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. 13-035-184 DPU Exhibit 2.0 DIR-RR

Artie Powell, PhD

Pre-Filed Direct Testimony

Revenue Requirement

Division of Public Utilities

May 1, 2014

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Exhibit List

PRELIMINARIES

Q: WOULD YOU STATE YOUR NAME, POSITION, AND BUSINESS ADDRESS FOR THE RECORD, AND EXPLAIN FOR WHOM YOU ARE TESTIFYING?

A: My name is Artie Powell; I am the manager of the energy section within the Utah Division of Public Utilities; my business address is 160 East 300 South, Salt Lake City, Utah. My testimony is on behalf of the Division.

Q: WOULD YOU SUMMARIZE YOUR EDUCATION AND QUALIFICATIONS FOR THE RECORD?

A: I hold a doctorate degree in economics from Texas A&M University. Prior to joining the Division, I taught courses in economics, econometrics, and statistics both for undergraduate and graduate students. I joined the Division in 1996 and have since attended several professional courses or conferences dealing with a variety of regulatory issues including, the NARUC Annual Regulatory Studies Program (1995) and IPU Advanced Regulatory Studies Program (2005). Since joining the Division, I have testified or presented information on a variety of topics including, electric industry restructuring, incentive-based regulation, revenue decoupling, energy conservation, evaluation of alternative generation projects, and the cost of capital.

Q: WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A: In addition to offering testimony and evidence to support the Division's positions on generation overhaul expense (GOE) and the Company's request to rate base its net prepaid pension asset (NPPA), I will provide an overview of the Division's other adjustments and introduce its witnesses.

SUMMARY OF DIVISION'S CASE

DIVISION'S ADJUSTMENTS AND RECOMMENDATIONS

Q: WOULD YOU PLEASE SUMMARIZE THE DIVISION'S ADJUSTMENTS AND RECOMMENDATIONS IN THIS CASE?

A: The Division recommends an overall revenue requirement **decrease** of approximately $5.1 million. The Division's recommendation is the culmination of 58 adjustments—totaling approximately negative $76 million— to the Company's filed case. The Division's recommended decrease in the revenue requirement includes the Company's net power cost update, which decreased the Company's filed request by approximately $4.9 million. The Division's adjustments are to various areas, including the cost of capital, net power costs, and rate base. A detailed summary of the Division's adjustments and recommendation are in DPU Exhibit 2.5 DIR-RR.

In all, the Division plans to sponsor 11 witnesses, including me, in this case.

DIVISION'S WITNESSES

Q: WOULD YOU IDENTIFY THE DIVISION'S WITNESSES?

A: The Division's witnesses include:

1. Mr. Charles Peterson. Mr. Peterson filed testimony on the Cost of Capital on April 17, 2014. The Division recommends a return on equity of 9.25%, which represents on a Utah basis a decrease to the Company's filed position of approximately $39.8 million.

2. Dr. Artie Powell sponsors one adjustment to decrease the requested revenue requirement by approximately $7 million by removing the Company's prepaid pension asset from rate base.

3. The Division engaged Mr. Richard Hahn, of LaCapra Associates, to assist in reviewing the Company's capital additions. Mr. Hahn testified in the previous general rate case, Docket No. 11-035-200. He will discuss several adjustments to rate base. On a Utah basis, Mr. Hahn's adjustments reduce revenue requirement approximately $4.7 million.

4. Mr. Matthew Croft, a technical consultant with the Division, has worked closely with Mr. Hahn in reviewing the Company's capital additions and will sponsor several additional adjustments, which decrease the Company's revenue requirement $3.1 million.

5. Mr. George Evans, of Evans Power Consulting Inc., will testify for the Division on the Company's net power costs. Mr. Evans is sponsoring 11 adjustments, which reduce revenue requirement by approximately $18.9 million.

6. Mr. Dave Thomson, a technical consultant with the Division, will sponsor several adjustments, including two to legal expenses, in this case. The total for Mr. Thomson's adjustments decrease the Company's request by $1.7 million.

7. Mr. Clair Oman, also a technical consultant, sponsors an adjustment to the Company's incentive plan. The adjustment decreases revenue requirement by $0.58 million.

8. Mr. Eric Orton, a utility analyst with the Division, sponsors three adjustments, one each to lobbying expense, civic membership dues, and challenge grants. The total decreases revenue requirement by approximately $0.33 million.

9. Mr. Robert Davis, also a utility analyst, sponsors four adjustments, including an adjustment to the Company's forecasted REC Revenue, which decrease the revenue requirement by approximately $0.33 million.

The Division plans to provide two additional witnesses in the cost of service phase of this case.

Summary of GOE and Net Prepaid Pension Asset

Q: Would you please summarize the Division's positions on GOE and the NPPPA?

A: The Division supports the Company's methodology for forecasting GOE. This methodology, from both an economic and statistical view, is superior to other methodologies presented in previous dockets.

The Division recommends that the Commission **not** allow the Company to include its NPPA in rate base at this time. Removing the NPPA from the Company's filed position reduces the Utah revenue requirement by approximately $7 million at the Division's cost of capital.

Generation Overhaul Expense

Q: You previously indicated that the Division supports the Company's methodology for estimating GOE. Have you testified on the GOE methodology in previous cases?

A: Yes, in Docket Nos. 09-035-23, 10-035-124, and 11-035-200. In Docket 09-035-23, the Commission concluded,

> In addition to those reasons enunciated in our prior order in Docket No. 07-035- 93, the Company provides no analysis of how their approach when applied to historical data provides reasonable results over time. The evidence provided in this case, and in other recent cases, is not sufficient to support adoption of the Company's method. (See Report and Order on Revenue Requirement, Cost of Service and Spread of Rates, February 18, 2010, p. 97)

In the latter two dockets, I presented additional information addressing the use of the Company's methodology. However, the settlements in those dockets did not resolve the GOE issue. Therefore, I am presenting that information here in this docket for the Commission's consideration.

Q: WOULD YOU EXPLAIN WHAT METHODOLOGY THE COMPANY IS USING IN THIS DOCKET?

A: Yes. In his direct testimony, Company witness Mr. McDougal states,

> This adjustment normalizes generation overhaul expenses using a four-year historical average for the 12 month periods ending June 2010 through June 2013. . . . Prior to averaging, annual expenses are restated to June 2013 dollars to make the dollars comparable.[1]

In other words, the Company's methodology escalates or restates the four historical amounts in terms of 2013 dollars and then averages these escalated amounts to estimate the GOE for the test period.

As Mr. McDougal explains, the use of the average of four historical years was approved by the Commission in Docket No. 07-035-93. However, in Docket Nos. 07-035-93 and 09-035-23, the Commission did not allow the use of escalation prior to averaging.

Q: IF THE COMMISSION DISALLOWED THE USE OF ESCALATION PRIOR TO AVERAGING IN PRIOR CASES, WHY DOES THE DIVISION NOW SUPPORT THE COMPANY IN ITS USE OF ESCALATION PRIOR TO AVERAGING IN THIS CASE?

A: The Division contends that the purpose of averaging is to smooth the volatility or variation in annual GOE; averaging does not account for escalation or

[1] "Direct testimony of Steven R. McDougal, Revenue Requirement & Test Period," Docket No. 13-035-184, January 2014, lines 503-509, p. 22.

inflationary changes from year to year. Failure to account for inflation will systematically underestimate or understate the Company's test period GOE.

Additionally, in the Company's last two general rate cases, Docket Nos. 10-035-124 and 11-035-200, the Division presented additional or new evidence and information not considered in Docket Nos. 07-035-93 or 09-035-23. Based on the conclusions presented above and this new information, the Division recommends adoption of the Company's methodology of escalating the four historical values prior to averaging.

Q: WAS THIS NEW INFORMATION FULLY CONSIDERED IN THOSE PREVIOUS RATE CASES, DOCKET NOS. 10-035-124 OR 11-035-200?

A: No. The settlements in those dockets did not address or resolve the GOE estimation issue.

ALTERNATIVE METHODOLOGIES

Q: WOULD YOU PLEASE EXPLAIN THE NATURE OF THE INFORMATION YOU PRESENTED IN THE THOSE PREVIOUS RATE CASES, DOCKET NOS. 10-035-124 AND 11-035-200?

A: Yes. I presented two alternative methods for estimating the test period GOE, namely, escalating the average of the four historical values, the method approved by the Commission in Docket No. 07-035-93; and the Company's then (and now) proposed method, averaging the escalated or restated four historical values. For convenience, I refer to these two methods respectively as Method 1 and Method 2. I compared the accuracy of these two methods using standard statistical techniques and the implications of each method on forecasting the Company's test period GOE.

Q: WHAT CONCLUSIONS DO DRAW FROM THIS NEW INFORMATION?

A: The statistical analysis and economic theory indicate that Method 2, the Company's proposed methodology, is a superior method for forecasting GOE.

Q: WOULD YOU EXPLAIN THE NATURE OF THAT EVIDENCE AGAIN FOR THE RECORD IN THIS DOCKET?

A: Yes. In past rate cases, parties have in general advocated one of two methods to forecast GOE. As I previously explained, the first method, Method 1, inflates the average of four historical values. For example, if G_1, G_2, G_3, and G_4 are the observed or actual historical annual GOE values, then the fifth or test period GOE, G_5, is estimated as,

$$\hat{G}_5 = \frac{(1+\pi)}{4}\left[G_1 + G_2 + G_3 + G_4\right] = \frac{(1+\pi)}{4}\sum_{i=1}^{4} G_i \qquad (1)$$

where π is the rate of inflation.[2]

The alternative method, Method 2, averages the inflated historical values to estimate the test period value. That is,

$$\tilde{G}_5 = \frac{1}{4}\left[G_1(1+\pi)^4 + G_2(1+\pi)^3 + G_3(1+\pi)^2 + G_4(1+\pi)\right] \qquad (2)$$

Or simply,

$$\tilde{G}_5 = \frac{1}{4}\sum_{i=1}^{4} G_i\,(1+\pi)^{5-i} \qquad (3)$$

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[2] In previous cases some parties have advocated using the average of the four historical values without any inflation or escalation factors, which is the method specified by the Commission in Docket No. 09-035-23. That method is a special case of Method 1 and amounts to setting the inflation rate, π, in Equation 1 to zero. The more general model as described in Equation 1 provides a general solution here for completeness. Its use does not change the qualitative results or conclusions described herein.

Of these two methods, economic and statistical theory suggests that Method 2 is on average more accurate.[3, 4] That is, on average, the estimator described in Equation 3 will produce better estimates of the GOE than the estimator described in Equation 1.

ECONOMIC CONSIDERATIONS

Q: WOULD YOU EXPLAIN WHY ECONOMIC THEORY SUPPORTS METHOD 2?

A: Economic theory suggests that in order to compare two values separated by time, the values need to have a common monetary base. That is, the values should be expressed in real terms, where the effects of inflation are taken into account, as opposed to nominal terms. Comparing values expressed in nominal terms—ignoring inflation—can lead to erroneous conclusions.

For example, suppose we bought a particular item in the year 2000, for $30; and another person bought the same item in 2010 for $50. Who paid more for the item? In a nominal sense, the second person paid more: $50 is greater than $30. However, a nominal comparison such as this ignores the effect of inflation on the purchasing power of the dollar between the two periods and can lead to erroneous conclusions. The proper comparison would take into account the effects of inflation using a price index—such as the Consumer Price Index—to

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[3] One could use different inflation rates in restating or escalating the four historical values. For example, for G_i, an inflation rate of π_i could be used to restate that value to a common base, e.g., $G_i(1 + \pi_i)^{5-i}$. Alternatively, different inflation rates for each period could be applied to bring each value to a common base. Using either method would complicate the presentation but would not change the qualitative results. Therefore, for simplicity, the following presentation assumes a single or common inflation rate. It is important to note that in its filing the Company did use specific annual inflation rates in its formulation.

[4] Method 2 differs slightly from the Company's proposed method. In the Company's method the historical values are brought to a common base year short of the test period or period 5 described in Equation 2: the Company only escalates the historical values to the base year, the 12 months ending June 2013. As with the differences from past proposals and Method 1 (see discussion in footnotes 2 and 3), for purposes of this presentation the more general specifications in Equations 1 and 3 are inclusive of these other proposals. Again, these differences would not affect the qualitative conclusions or results presented herein.

either deflate the 2010 value to 2000 dollars; or, inflate the 2000 value to 2010 dollars. Suppose the price index in 2000 was 1.00 and in 2010, the price index was 1.75. Then, the $30 price paid in 2000 would be equivalent to $52.50 (=1.75*$30) in 2010. Thus, in this example, the person buying the item for $50 in 2010 actually paid less in real terms than the person paying $30 in 2000.

By inflating each of the historical values to a common base, Method 2 properly takes into account the effects of inflation before making a comparison (or forecast) to the test year.

STATISTICAL CONSIDERATIONS

Q: WOULD YOU EXPLAIN HOW STATISTICAL THEORY SUPPORTS METHOD 2?

A: Yes. To demonstrate how statistical theory supports the use of Method 2 over Method 1, consider the following specification of the annual generation overhaul expense. Let the generation overhaul expense, G, for year "i" be specified as,

$$G_i = H_i + \varepsilon_i \qquad (4)$$

where,

G_i = the actual or observed generation overhaul expense for period "i";

H_i = the base or unobserved (unknown) generation overhaul expense for period "i";

εi = a random error (shock) term with a mean zero and standard deviation σ_ε; and

$H_i = H_{i-1} (1 + \pi)$.

On average, under this specification, Method 1, $\hat{G}_5$, Equation 1, will likely underestimate the GOE in the test period, whereas, Method 2, $\tilde{G}_5$, Equation 2 or the Company's method, will on average equal the test period value. That is,

$$E\left(\hat{G}_5\right) \;=\; \theta * H_5 \;\leq\; H_5 \qquad (5)$$

where E(•) is the linear expectation operator, and θ is a constant between zero and one:

$$\theta \;=\; \frac{1}{4}\left[1 \;+\; (1+\pi)^{-1} + (1+\pi)^{-2} + (1+\pi)^{-3}\right] \qquad (6)$$

The Expectation operator, E(•), can be read as "on average." Thus, Equation 5 indicates that on average, Method 1 will underestimate the test period value H_5. Whereas,

$$E\left(\tilde{G}_5\right) \;=\; H_5 \qquad (7)$$

That is, Method 2 on average will equal the test period value. DPU Exhibit 2.1 DIR-RR provides a derivation or demonstration of Equations 5 through 7.

In summary, Method 2 will on average yield a more accurate result and, thus, is the preferred method for forecasting the GOE for the test year. Therefore, the Division recommends that the Commission adopt the Company's methodology for forecasting the GOE.

GOE Model Simulation

Q: DO YOU HAVE ANY OTHER EVIDENCE THAT METHOD 2 IS LIKELY TO PROVIDE A BETTER ESTIMATE OF THE TEST YEAR LEVEL OF GENERATION OVERHAUL EXPENSE?

A: Yes. I have simulated the two estimation methods for the model previously defined in Equation 4. Since the simulation is relatively large—10,000 replications—I provide the full simulation only in electronic form as part of my pre-filed testimony. However, I provide a summary of the simulation in DPU Exhibit 2.2 DIR-RR attached to my testimony.

To perform the simulation I chose a value for Year 1's base or unobserved value, H_1, of 1,000 and an inflation rate of three percent. Given the model specified herein, these assumptions yield a fifth year base value, H_5, of 1,126, which is the value to estimate using the first four values. To generate the observed values, G_i, for the four historic years, I used the RAND() function in EXCEL© to generate random deviates, which were added to the four historic base values.

Under these conditions, Method 1 underestimates the fifth year value 95% of the time; whereas, Method 2 underestimates the fifth year value as expected approximately 50% of the time. The root mean squared error, RMSE, of the estimates from the two methods also indicate that Method 2 provides a better estimate on average—the RMSE for Method 1 is approximately two times as large as the RMSE for Method 2.[5]

The simulation confirms the conclusions drawn from the statistical modeling (and economic reasoning), namely, Method 2 provides a better estimate of the test year value. See *Table 1* for a summary of the simulation results.

[5] The RMSE is similar in calculation and interpretation as the sample standard deviation.

Table 1: GOE Model Simulation (10,000 Replications)

	Average Estimate	Minimum Estimate	Maximum Estimate	RMSE	Number Under Estimated	Percent Under Estimated
Method 1	1,078	987	1,166	56	9,496	94.96%
Method 2	1,126	1,031	1,218	31	5,046	50.46%

NET PREPAID PENSION ASSET

Q: WILL YOU SUMMARIZE THE PREPAID PENSION ASSET ISSUE?

A: In direct testimony, the Company’s witness Mr. Stuver requests that the Commission allow the Company to earn a return on its net prepaid pension asset (NPPA) by including the cumulative balance in rate base.

The NPPA is the cumulative difference in the Company’s cash contributions to the pension fund and its pension expense. The balance the Company requests it be allowed to include in rate base is the net of two items: (1) the ERISA prepaid pension cash contributions in excess of its FAS 87 expense, net of the accumulated deferred income tax (ADIT); and (2) the cumulative excess other postretirement welfare expense over its cash contributions, net of ADIT. According to the Company’s witness, Mr. McDougal, the test year NPPA balance on a total Company basis is approximately $162 million or on a Utah basis approximately $69 million. The majority of the $162 million, approximately $312 million excluding ADIT, is attributable to the excess of the ERISA contributions over the FAS 87 expense. (See Exhibit RMP_(SRM-3), pp. 8.14, 8.14.1).

The Utah revenue requirement is approximately $7.5 million. (See Exhibit RMP_(SRM-3), p. 8.0.3)

Unlike other rate base additions or assets, the Company is only seeking to recover the return *on* the asset—what the Company characterizes as a financing expense—and not the return *of* the asset. In part, this is because over the life of the pension the ERISA contributions should equal the FAS 87 expense. However, unlike other rate base assets, the NPPA will not decline—depreciate or amortize—by an appreciable amount in the near future.

According to the Company's response to DPU data request 39.13, the net prepaid asset before ADIT in 2013 was approximately $280 million and is forecasted to decline to approximately $268 million in 2023, a decrease of only approximately $12 million, 4.4%, or an average annual decline of less than 0.5%. (See DPU Exhibit 2.3 DIR-RR, Pension Asset Timeline)

Q: WILL YOU PLEASE SUMMARIZE THE DIVISION'S POSITION AND RECOMMENDATIONS ON THE COMPANY'S REQUEST TO INCLUDE IN RATE BASE THE CUMULATIVE NET PREPAID PENSION ASSET?

A: In general, prepayments are costs the Company incurs in advance of recovery from ratepayers. Conceptually, the Division supports the inclusion in rate base of such prepaid costs that the Company incurs in providing service to its customers.

However, in the instant case, the Division believes that the Company has failed to demonstrate the reasonableness of its proposal to include in rate base the NPPA balance. For reasons stated herein, the Division concludes that the Company has not provided adequate proof for the Commission to justify changing the regulatory treatment or recovery of related pension costs and recommends at this time that the Commission deny the Company's request to include its NPPA in rate base for the purposes of earning a return.

Q: WOULD YOU SUMMARIZE THE DIVISION'S BASIS FOR ITS RECOMMENDATION?

A: Prior to 1999, ratemaking tied the recovery of the Company's pension costs—the cost included in rates—to the Company's cash contributions to the pension fund.

In Docket No. 00-035-10, the Commission approved a change to the current accrual accounting methodology under FAS 87. In the current case, the Company is once again asking the Commission to change the methodology (or policy) for recovering pension costs. In essence, the Company is asking the Commission to adopt a hybrid methodology where rates would include not only the expected FAS 87 expense, but also a return on its NPPA. One would expect that a utility asking for such change would provide the Commission with substantial evidence upon which to base a decision. To the contrary, the Company's testimony fails to explore several potentially important issues for the Commission.

For example, the Company claims that the prepaid pension asset or balance is shareholder funded, yet the Company's testimony and exhibits fail to address this crucial claim in any meaningful way. The Company's testimony also fails to address other pertinent questions including,

1. Whether allowing recovery of the "carrying charge" or "financing costs" on the cumulative balance beginning now creates inequities due to past pre-payments by ratepayers that may have been uncompensated or treated in a dissimilar manner;
2. What portion, if any, of the prepaid contributions' amount included in RMP's filing may have been borne by ratepayers under different regulatory treatment in the past;
3. What benefits, if any, flow to customers from the Company's prepaid pension contributions, including an understanding of the ratemaking or rate impact implications of the disparate treatments of the contributions and expenses as governed by the ERISA and FAS 87 or other applicable rules or laws;

4. Whether income generated from pension assets has actually reduced the Company's pension expense for those years included in the Company's current cumulative prepaid pension asset;
5. What are the implications of negative pension expenses for the Company and rate payers;
6. Whether pension expense should continue to be included in the determination of cash working capital;
7. What precedent might support the Company's proposal; and
8. Given the potential for long-term residence on the balance sheet what is the appropriate return, if any, to allow on prepaid pension amounts (i.e. WACC, short-term or long-term debt rate, etc.)

Q: WOULD YOU EXPLAIN THE BASIS OF YOUR GENERAL SUPPORT FOR THE RECOVERY OF THE NPPA COSTS FROM RATEPAYERS?

A: In addition to the fact that other prepaid assets are included in rate base, the FERC appears to allow, "as a general matter," prepaid pension assets in rate base as part of a utility's OATT:

> As a general matter, it is appropriate to include prepayments in rate base when they represent amounts that a utility has paid for costs that are allowed to be collected in rates in the future, such as for prepaid insurance or prepaid rent. This is because the utility is out-of-pocket for such costs until they are recovered from ratepayers and is therefore entitled to recover its cost of financing such prepaid expenses. . . . prepaid pensions arise when the income earned on pension funds accumulated in an external trust exceeds the net periodic pension cost . . . By law, a utility cannot withdraw such income, although it is required (under Generally Accepted

> Accounting Principles) to reflect the income as a reduction to its pension expense . . . At the same time, the utility records a corresponding amount of prepaid pensions. If that reduction in pension expense is used in determining a utility's rates, there will be a corresponding reduction in the amounts collected from ratepayers. Because a utility cannot withdraw the pension income, it will be out-of-pocket for the amount of pension income that has reduced rates, i.e., it must reduce its pension expense by the amount of income, even though it is not allowed to receive such income from the pension trust. Thus, when a utility's rates have been reduced by pension income, but the utility has not received such income from the external trust, it will have to finance such amount, and is entitled to include the pension income in rate base.[6]

In other words, as I understand the FERC order, if the income earned by the Company's external pension fund reduces the Company's FAS 87 expense, and the Company does not receive a corresponding income credit, then FERC would allow the Company to rate base its pension asset to recover its financing costs.

Q: DID THE COMPANY DEMONSTRATE OR SHOW THAT THE INCOME FROM PENSION FUND HAS REDUCED THE COMPANY'S PENSION EXPENSE FOR THE YEARS COVERED BY THE NPPA?

A: The Company made no attempt in its direct testimony to demonstrate that ratepayers have benefitted through a reduction in its FAS 87 expense.

[6] See, "Order on Tariff Filing," Southern Company Services, Inc., Docket Nos. ER08-129-000 and ER08-129-001, March 10, 2008, pp. 8-9. Internal references omitted.

Interestingly, in the FERC case previously cited, the FERC disallowed in part the Southern Company's request because it had failed to demonstrate just such a relationship:

> Southern Companies' Attachment C . . . shows that, between 2003 and 2006, Southern Companies reduced their pension expense by $320,623,404. . . . the Commission concludes that Southern Companies have justified inclusion of the jurisdictional portion of such prepaid pensions in rate base. Therefore, we will accept Southern Companies' filing to the extent that they seek to include the jurisdictional portion of prepaid pension assets accrued since May 2003 in rate base.
>
> However, Southern Companies have not justified inclusion of any other prepaid pension amounts that they seek to include in rate base. . . . Southern Companies do not address, either in their original filing, or in their response to Staff's deficiency letter, how amounts included in prepaid pensions **actually** reduced transmission rates for years prior to May 2003. . . . Therefore, the Commission finds that it is not just and reasonable for Southern Companies to include any amounts related to prepaid pensions accumulated prior to May 2003 in rate base under Southern Companies' OATT.[7]

[7] See, "Order on Tariff Filing," Southern Company Services, Inc., Docket Nos. ER08-129-000 and ER08-129-001, March 10, 2008, pp. 9-10. Emphasis added; internal references omitted.

Q: **HAS THE COMPANY SUBSEQUENTLY PROVIDED ANY EVIDENCE THAT INCOME FROM THE PENSION HAS REDUCED ITS PENSION EXPENSE?**

A: Yes. In response to DPU data request 39.4, the Company did provide an accounting of how the expected pension income acts as a reduction in revenue requirement in the current case. The Company's response demonstrates that the expected returns on the pension fund reduce the test year FAS 87 expense on a total Company basis by approximately $76 million and the overall pension expense $74 million. On a Utah basis, the reduction is approximately $32 million for the FAS 87 expense and $31 million for the overall pension expense.

Q: **HAS THE COMPANY PROVIDED SIMILAR EVIDENCE FOR YEARS PRIOR TO THE TEST YEAR?**

A: No, at least not as directly as provided in DPU data request 39.4. However, in response to DPU data request 39.8, the Company provided limited evidence that income from the pension fund potentially reduced pension expense in the past. The Company's response shows that from 1997 through 2013, the expected returns from the Company's cumulative pension contributions were approximately $76.7 million.

However, given the timing of rate cases and test years, it is not possible to conclude that the entire amount produced a reduction in the Company's revenue requirement as reflected in actual rates or for which years rates captured the related benefits. For example, if there were several years between rate cases, then rates for one or more years would not pick up or reflect the reduction and, thus, the actual cumulative reduction in revenue requirement is likely to be somewhat less than $76.7 million. Of course, this is not different from any reduction or increase in an expense between rate cases: rates do not capture or reflect changes—increases or decreases—between rate cases.

The DPU concludes that the Company's response to DPU 39.8 demonstrates the potential maximum benefit rate payers received from pension income and not the actual reduction to the FAS 87 expense reflected in rates.

Q: IF THE COMMISSION DECIDES TO ALLOW THE NPPA IN RATE BASE, ARE THERE OTHER CONSIDERATIONS OR RECOMMENDATIONS THAT IT SHOULD CONSIDER?

A: Yes. There are two additional concerns that the Division would stress. First, the NPPA is the cumulative difference between the Company's cash contributions to the pension fund and its pension expense. Of the two sides of the NPPA, the cumulative cash contributions, approximately $312 million, through the test year, are the largest component. Thus, it appears that the issue of the NPPA is a cash flow issue more than a traditional or typical investment. Therefore, the Division would recommend the use of a lower return than the weighted cost of capital to determine the financing costs.

Second, the test year NPPA balance is the cumulative difference between the pension cash contributions and the expenses from approximately 1993 through the test year. For many years, the cumulative balance was negative. For example, in 1998, the balance was a negative $71.5 million. If the NPPA balance had been included in rate base at the time the Commission approved switching from cash accounting to accrual accounting, ratepayers would have benefitted from lower rates. Therefore, if the Commission allows the NPPA in rate base in this docket, the fact that the test year balance is composed of negative as well as positive past balances warrants an adjustment.

Q: WHAT INTEREST RATE WOULD THE DIVISION RECOMMEND BE APPLIED TO THE NPPA IF IT IS ALLOWED IN RATE BASE?

A: The Division recommends the application of the Company's average long-term debt rate.

Q: WHY THE LONG-TERM DEBT RATE?

A: There are two primary reasons. First, as I previously explained, the Company projects that the NPPA balance will decline very little over the 10 years. (See DPU Exhibit 2.3 DIR-RR) While the cash contributions and expenses will equal one another over the life of the pension plan, the inclusion of the NPPA will require ratepayer financing until the balance begins to decline and, eventually reaches zero. Once included in rate base, there seems little risk in recovery of the financing costs. That is, removal of the NPPA would be unlikely once the Commission authorized its inclusion in rate base.

Second, the NPPA is also unique as a rate base item. Unlike a typical hard asset, such as a power plant, the NPPA does not have a predictable depreciation or amortization schedule. Furthermore, unlike a typical investment made to generate income for its shareholders, the Company's NPPA arises from its excess cash contributions to the pension fund in order to meet its future pension and other welfare employee obligations. In the long-run, those cash contributions will decline until over the life of the pension, they are equal on a cumulative basis to the expenses that the Company incurs. In essence, the NPPA, which can be both positive and negative, acts more like a balancing account than an investment in a hard asset. Balancing accounts typically utilize a lower interest rate than rate base investments.

Q: WHAT ADJUSTMENT WOULD THE DIVISION RECOMMEND IF THE COMMISSION ALLOWS THE NPPA IN RATE BASE?

A: The Division recommends offsetting the revenue requirement impact, approximately $7.5 at the Company's requested rate of return, by approximately $4.2 million on a Utah basis.

Q: WOULD YOU EXPLAIN THE BASIS FOR THE $4.2 MILLION?

A: In a supplemental response to DPU data request 39.12, at the DPU's specific request, the Company provided an analysis of the NPPA as if it had been included in rate base from 1993 through August 2014, essentially the beginning of the test year. This analysis shows that in constant or real dollars, the revenue requirement impact of those past balances is a decrease of $4.2 million. (See DPU Exhibit 2.4 DIR-RR)

Q: WOULD YOU EXPLAIN WHAT YOU MEAN BY REAL DOLLARS?

A: Similar to the methodology for the GOE, the analysis in DPU 2.4 inflates each annual revenue requirement to 2014 dollars using the consumer price index. For example, the revenue requirement decrease in 1997 was approximately $1.3 million on a Utah basis. In 2014 dollars, the 1997 revenue requirement decrease is approximately $2.0 million. The $4.2 million adjustment represents the sum of the real dollar revenue requirements from 1993 through August 2014.

Q: HOW LONG WOULD THE ADJUSTMENT BE REFLECTED IN RATES?

A: The adjustment recognizes the fact that the current NPPA balance is the cumulative difference in cash contributions and expenses. From 1993 through 2007, the NPPA balance was negative. The adjustment would constitute a onetime offset to the Company's revenue requirement in recognition of these facts.

If the Commission decides to adopt this adjustment, the adjustment would be reflected in rates until the next general rate case. For example, if the Company files a rate case next January, the adjustment would be in place for approximately one year.

CONCLUSION

Q: WOULD YOU CARE TO SUMMARIZE YOUR RECOMMENDATIONS?

A: Based on the Division's investigation in this case, the Division has made a number of adjustments in this case as part of its direct testimony. The total impact of these adjustments indicates that the Company's revenue requirement request should be reduced by approximately $76 million; including the Company's net power cost update, the reduction is approximately $81 million from the Company's requested increase. Overall, the Division recommends that the Company's revenue requirement be reduced by approximately $5 million.

For my part, I have presented testimony on two issues: generation overhaul expense (GOE) and rate basing the Company's net prepaid pension asset (NPPA). This is not the first presentation of the GOE issue in testimony. However, I provide new evidence that the Commission has not before considered. Based on this evidence, the Division supports and recommends that the Commission adopt the Company's methodology for forecasting GOE.

After considering the Company's request to include its NPPA in rate base to recover its financing costs, the Division concludes that the Company's testimony fails to meet its burden of proof on this important issue, leaving many issues unaddressed. While the Division is conceptually supportive of the Company's request, the Division recommends that the Commission deny the Company's request at this time.

As an alternative, if the Commission is inclined to allow the inclusion of the NPPA in rate base, the Division recommends that the Company's long-term debt rate apply for the purpose of calculating the return and a onetime reduction in the Company's revenue requirement in the amount of $4.2 million.

Q: DOES THAT CONCLUDE YOUR DIRECT REVENUE REQUIREMENT TESTIMONY?

A: Yes.