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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 REBUTTAL TESTIMONY OF NEAL TOWNSEND

[RATE DESIGN]

The UAE Intervention Group (UAE) hereby submits the Prefiled Rebuttal Testimony of Neal Townsend on rate design issues.

DATED this 23rd day of March, 2010.

/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 23rd day of March, 2010, on the following:

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BEFORE

THE PUBLIC SERVICE COMMISSION OF UTAH

Rebuttal Testimony of Neal Townsend

On behalf of

UAE

[Rate Design]

March 23, 2010

REBUTTAL TESTIMONY OF NEAL TOWNSEND

Introduction

Q. Please state your name and business address.

A. My name is Neal Townsend. 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 Senior Consultant 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 Neal Townsend who previously filed direct testimony in this proceeding on behalf of UAE?

A. Yes, I am.

Overview and Conclusions

Q. What is the purpose of your rebuttal testimony?

A. My rebuttal testimony addresses: (1) the proposal of the Utah Division of Public Utilities (DPU) to increase the current residential summer tail-block rate; (2) the proposal by Southwest Energy Efficiency Project and Utah Clean Energy (SWEEP/UCE) to concentrate the residential rate increase in the third summer block usage tier, a new fourth summer block usage tier, and a new second winter block usage tier; (3) the proposal by Western Resource Advocates (WRA) to impose a residential High Usage Surcharge; and (4) the DPU's proposal to

decouple rates on a pilot basis to collect fixed distribution costs for the residential rate class.

Q. What is UAE's interest in this residential rate issue?

A. UAE members take electric service under non-residential rate schedules, which are not directly affected by the various rate design and decoupling proposals in this proceeding. However, UAE members are concerned about sound ratemaking principles and the possible precedential value of issues in this proceeding.

Q. What conclusions and recommendations do you offer on the various residential rate design and decoupling proposals in this proceeding?

A. I offer the following conclusions and recommendations:

(1) If the Commission approves any of the inverted residential rate design proposals offered by DPU, SWEEP/UCE or WRA, I encourage the Commission to understand and find that the rationale underlying any such rate design does not extend to commercial and industrial rates.

(2) If the Commission approves the DPU's pilot decoupling proposal, I recommend that the Commission expressly limit its applicability to residential schedule and find that the rationale underlying the proposal does not extend to commercial and industrial rates.

Rate Design - Schedule 1 Inverted Block Rate Design

Q. Can you please briefly summarize the proposals of the DPU, SWEEP/UCE, and WRA for inverted residential rate design?

A. Yes. If the Commission approves the DPU's proposed three-year pilot decoupling mechanism (which I discuss later), DPU recommends, along with maintaining a $3.00 customer charge, a 1% percent increase in the summer first, summer second and winter block rates, and an 11% increase in the summer third block rate to send a stronger price signal to customers with usage levels higher than 1,000 kWh. Alternatively, if the Commission does not adopt the DPU's decoupling proposal, the DPU proposes to increase the customer charge to $3.40 and increase the third block rate by 8.5%.

SWEEP/UCE recommends a four-tiered summer rate/two-tiered winter rate for Schedule 1 that contains a more accentuated inverted structure than exists in the current rate design. Similar to the DPU's proposal, this recommended rate design is intended to send a strong price signal to large residential customers with the hope of eliciting a demand response.

WRA recommends the imposition of a High Usage Surcharge to recover the revenue increase for residential rate schedules. No surcharge would be imposed for monthly usage below 1,000 kWhs, but a surcharge would be imposed above 1,000 kWh. The amount of the surcharge would increase with increasing usage.

Q. Do you have any comments on the various proposals of the DPU, SWEEP/UCE, and WRA for Schedule 1 rate design?

A. As UAE's members do not take service on Schedule 1, UAE is not taking any specific position on rate design for Schedule 1 rates. However, I am commenting on the various rate design proposals in order to explain why any such proposals for inverted block rates would be inappropriate for non-residential customers.

Q. To your knowledge, has any party to this proceeding proposed inverted block rates for non-residential customers?

A. No. However, I am aware that such proposals have been made in other jurisdictions.

Q. In your opinion, would it be appropriate for an inverted block rate design to be implemented for commercial and industrial rate schedules?

A. No. Any proposal for inverted block rates for commercial and industrial customers would be a misguided notion and entirely inappropriate.

Q. Please explain.

A. The premise behind inverted block rates is that it is important to send a price signal to customers that increasing energy usage is costly to the utility system. This concept is typically paired with the notion that there is a critical minimum amount of electric power that is necessary to meet basic needs. The rate design that results from combining these ideas is often one in which the initial pricing block (corresponding to the first energy used in the billing period) is priced at a relatively low rate, whereas energy consumption above this amount is priced at higher rates.

The notion of a critical minimum or a "baseline" amount of electric power (that is priced at a lower rate) is grounded in a value judgment about what portion of electric power consumption for a residential customer is for "necessities" (e.g., lighting) and what portion constitutes discretionary or even luxury usage (e.g., heating a hot tub). As varied as households may be, they are significantly more homogeneous than businesses. In light of this homogeneity, it may be reasonable to establish prices for residential customers that distinguish between necessary "baseline" power consumption and discretionary or luxury usage. Consequently, inverted block rates may be appropriate for residential customers.

However, the notion of "baseline" rates does not translate in any meaningful way to commercial and industrial customers. The relative differences in electricity usage among commercial and industrial customers are driven largely by the differing requirements of their respective businesses, as opposed to individual consumption preferences. For example, a grocery store that is pursuing vigorous energy efficiency measures may still be consuming ten times the electric power of a gas station, due to the nature of the business. It is not reasonable to artificially reduce the energy rates paid by the gas station below the average cost to serve it, and then transfer the burden of meeting the revenue shortfall to the energy rate paid by the grocery store in order to send a stronger conservation price signal to the grocer. Any such pricing scheme merely creates new subsidies in which the larger customers on the rate schedule pay for the energy costs of the smaller customers, without regard to the energy efficiency practices of either.

Q. What is your recommendation to the Commission on this issue?

A. If the PSC approves any of the proposals of the DPU, SWEEP/UCE, WRA, or any similar inverted residential rate design proposals, I urge the Commission to recognize and expressly find that the rationale underlying any such rate design does not extend to commercial and industrial rates. Inverted block rates for commercial and industrial customers are entirely inappropriate and should not be considered.

Rate Design – Schedule 1 Distribution Decoupling

Q. Can you please briefly summarize the DPU's proposal to decouple rates to collect fixed distribution costs for the Schedule 1 residential rate class?

A. Yes. The DPU is proposing a decoupling mechanism on a pilot basis designed to collect the Company's fixed distribution costs for residential customers. Decoupling severs the relationship between the revenues collected by the utility and the sales volumes, in kilowatt hours, used by customers. The DPU apparently believes that decoupling will allow flexibility in designing rates to promote energy efficiency while mitigating the risk of cost recovery from reductions in energy consumption and other factors such as weather.

Q. Do you have any comments on the DPU's proposed decoupling mechanism?

A. Yes. Again, UAE's members do not take service on residential schedules and would not be directly affected by this proposal. However, I am generally opposed to the adoption of decoupling mechanisms because they are typically unwarranted applications of single-issue ratemaking. Further, because decoupling

results in a material reduction in utility risk, it should not be adopted without explicit recognition in the utility's allowed return on equity.

Q. How would DPU's decoupling proposal reduce RMP's risk?

A. Various factors affect customers' usage – price being but one factor. For example, the weather may be cooler in the summer or warmer in the winter relative to normal conditions. Currently, Utah rates are set to recover RMP's revenue requirement using normal weather. The risk of deviations in usage from abnormal weather, both high and low, is borne by RMP. RMP is compensated for taking this risk in the determination of its allowed ROE. By its very design, the DPU's proposal is intended to reduce RMP's risk from weather and other factors.

Q. Do you have any additional comments on decoupling at this time?

A. Yes. I note that decoupling implementation proposals in Utah have been designed based on deviations in average usage per customer. This is the case for the existing QGC decoupling mechanism, as well as the DPU proposal in this proceeding. I concur that, if decoupling is to be adopted, such a design may make the most sense. However, the usefulness of this design concept is limited to customers that are relatively homogenous in character. A decoupling mechanism based on deviations in average usage per customer would be entirely without merit if applied to industrial customers. For industrial customers, changes in usage per customer are far more likely to be driven by changes in the *composition* of the customers and changes in the *economy* than by changes attributable to utility-sponsored conservation programs. For this reason, if decoupling is to be

further considered in Utah, I strongly recommend that it not be considered for non-residential customers.

Q. Please summarize your recommendation to the Commission on this issue.

A. I am generally opposed to the adoption of decoupling mechanisms because they represent problematic applications of single-issue ratemaking. Further, because decoupling leads to a material reduction in utility risk, I caution against the adoption of any decoupling mechanism absent a corresponding reduction in the utility's allowed return on equity. If the Commission approves the DPU's decoupling proposal, I recommend that the Commission expressly limit its use to residential schedules and find that the rationale underlying such a proposal does not extend to commercial and industrial rates.

Q. Does this conclude your direct testimony?

A. Yes, it does.