orders cited by Mr. Paice. However, I believe the allocation approach is conceptually incorrect and inconsistent with a very recent Commission order in a Questar Gas Company case. I respectfully suggest that the Commission's treatment of this issue in RMP cases should be brought into conformance with its treatment of the same issue in Questar Gas cases.

Allocation of income taxes is a non-standard and conceptually inaccurate treatment that produces exaggerated class rates of return on either side of unity. The Commission's recently approved change from allocation of income taxes to calculation of income taxes in Questar Gas Company's class cost-of-service studies in Docket No. 07-057-13 presumably reflects the Commission's latest thinking on this matter. I recommend that this same approach be extended to RMP's cost-of-service studies as well, so that the interpretation of class relative

rates of return at current revenues will be consistent across dockets, in addition to being more accurate.

Q. What is your response to Mr. Paice on the topic of the treatment of the MSP rate mitigation cap for class cost allocation purposes?

A. In my direct testimony, I argued that RMP's depiction of class cost of service at the MSP rate mitigation cap revenue requirement is conceptually incorrect. I demonstrated the problem with the Company's approach by showing that it produces a different distribution cost-of-service result under the Rolled-in method than under the MSP rate mitigation cap, even though there is no conceptual basis for such a difference. This problem is further compounded by the fact that RMP's allocation of distribution cost to Utah is *lower* under the MSP rate mitigation cap than under Rolled-in, despite the fact that the MSP rate mitigation cap produces an overall cost responsibility for Utah that is *greater* than under Rolled-in. This improper treatment of the functionalized costs distorts class cost responsibility.

In his direct testimony, DPU witness Joseph Mancinelli also critiqued RMP's treatment of the rate mitigation cap. Mr. Mancinelli correctly noted that the rate mitigation cap is directly related to production and therefore should be entirely applied to the production function.

In response to my direct testimony, Mr. Paice states that he agrees there may be alternative approaches to this issue, but does not believe the Company's approach has produced a conceptual error. Mr. Paice goes on to assert that "the

[rate mitigation cap] does not limit the allocation of generation costs (sic) it only limits the level of revenues the Company is allowed to collect effectively lowering the rate of return the Company will actually realize in Utah."[3]

This argument completely ignores the fact that the increase in costs allocated to Utah *in the first place* under the MSP Revised Protocol relative to Rolled-in is due to an upward adjustment in production-related costs allocated to Utah. It is obvious that it is this very increase in production-related costs that is being mitigated by the MSP rate mitigation cap; it is disingenuous to assert otherwise.

It appears to me that in making this argument the Company is not adequately focused on the issue at hand, which is to equitably allocate costs among Utah customers. Instead, RMP appears unduly concerned with representing the MSP rate cap as a reduction in the Company's rate of return. The problem with this approach in a class cost-of-service context is that it distorts the allocation of responsibility for recovering the authorized Utah revenue requirement.

Q. What is your response to Mr. Paice's suggestion on page 22 of his rebuttal testimony that the target return on generation could be lowered while retaining the authorized returns for the other functions?

A. While this would avoid the obvious logical flaw of reducing the allocation of non-generation-related costs to Utah under the rate mitigation cap, it would prove to be unhelpful in allocating class costs. In my direct testimony I suggested

[3] Rebuttal testimony of C. Craig Paice, p. 21, lines 494-496.

that this approach might be a workable alternative to my primary recommendation; however, upon further consideration, I conclude that it would not adequately address the problem at hand.

Class cost responsibility is determined by calculating class rates of return. If, by virtue of the MSP rate cap, the rate of return on generation is deemed to be lower than for other functions, this lower return would be blended in with the calculation of each class's overall return, distorting the relative returns among classes. To see this point, assume (for simplicity) that a particular customer class utilizes only the generation function, and assume further that this class is fully recovering its share of Utah generation costs (i.e., it is earning the system average return for generation). Yet when this class's return on rate base is compared with other classes it likely would be deemed to be "under-recovering" – even though it is fully recovering its costs – because the return on generation is set lower than the returns on the non-generation functions. This is the problem with the alternative suggested by Mr. Paice: it would not produce reasonable results for cost-of-service purposes. For this reason, it is preferable to recognize the MSP rate mitigation cap for what it is and reflect it for class cost of service purposes as an adjustment in the generation expenses allocated to Utah.

Response to Scott D. Thornton and Paul Chernick

Q. What aspect of Mr. Thornton's and Mr. Chernick's rebuttal testimony do you address?

A. I respond to their discussions of the calibration of class loads. Mr. Thornton disagrees with my statement that the Company's decision several years ago to stop calibrating estimated loads to the measured jurisdictional load is causing an unreasonable detrimental impact on Schedules 8 and 9 in the cost-of-service study. Mr. Chernick disagrees with the recommendations of Mr. Brubaker and me to revisit the issue of calibration.

Q. What is your response to Mr. Thornton?

A. As I discussed above and in my direct testimony, in RMP's direct case, the gap between jurisdictional loads allocated to Utah and the sum of class loads was 9.6%. The absence of any calibration effort allowed this substantial gap to persist within the Company's cost-of-service study until it was challenged in this case by UIEC and UAE. To RMP's credit, in its rebuttal filing the Company revised its method for aligning historical hourly load research data with the projected class usage on the monthly forecasted peak days. As Mr. Thornton testifies, this correction reduces the aforementioned gap to an average of about 2% for the test year.[4]

The correction in the Company's rebuttal cost-of-service study, which reduces the gap between jurisdictional loads allocated to Utah and the sum of class loads from 9.6% to about 2%, does indeed reduce significantly the costs incorrectly allocated to Schedules 8 and 9. This result is entirely consistent with the thrust of my argument on this point in my direct testimony. The decision not to calibrate permitted a large, unexplained gap between Utah jurisdictional load

[4] Rebuttal testimony of Scott D. Thornton, p. 8, lines 151-153.

and Utah class loads to go unchecked in the Company's direct case. When RMP took corrective steps that reduced the gap, the costs allocated to Schedules 8 and 9 were significantly reduced, demonstrating that the initial allocation of costs to these classes was unreasonably detrimental.

Q. In response to Mr. Thornton and Mr. Chernick, do you continue to maintain that it is necessary to revisit the decision not to calibrate class loads to the Utah jurisdictional load?

A. Yes. As I stated in my direct testimony, the decision not to calibrate non-census loads to the Utah jurisdictional load represents a methodology change that was introduced by RMP several years ago, but never evaluated or approved by the Commission. This change followed the issuance of a Load Research Working Group Report in July 2002, which, according to RMP Response to UIEC Data Request 10.23, was apparently authored by the Committee of Consumer Services, whose constituency may be a primary beneficiary of the decision to discontinue calibration. Mr. Thornton defends this methodology change, stating that RMP has presented several reasons why class loads are not calibrated to jurisdictional loads and "why the various parties who participated in the Load Research Working Group agreed it should not be done."[5]

However, the experience in this case provides very little assurance to customers in census-measured classes that class costs are being fully and properly accounted for, in light of the Company's direct filing. While the correction in the Company's rebuttal cost-of-service study has significantly reduced the

[5] Ibid., p. 15, lines 312-315.

problematic "gap" discussed herein, it has not eliminated it. Moreover, the Load Research Working Group Report, by its own admission, did not address the fundamental question of why measured retail loads in Utah plus expected losses do not equate to the Utah jurisdictional load, concluding that "investigation of the impact of this discrepancy between measured Utah Retail Load and Utah Border Load is outside the scope of this forum."[6] I continue to maintain that this entire issue requires further analysis.

Response to Jonathan Nunes

Q. What aspect of Mr. Nunes' rebuttal testimony do you address?

A. I respond to Mr. Nunes' statement that the results of the sensitivity analysis presented in my direct testimony should be disregarded.

Q. What is your response to Mr. Nunes' on this point?

A. Mr. Nunes misconstrues the purpose of my sensitivity analysis. In presenting my sensitivity analysis, I never claimed that the discrepancy between the Utah jurisdictional load and sum of the class loads was wholly attributable to load estimated errors, as inferred by Mr. Nunes.[7] If I had believed that to be the case, I would have presented the analysis as a substitute cost-of-service study, rather than a sensitivity analysis. Rather, as I stated in my direct testimony, I performed the analysis to gauge whether measurement error is *potentially* causing significant shifts in cost-of-service responsibility assigned to census-measured

[6] Load Research Working Group Report, p. 12.
[7] Rebuttal testimony of Jonathan Nunes, p. 8, lines 135-138.

classes. I went on to state that if the results of the sensitivity analysis were similar to RMP's results, "then the question I have raised with regard to the efficacy of the cost allocation results using the sample estimates may not be material." Thus, it was a way of testing whether measurement error *could be ruled out* as having a significant impact on cost-of-service results for census-measured classes. But as the analysis showed, it could not be ruled out.

As it turns out, RMP itself has now acknowledged that it did have a significant measurement problem with respect to the sampled classes; the problem identified by the Company was not related to its sampling methodology, but rather how the sample load data was translated into forecasted class peak demands. And, as I discussed above, the correction of this error resulted in significantly-reduced cost allocations to Schedules 8 and 9 – a result that is entirely consistent with the potential adjustment identified in my sensitivity analysis. Thus, Mr. Nunes' dismissal of the results of my sensitivity analysis should be disregarded.

Response to Joseph Mancinelli

Q. What aspects of Mr. Mancinelli's rebuttal testimony do you address?

A. I respond to Mr. Mancinelli's representation that the RMP system load factor (for Utah) is 72%, as well as to Mr. Mancinelli's suggestion that the Commission establish a working group to discuss, identify, and recommend the

appropriate cost classification for various kinds of generation resources within the PacifiCorp system.

Q. What are your comments regarding RMP system load factor for Utah?

A. On page 12 of his rebuttal testimony, Mr. Mancinelli presents a calculation indicating that the RMP annual system load factor for Utah is 72%. Based on this result, Mr. Mancinelli goes on to state that if the Average and Excess Demand method were used to allocate RMP costs, then 72% of the demand-related costs would be allocated to classes based on energy.

At first blush, a 72% load factor for Utah seems too high. Upon closer inspection, it appears that the denominator in Mr. Mancinelli's load-factor equation is not the Utah jurisdictional peak demand, but the Utah jurisdictional demand at the time of the PacifiCorp system coincident peak. [8] The former is the proper basis for calculating Utah load factor and is materially greater than the latter.

Using the Utah hourly loads reported by RMP in its direct case to measure Utah demand, I calculate a revised Utah load factor of 59.2%. But even this load factor is overstated, as we now know that RMP's estimate of sampled class loads was materially understated in its direct filing. Thus, we can conclude that the Utah jurisdictional load factor is no greater than 59.2%, and is probably somewhere in the vicinity of 55%. Thus, if the Average and Excess Demand method were used to allocate costs in Utah, the demand-related costs allocated to

[8] Somewhat surprisingly, the Utah jurisdictional peak demand apparently does not occur at the time of the PacifiCorp system coincident peak.

classes based on energy would be in the range of 55-59%, rather than 72% as indicated by Mr. Mancinelli.

Q. What is your response to Mr. Mancinelli's suggestion to establish a working group to discuss, identify, and recommend the appropriate cost classification for various kinds of generation resources within the PacifiCorp system?

A. While I believe this suggestion is well intended, I do not support it. I believe the Commission and the parties have already given significant time and attention to these classification issues. Further effort and expense by the parties on this issue is unwarranted. The Commission has consistently held that 75% demand/25% energy is the appropriate basis for allocating production costs to classes in the Utah jurisdiction. Moreover, a cost-of-service task force was conducted as recently as 2005, with little or no consensus. I am not persuaded that re-arguing the classification issue among the interested parties in a working group would be a productive expenditure of time and resources, particularly in light of the other demands on parties active in Utah regulatory matters. Instead, I believe effort would be better directed in a more focused and unexplored area – investigating the load measurement discrepancies that remain unresolved in the Utah jurisdiction.

Q. Does this conclude your surrebuttal testimony?

A. Yes, it does.