Witness OCS – 3R

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application of Rocky	**)**	**Docket No. 11-035-200**
Mountain Power for Authority to Increase	**)**	
Its Retail Electric Utility Service Rates in	**)**	
Utah and for Approval of Its Proposed	**)**	**Rebuttal Testimony**
Electric Service Schedules and Electric	**)**	**of Donna Ramas**
Service Regulations	**)**	**For the Office of**
	)	**Consumer Services**

July 13, 2012

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INTRODUCTION

Q. WHAT IS YOUR NAME, OCCUPATION AND BUSINESS ADDRESS?

A. My name is Donna Ramas. I am a Certified Public Accountant licensed in the State of Michigan and a senior regulatory analyst at Larkin & Associates, PLLC, Certified Public Accountants, with offices at 15728 Farmington Road, Livonia, Michigan 48154.

Q. ARE YOU THE SAME DONNA RAMAS WHO SUBMITTED DIRECT TESTIMONY IN THIS DOCKET ON JUNE 11, 2012?

A. Yes, I am.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. I am addressing two issues discussed in the direct testimony of Artie Powell on behalf of the Division of Public Utilities (DPU). Specifically, as I have done in several prior cases, I address Dr. Powell's contention that the actual historical generation overhaul expense amounts used in normalizing the amount of generation overhaul expense to include in base rates should be escalated to test year dollars prior to averaging. I again respectfully disagree with Dr. Powell's recommendations and conclusions in this regard.

Additionally, at page 13 of his testimony, Dr. Powell indicates that he has estimated the impact of RMP's proposed treatment of the Klamath costs as approximately $14 million on a Utah basis. As will be discussed in this testimony, the estimated impact of $14 million is substantially understated and the full impact incorporated in this case is in excess of $19.8 million on a Utah basis.

I also address two recommendations made in the Direct Testimony of UAE Intervention Group ("UAE") witness Kevin C. Higgins. The first pertains to the return to apply to the Klamath settlement and relicensing costs. The second pertains to the treatment of rate increases associated with certain special contracts in determining the revenue requirements.

<u>Generation Overhaul Escalation</u>

Q. WOULD YOU PLEASE FIRST PROVIDE A BRIEF SUMMARY OF THE GENERATION OVERHAUL EXPENSE NORMALIZATION AS WELL AS THE ISSUE OF CONTENTION INVOLVING THE NORMALIZATION OF THE GENERATION OVERHAUL EXPENSES?

A. The amount of expense incurred by RMP for the overhaul of generation facilities can vary significantly from year to year and from generation unit to generation unit. The amount of overhaul costs that are capitalized versus expensed will also vary between overhauls and between units depending on the specific work done during a particular overhaul. In order to ensure that base rates are not set at a level to include either an abnormally high level or an abnormally low level of generation overhaul expense, it has been the practice of RMP and the parties to recommend that the overhaul expense to be incorporated in rates be based on an average level. For existing plants that have been in service for four years or more, the normalization calculation includes the most recent four years of actual overhaul expense on a plant by plant basis. For plants that have been in service for less than the four-year period used to normalize the costs, a combination of actual and projected costs are used so that the normalization is still based on a four-year period.

Over the years the adjustment has gone in both directions. In some cases the amount of generation overhaul expense has been increased from the base year level as a result of normalization, and in other cases it has been reduced. However, the parties have consistently agreed that the costs should be normalized based on a four-year average of generation overhaul expense on a plant by plant basis.

What the parties have not consistently agreed on is the application of escalation factors to the actual historical costs incurred prior to determining the four-year average cost. The OCS has consistently recommended that the historical costs should NOT be escalated prior to determining the normalized cost level, consistent with the Commission's findings in two prior orders. These prior orders were quoted in my direct testimony and will not be repeated here. The Company has filed its cases in recent years under both approaches. In the last general rate case it did not escalate the historical costs prior to determining the average in its initial filing, in this case it applied the escalation. Division witness Artie Powell has advocated for the escalation of the costs prior to averaging in this general rate case, as well as the prior two RMP general rate case proceedings.

Q. HAS DR. POWELL PRESENTED ANY NEW EVIDENCE IN THIS CASE IN SUPPORT OF HIS ESCALATION OF THE HISTORICAL BALANCES IN DERIVING THE NORMALIZED GENERATION OVERHAUL EXPENSE LEVEL THAT HAS NOT PREVIOUSLY BEEN CONSIDERED BY THE COMMISSION IN THE LAST FULLY LITIGATED RMP RATE CASE PROCEEDING?

A. In my opinion, no. Although he states at page 6 of his Direct Testimony that the Division presented additional or new evidence and information in the last case that had not been considered in Docket No. 09-035-23, the same or similar information had been presented to the Commission with Dr. Powell's surrebuttal testimony in Docket No. 09-035-23. In the testimony in the current case, Dr. Powell presents a discussion comparing Method 1 and Method 2 of forecasting General overhaul expenses. The information presented in Dr. Powell’s testimony comparing his “Method 1” (i.e., inflation of the average of four historical values) and “Method 2” (i.e., averaging of the inflated historical values) and the arguments regarding why Method 2 is superior to Method 1 was previously presented to the Commission in his surrebuttal testimony in Docket No. 09-035-23 and in his direct testimony in Docket No. 10-035-124. Docket No. 10-035-124 was resolved through a settlement, which was approved by the Commission. A comparison of Method 1 to Method 2 and various model simulations and statistical comparisons under either Method 1 or Method 2 was presented to the Commission for consideration in both cases.

In explaining his contention that it is preferable to escalate the actual historical costs prior to determining the normalized average cost level, Dr. Powell does present a lot of formulas in this case that may not have been fully included in Docket No. 09-035-23. However I find nothing persuasive that would cause me to change my long-standing belief that the generation overhaul expenses should not be escalated or inflated prior to averaging. This belief is consistent with the Commission’s findings on the issue. There is nothing new presented in this case that should lead to the conclusion that the historical costs should be escalated in determining the normalized cost level. The Commission should re-affirm, once again in this docket, that the historical generation overhaul expenses should not be escalated for purposes of normalizing generation overhaul expense to include in base rates. To do otherwise could open the door in future cases for parties to recommend that other costs which are normalized also be escalated prior to averaging. This could become a slippery path that I recommend not be taken which could cause future rates to be higher than necessary for RMP to adequately recover its costs of serving customers.

Q. WHAT IS THE OCS' RECOMMENDATION WITH REGARDS TO WHETHER OR NOT THE HISTORICAL COST LEVELS SHOULD BE ESCALATED IN DERIVING THE AVERAGE?

A. OCS's recommendation has not changed. In my opinion, the issue of whether or not the historical costs should be escalated in deriving the normalized amount for inclusion in rates was thoroughly vetted by the parties in RMP Docket Nos. 07-035-93 and 09-035-23. The issue was addressed in testimony in both of those cases, and I was cross examined on this very issue during the hearings before the Commission. In each of those cases, the Commission determined that the historical costs should not be escalated in deriving the normalized cost level to include in rates. The DPU's and RMP's recommendation in this case that the costs be escalated in deriving the normalized generation overhaul expense level should, yet again, be denied.

Q. WITHOUT REPEATING YOUR DIRECT TESTIMONY ON THE ISSUE IN THIS CASE, DO YOU HAVE ANY ADDITIONAL COMMENTS IN RESPONSE TO DR. POWELL'S TESTIMONY?

A. Yes. While the testimony presented by Dr. Powell presents extensive information on inflation and the formulas needed to calculate the inflated averages, it fails to consider a key point.

Q. WHAT IS THE KEY POINT THAT YOU FEEL IS NOT CONSIDERED IN DR. POWELL'S ANALYSIS?

A. Dr. Powell's calculations and hypothetical examples focus on the pressures of inflation on costs. However, it does not factor in the productivity offsets that have been and will continue to be realized by RMP. While some of the costs of the materials used in overhauling the generation units may be subject to inflation pressures, and the wages of employees performing the work may be increasing over time, there are also productivities that are realized. The experience gained from prior overhauls can be applied in future overhauls to make future overhauls more efficient. Lessons are learned and retained. Additionally, over the years RMP has undertaken several cost saving measures. It sometimes uses contract labor, presumably at a lower cost, in working on the generation units. Dr. Powell's hypothetical examples may address inflation and compare different methods of inflating costs, but it is not specific to the overhaul expenses realized by RMP. It also does not address the productivities that are gained as a result of regularly performing overhauls on the various generation facilities.

<u>Klamath Impact on Utah Rates</u>

Q. ON PAGE 13 OF HIS DIRECT TESTIMONY, DR. POWELL ESTIMATES THE IMPACT OF THE COMPANY'S PROPOSED TREATMENT OF THE KLAMATH COSTS ON RATES AS $14 MILLION. IS $14 MILLION THE FULL IMPACT?

A. No, the full impact on customer rates in Utah, under RMP's proposal in this case, is significantly higher than $14 million. Dr. Powell indicates at lines 245 – 247 of his Direct Testimony that the $14 million was estimated by turning the Klamath adjustment off in the model provided by the Commission in this docket. I was able to independently confirm that turning off the adjustment in the model does, in fact, cause the revenue requirement in the model to change by $14 million on a Utah basis. However, merely turning off the Klamath adjustment does not remove all of the impacts of the Klamath costs that RMP is requesting to recover in this case.

Q. CAN YOU EXPLAIN WHY NOT?

A. Yes. While turning off the Klamath switch removes the incremental adjustment made by RMP to the base year, it does not remove the

Klamath impacts that were recorded by RMP on its books during the base year ended June 30, 2011. RMP began recording the accelerated depreciation of the Klamath facility in January 2011, resulting in $2,154,440 of accelerated depreciation on its books during the base year. RMP also began amortizing the relicense and process costs during the base year, resulting in $4,136,777 included in base year amortization expense. Similarly, base year rate base, on a 13-month average basis, includes $37,055,857 of Klamath Relicense and Process costs. Base year operation and maintenance expenses include $3,315,283 of Klamath Hydroelectric Settlement Agreement ("KHSA") implementation expenses, which RMP increased by $250,481 to arrive at the test year balance. Turning off the switch in the model merely removes the incremental costs in going from the base year to the test year, but the costs recorded and included on RMP's books during the base year would remain.

Q. HAVE YOU CALCULATED THE FULL IMPACTS OF THE KLAMATH COSTS USING THE COMMISSION'S MODEL?

A. Yes. In order to be comparable to the method used by Dr. Powell in deriving his estimated impact of $14 million, I also used the Commission's model to estimate the impact. Instead of turning off the Klamath switch, I entered an adjustment to the model that would remove 100% of the costs identified in the Company's Exhibit RMP__(SRM-3), pages 8.11 through 8.11.5 as being incorporated in the adjusted test year. The necessary adjustments were presented with my direct testimony in this case as Exhibit OCS 3.6D.

Q. USING THE COMMISSION'S MODEL, WHAT WAS THE IMPACT OF THE REMOVAL OF ALL OF THE KLAMATH COSTS IN THE ADJUSTED TEST YEAR THAT WERE IDENTIFIED IN COMPANY EXHIBIT RMP__(SRM-3), PAGES 8.11 THROUGH 8.11.5?

A. Using the model, the impact of RMP's proposed treatment of the Klamath costs to Utah ratepayers is $19.8 million, which is $4.8 million higher than the amount identified in Dr. Powell's testimony.

Q. ARE YOU AWARE OF ADDITIONAL COSTS IN THE TEST YEAR RELATED TO THE KHSA THAT WERE NOT IDENTIFIED BY RMP ON EXHIBIT RMP__(SRM-3), PAGES 8.11 THROUGH 8.11.5?

A. Yes. Subsequent to the direct testimonies being filed by intervenors in this case, RMP provided a response to OCS Data Request 30.8 which asked RMP for the amount of legal expenses in the adjusted test year associated with the KHSA and if there were additional expenses in the adjusted test year that had not been identified or included in the Klamath adjustment presented in its filing. In response, the Company indicated that there were legal expenses in Account 557 in the test year and Klamath relicensing costs that had been recorded in Account 928. The confidential attachment provided with the response identifies ****BEGIN**

CONFIDENTIAL** [redacted] **END CONFIDENTIAL**** recorded in the base year on a total Company basis that would have been escalated by RMP in deriving the test year expenses in this case. These costs were not removed in my adjustment on Exhibit OCS 3.6D as I was not aware of the amount of additional KHSA related costs that had been recorded by RMP during the base year and not disclosed in its adjustment until receipt of the response. These costs are in addition to the $19.8 million impact identified above and would not have been included in the $14 million impact discussed in Dr. Powell's testimony.

Return to Apply to KHSA Costs

Q. ARE THERE ADDITIONAL KHSA ISSUES THAT YOU WISH TO ADDRESS IN THIS REBUTTAL TESTIMONY?

A. Yes. OCS Witness Michele Beck presents the Office's recommendation on this issue, which is that the settlement and relicensing costs should not be charged to customers in the state of Utah. In her rebuttal testimony, Ms. Beck reaffirms the Office's position that the prudence of the costs has not been established. While I do not address the appropriateness of recovering the KHSA costs from Utah customers, I will address a proposal offered in the Direct Testimony of UAE Witness Kevin Higgins regarding recovery of the costs, if recovery is allowed.

UAE witness Kevin Higgins proposes in his direct testimony that, based on the assumption the relicensing costs were prudently incurred by RMP and a share of the costs should be allocated to Utah ratepayers, the “forward going carrying charges” on the associated regulatory asset be limited to the Company’s long-term cost of debt. Mr. Higgins indicates, at page 18 of his Direct Testimony, that “This approach would fully reimburse the Company for its costs plus a reasonable cost of capital without unjustly enriching the Company, which is what would occur if it were rewarded with a return on equity on this ‘non-asset’.” I will address this proposal.

Q. YOU INDICATE THAT MR. HIGGINS ADDRESSES THE “FORWARD GOING CARRYING CHARGES” ON THE REGULATORY ASSET. PLEASE COMMENT ON THE “FORWARD GOING CARRYING CHARGES.”

A. I would like to clarify that once the relicensing costs are included in base rates (if such an outcome does ultimately result despite the Office’s recommendation against inclusion), then the accrual of carrying costs on the regulatory asset would cease. Presumably Mr. Higgins is only referencing the amount of return to be allowed on the regulatory asset balance for purposes of determining the revenue requirements in this case and not recommending that carrying costs continue to be accrued on the regulatory asset balance once the regulatory asset is incorporated in rates.

However, if the Commission ultimately allows recovery of either all or a portion of the costs from Utah ratepayers, then limiting the return to be applied to the resulting regulatory asset to the weighted cost of debt would be appropriate.

Additionally, if the Commission allows recovery of any of the KHSA costs requested by RMP, it should consider an additional reduction to the costs by evaluating whether the Allowance for Funds Used During Construction ("AFUDC") amount and/or rate used to calculate the KHSA balance being requested in RMP's filing was appropriate. While the Stipulation in Docket No. 10-035-124 allowed RMP to record a carrying charge based on the AFUDC rate from the date of the decision in that case, it is silent regarding whether the AFUDC accrued to that point in time was reasonably calculated or appropriate. The application of an AFUDC rate to qualifying costs ceases once a project is complete. Project completion date is different from the date that a project is added to rate base and included in rates as part of a general rate case. As a result of the Stipulation in the last case, RMP was permitted to continue accumulation of carrying costs based on the application of the AFUDC rate.

As observed by Mr. Higgins, "…over 40 percent of the proposed regulatory asset is comprised of accumulated carrying costs (AFUDC) dating back to 1998." Some of this has accumulated as a result of the parties agreeing to delay consideration of this issue in the last rate case. Much of it accumulated before the Company ever brought the issues before the Utah Commission. The Commission must decide first if the costs are prudent, second what the appropriate carrying charge to date should be, and third what return should be applied to the allowed costs on a going-forward basis.

Q. MR. HIGGINS RECOMMENDS THAT THE RETURN ON THE COSTS BE BASED ON THE LONG TERM DEBT RATE, WHEREAS YOU RECOMMEND ABOVE THAT THE APPROPRIATE RETURN TO APPLY TO THE BALANCE ULTIMATELY APPROVED BY THE COMMISSION (IF ANY) SHOULD BE LIMITED TO THE WEIGHTED COST OF DEBT. PLEASE EXPLAIN WHAT THE DIFFERENCE IS AND WHY YOU RECOMMEND THE WEIGHTED COST OF DEBT RATE.

A. On UAE Exhibit RR 1.4, Mr. Higgins' determines the reduction in revenue requirements for the return to be applied to the Klamath Relicensing and Settlement costs by applying the difference between RMP's requested overall rate of return of 7.906% and the long term debt rate of 5.41%. The result is then increased by the tax gross-up factor. However, long term debt is only 47.60% of the overall capital structure. In order to remove the full impact of the return on equity that is applied to the costs in RMP's filing, the difference between the overall rate of return and the weighted cost of debt of 2.575% should be used, with the results increased by the tax-gross up factor since the equity component of the return is taxable. This would remove the full impact of the application of the equity return to the project balances and limit the return to the debt portion of the overall rate of return.

RMP's financing of its capital, including the KHSA expenditures, uses all sources of capital. In order to remove the return (or profit) to shareholders on the KHSA costs on a going-forward basis and limit the revenue requirement impact of the regulatory asset to the debt portion of the capital sources, the weighted cost of debt should be applied in the calculation presented by Mr. Higgins instead of the full long term debt rate.

<u>Special Contract Rate Increases</u>

Q. UAE WITNESS KEVIN HIGGINS DISCUSSES A METHOD OF FACTORING IN THE IMPACT OF THE RATE INCREASE THAT WILL RESULT FROM THIS CASE ON CERTAIN SPECIAL CONTRACT CUSTOMERS. PLEASE COMMENT ON HIS RECOMMENDATION.

A. The OCS is aware that certain special contracts have provisions that result in rate increases for those customers that are calculated based on the rate increase resulting from a general rate case, and that the timing of the increases in the special contract rates don't necessarily align with the overall increase in base rates. Thus, the increased revenue that will be realized by RMP as a result of the subsequent increase in rates that will be paid by special contract customers are not factored into the revenue requirement calculations in the rate case. This results in additional revenues being realized by RMP that have not in the past been factored into the calculations of the revenue requirements in the general rate case.

While I am not personally familiar with the special contracts specifically discussed by Mr. Higgins in his testimony, he does present what can be a workable solution for reflecting at least a partial impact of the increased revenues that will be received from the special contract customers in his testimony. Assuming that Mr. Higgins' statement that the rate increase for Special Contracts 1 and 2 will take effect on January 1, 2013 and will be tied to the amount of base rate increases in effect during calendar year 2012 is accurate, then his offered solution presented on page 11 for factoring in the impact of the increased revenue in the Commission's decision in this case appears reasonable. While it may not pick up the entire impact of the ultimate increase in revenues that would be received from the special contract customers as a result of the base rate increase to be granted by the Commission in this case, recognizing at least some of the impact is better than recognizing none.

Q. AT PAGE 12 OF HIS TESTIMONY, MR. HIGGINS ALSO RECOMMENDS A RIDER SURCREDIT APPROACH FOR RECOGNIZING THE ADDITIONAL INCREASE IN REVENUES FROM SPECIAL CONTRACT CUSTOMERS THAT WOULD OCCUR THE FOLLOWING YEAR AS A RESULT OF THE RATE INCREASE THAT WOULD RESULT FROM THIS CASE. DO YOU WISH TO ADDRESS THIS SECOND RECOMMENDATION REGARDING THE SPECIAL CONTRACT REVENUES?

A. Not at this time. I would prefer to see RMP's response to this second recommendation prior to weighing in on the matter as it may have additional implications that I have not fully evaluated at this time. Additionally, as I am not personally familiar with the Special Contracts in question, or of the amount of rate increase that will be awarded by the Commission in this case, it is unclear at this point that the amount of increased revenues that would be triggered to take effect for those customers on January 1, 2014 as a result of this case would be of a level to justify a rider.

Q. DOES THIS COMPLETE YOUR REBUTTAL TESTIMONY?

A. Yes.