

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Voluntary)	
Request of Rocky Mountain)	
Power for Approval of Resource)	DOCKET NO. 14-035-147
Decision and Request for)	Exhibit No. DPU 2.0 DIR
Accounting Order)	
)	Direct Testimony of
)	Charles E. Peterson
)	
)	

**FOR THE DIVISION OF PUBLIC UTILITIES
DEPARTMENT OF COMMERCE
STATE OF UTAH**

**Direct Testimony of
Charles E. Peterson**

March 17, 2015

REDACTED

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Direct Testimony of Charles E. Peterson

I. INTRODUCTION

Q. Please state your name, business address and title.

A. My name is Charles E. Peterson; my business address is 160 East 300 South, Salt Lake City, Utah 84114; I am a Technical Consultant in the Utah Division of Public Utilities (Division, or DPU).

Q. On whose behalf are you testifying?

A. The Division.

Q. Would you summarize your background for the record?

A. I am currently a Technical Consultant for the Division. I have been employed by the Division for 10 years, during which time I have filed testimony and memoranda with the Commission involving a variety of economic, financial and policy topics.

Most significant for this matter, I was the principal witness for the Division in the 2009 Energy Cost Adjustment Mechanism matter, Docket No. 09-035-15, which gave rise to the Energy Balancing Account (EBA) mechanism currently enjoyed by PacifiCorp (Company).

23 I have an M.S. in Economics and Master of Statistics degree, both from the University of
24 Utah. My resume is attached as DPU Exhibit 2.1 DIR.

25

26 **Q. What is the purpose of your testimony in this matter?**

27 A. I present the Division's position regarding PacifiCorp's request to use the EBA mechanism
28 as a pass through for certain items of plant and equipment that are no longer in service (the
29 stranded investment) and that those items earn a rate of return equal to the Company's
30 weighted average cost of capital instead of the 6.0 percent authorized in the EBA. Finally, I
31 give an overview of the Division's recommendation on what to do with the stranded
32 investment.

33

34 **Q. Please outline your testimony.**

35 A. First, I will briefly outline the Division's understanding of the Company's proposal is to use
36 the EBA mechanism as a pass through for stranded investment costs. Then I will briefly
37 describe the EBA instituted by the Public Service Commission (Commission) focusing on
38 comments made by the Commission in its Order regarding the sharing bands. In this part I
39 will discuss the Division's understanding of the purpose of the sharing bands, which were
40 part of the Division's recommendation in Docket No. 09-035-15 (EBA Docket). Following
41 that I will discuss why the Division believes that it is completely inappropriate to make use
42 of the EBA mechanism in the manner proposed by the Company. Finally, I will give an
43 overview of the Division's recommendation regarding the stranded investment.

44

45

46 **II. THE COMPANY'S EBA PROPOSAL.**
47

48 **Q. What does the Company propose to do with the EBA?**

49 A. The Company proposes to use the EBA mechanism to include Utah's portion of the annual
50 amortization that the Company proposes to accrue on the stranded investment. This
51 amortization rate is equivalent to the annual depreciation the assets were accruing while still
52 functioning as plant in service.¹ The Company proposes to add this amortization expense to
53 the EBA deferred balance without the application of the 70-30 percent sharing bands ordered
54 by the Commission in its EBA Order.² The Company also wants to accrue and collect
55 interest on the Utah portion of this amortization of the stranded investment in the EBA at the
56 Company's authorized³ weighted average cost of capital⁴ rate rather than the 6.0 percent rate
57 on EBA balances that the Commission ordered in the EBA.⁵

58

59 The Company proposes that this amortization expense for calendar year 2015 be included in
60 the Company's EBA filing in March 2016, and included for a partial year in 2016 in the
61 Company's March 2017 filing. The Company is requesting that the remaining balance, net of
62 the amortization that was run through the EBA, of the stranded costs at the time of the rate

¹ Confidential Direct Testimony of Company Witness Douglas K. Stuver, lines 161-163.

² Ibid., lines 165-168.

³ In the last General Rate Case, Docket No. 13-035-184, the Commission authorized a weighted average cost of capital rate of 7.57 percent.

⁴ In response to Division DR 4.3 the Company stated "Thus, until the next general rate case, the Company is requesting a return using its authorized weighted average cost of capital to recover its financing costs."

⁵ Public Service Commission, Corrected Report and Order, Docket No. 09-035-15, March 3, 2011, page 76.

63 reset in (presumably) the latter part of 2016, “to be recovered over a period approved by the
64 Commission.”⁶

65

66 **Q. What is included in the stranded investment?**

67 A. For this part of the Resource Decision, the Company wants to recover the net book value of
68 the Deer Creek Mine assets, a coal preparation plant at the Hunter power plant, a warehouse,
69 and some remaining assets associated with the already closed Trail Mountain Mine. The
70 Company’s application in this docket gives the net book value of these assets as [REDACTED].⁷
71 The Company estimates that Utah portion of the depreciation and depletion of these assets
72 will amount to approximately \$9.46 million if recovery is ordered in 2015.⁸

73

74 **III. CURRENT PACIFICORP EBA**

75 **Q. Please briefly describe the EBA as the Commission approved it in EBA Docket.**

76 A. The current EBA specifies the accounts that are included in the Company’s NPC
77 calculations. The Division had referred to this as an “all in”⁹ approach since virtually all
78 costs that the Company has traditionally included in NPC are part of the EBA calculations.
79 The first step is to take the forecast NPC that are determined in the latest general rate case
80 and convert them to a dollar per megawatt-hour (\$/MWh) rate using the forecast load for the
81 test year in the general rate case. This \$/MWh rate derived from the general rate case sets the

⁶ Stuver, Op. Cit. lines 169-170.

⁷ See the Company’s Application, page 16.

⁸ Provided by the Company in DPU DR 4.1.

⁹ See “Response of the Division of Public Utilities to Rocky Mountain Power’s Request for Clarification and Reconsideration or Rehearing” Docket No. 09-035-15, May 2, 2011, fn. 1, page 2.

82 “base” for the EBA. In the subsequent calendar year, the Company tracks the actual NPC and
83 files with the Commission each March for the difference between the Utah base EBAC
84 \$/MWh and the actual EBAC as measured in \$/MWh. This difference in \$/MWh is then
85 multiplied by the actual Utah sales (MWh) to give a gross EBA deferral amount. The 70
86 percent figure is the sharing band rate approved by the Commission. If the actual \$/MWh
87 was greater than the base \$/MWh, the Company recovers 70 percent of the difference. If
88 actual \$/MWh was less than the base \$/MWh, the Company returns to customers 70 percent
89 of the difference (the Company keeps 30 percent of the benefit). The 70-30 percent figures
90 are the sharing band percentages approved by the Commission. The difference between the
91 base NPC and the actual NPC accrues interest at a 6.0 percent rate.¹⁰

92

93 **Q. What was the purpose and significance of the 70-30 sharing band ordered by the**
94 **Commission as part of the EBA mechanism?**

95 A. The Commission in its Corrected Report and Order dated March 3, 2011 states the following:

96 As in the past, we will continue to rely on prudence reviews during rate
97 setting proceedings to determine the extent to which the Company is
98 providing least-cost, risk-adjusted service to its Utah customers, consistent
99 with integrated resource planning and competitive solicitation analyses.
100 We recognize, however, relying solely on prudence reviews will shift too
101 much of the risk for suboptimal planning and operation currently borne by
102 the Company, who is in the best position to manage this risk, to customers,
103 who are not. Therefore, the balancing account we adopt requires both
104 Company customers and shareholders to remain at risk for a portion of the
105 actual net power cost which deviates from approved forecasts. This
106 decision recognizes the value of Company management having
107 meaningful financial incentives to minimize net power cost in the short-

¹⁰ For the specific details of the EBA see the Company’s Utah Electric Service Schedule No. 94 and the Commission’s Corrected Report and Order in Docket No. 09-035-15 issued March 3, 2011, especially pages 63-81.

108 run and long-run, regardless of the extent of net power cost volatility. We
109 find a sharing mechanism is the best method, at this point, to ensure
110 customer and shareholder interests are aligned and the public interest is
111 maintained.

112
113 Parties proposing risk sharing recommend, at a minimum, a 70-30
114 percentage sharing between customers and shareholders, respectively, of
115 differences between the forecasted and actual net power cost which are
116 subject to the balancing account mechanism. Based on the arguments
117 presented in this case, we agree. We find this design component provides
118 an appropriate sharing of risk for the pilot period based on the principle of
119 gradualism, especially given the difficulty in identifying controllable and
120 uncontrollable components of net power costs. Currently, when using
121 forecasted net power costs to set rates, both customers and shareholders
122 face 100 percent of the risk that actual costs will differ detrimentally and
123 substantially from forecasted costs. This is a zero sum game, where all
124 benefits flow to one group (customers or shareholders) at the expense of
125 the other. A balancing account designed to include the 70-30 sharing
126 component described above for the approved net power costs will dampen
127 this risk and improve the fairness of outcome for both customers and
128 shareholders. We will review this level of sharing at the conclusion of the
129 pilot period to determine whether it continues to be reasonable.¹¹
130

131 **Q. Pursuant to the Commission’s Corrected Report and Order issued on March 3, 2011,**
132 **the Division filed its Preliminary Evaluation Report (Report) on the EBA pilot**
133 **program. In response, did the Company lobby the Commission to do away with the**
134 **sharing bands?**

135 A. Yes. The Company recommended that the EBA could be “improved” by, among other things,
136 eliminating the sharing bands.¹²

¹¹ Corrected Report and Order, pages 69-70.

¹² “Order on the EBA Pilot Program Preliminary Evaluation Report and Acknowledging a Stipulation Commitment Fulfillment,” Docket Nos. 09-035-15 and 14-035-31, page 6, issued February 19, 2015.

137

138 **Q. Did the Commission adopt the Company's recommendation?**

139 A. No. Broadly, the Commission stated that it agreed with the Division and Office that it was
140 premature to make any changes to the EBA.¹³ The Commission did note that "Due to
141 resource constraints, the Division relies on examining a small sample of transactions and on the
142 work of a consultant's review [to determine prudence of energy-related transactions]. The
143 Division states it relies on the 70/30 sharing mechanism to have confidence the Company acts
144 with prudence. The Division concludes it is premature to make changes to the 70/30 sharing
145 mechanism."¹⁴

146

147 **Q. What was the Division's position regarding the 70-30 sharing band in EBA Docket?**

148 A. The Division supported the 70-30 sharing band.

149

150 **Q. Has the Division's position regarding the 70-30 sharing band changed since the EBA**
151 **Docket?**

152 A. No. The Division continues to believe that the 70-30 sharing band is an integral, necessary
153 part of the EBA in order for the EBA to be in the public interest. The Division, and some of
154 the other parties in the EBA docket had recommended the 70-30 sharing band.

155

156

¹³ Ibid., pages 8-9.

¹⁴ Ibid., page 6.

157 **IV. THE DIVISION POSITION ON THE COMPANY'S PROPOSAL**
158
159

160 **Q. Does the Division believe that the Company is necessarily recovering 100 percent of the**
161 **stranded investment depreciation in the current NPC base rates?**

162 A. No. This is an assumption promoted by the Company.¹⁵ As evidence in support of that
163 assumption the Company, in response to a Division data request DR 6.1, refers to a GRID
164 run that it made after the agreement by the parties of the total Utah NPC was reached in the
165 amount of \$630 million in the general rate case Docket No. 13-035-184. The Division's view
166 is that the Settlement in the general rate case Docket No. 13-035-184 was for Utah's
167 allocated NPC and Utah's base EBAC rate(\$/MWh).¹⁶ The Company then manipulated a
168 GRID run by adjusting system balancing purchases¹⁷to make the bottom line match the NPC
169 settlement. The finer details of the Company's adjusted GRID run were not part of the
170 Settlement and were not approved by the Commission.

171
172 **Q. At a high level were any results of the Company's adjusted GRID run included in the**
173 **stipulation in Docket No 13-035-184?**

174 A. Page 2 of Exhibit A in the stipulation in Docket No. 13-035-184 shows total Company NPC
175 and Utah allocated NPC by certain NPC *categories*. For example, the exhibit shows Fuel

¹⁵ Implicit in the Company Response to DPU DR 4.1 and subsequent explanation in its response to DPU DR 6.1.

¹⁶ See Settlement Stipulation, paragraphs 24-25, Docket No. 13-035-184

¹⁷ See DPU Exhibit 2.2 and Confidential DPU Exhibit 2.3. DPU Exhibit 2.2 is the Company's response to a DPU data request 6.1 which requested information regarding the origin of Hunter and Huntington fuel expenses the Company presumes to be in base rates. Confidential DPU Exhibit 2.3 is the Company's attachment response to DPU 6.1 which shows the result of the GRID run produced by the Company to match the settled Utah Base NPC and Utah Base EBAC (\$/MWh). Specifically the "a1 NPC" tab at line 237 of the GRID file shows the Company's adjustment to system balancing sales. Confidential DPU Exhibit 2.3 is provided in an electronic format only because of its size.

176 Expense as well as a “Fuel Consumed – Coal” line item. The numbers shown in Exhibit A
177 for these cost categories appear to be derived from the Company’s adjusted GRID run.
178 However, the details of that GRID run including the sub components of “Fuel Consumed-
179 Coal” were never specified in the Stipulation. Neither the run nor its components was agreed
180 to by the Division or the other parties as representing how the figures in the NPC categories
181 in Exhibit A were determined. Indeed the Settlement Stipulation itself states:

182 45. Not all Parties agree that each aspect of this Stipulation is
183 warranted or supportable in isolation. Utah Code Ann. §54-7-1
184 authorizes the Commission to approve a settlement so long as the
185 settlement is just and reasonable in result. While the Parties are not able
186 to agree that each specific component of this Stipulation is just and
187 reasonable in isolation, all of the Parties agree that this Stipulation as a
188 whole is just and reasonable in result and in the public interest.¹⁸
189

190 **Q. Theoretically, can the Company receive 100 percent recovery for any fixed assets in the**
191 **EBA? Please explain.**

192 A. Yes. However, such an event is unlikely: the likely outcome is that the Company will either
193 earn somewhat more, or somewhat less than a 100 percent recovery. Assuming that 100
194 percent recovery of fixed assured in base rates, after running actual NPC through the EBA,
195 the Company will earn more or less than 100. Table 1 sets forth two examples.

196

197

198

199

¹⁸ Ibid., paragraph 45.

TABLE 1

Hypothetical Company Recovery Rate
Through the EBA

Base Rate	\$100.00
Actual Rate	\$110.00
Company Recovery after Sharing Band	\$107.00
Company Recovery Percentage of Actual	97.27%
Company Recovery Percentage of Base	107.00%
Base Rate	\$100.00
Actual Rate	\$90.00
Company Recovery after Sharing Band	\$93.00
Company Recovery Percentage of Actual	103.33%
Company Recovery Percentage of Base	93.00%

200

201

202 The only time the Company would receive exactly 100 percent recovery of any fixed assets
203 in the EBA is (1) when the base rate provides for 100 percent recovery, and (2) the actual
204 rate is exactly equal to the base rate. Number (2) is an unlikely occurrence and historically
205 has never happened; that number (1) is true to begin with is probably an optimistic view of
206 the precision of regulation and rate making.

207

208 **Q. If the Deer Creek mine were to continue to operate until the end of its useful life, would**
209 **they Company have recovered 100 percent of the investment through depreciation**
210 **expense included in the Hunter and Huntington fuel cost expense in the EBA?**

211 A. As discussed in the previous question, while it is theoretically possible that PacifiCorp would
212 recover exactly 100 of its investment in the Hunter and Huntington fuel cost expense, in
213 practice, it is highly unlikely that that would occur.

214

215 **Q. What is the significance of the above analysis?**

216 A. The Company's request for recovery of 100 percent of the stranded investment amortization
217 through the EBA is based, at least in part, on the assumption that it was going to receive 100
218 percent recovery of the assets anyway through base rates and the EBA. The Division believes
219 that that assumption is unsupported and unlikely.

220

221 **Q. If 100 percent of the fixed costs are not necessarily being recovered through base rates
222 and the EBA, what is being recovered in the EBA?**

223 A. As explained below, the Division believes that the EBA is set up to assure the Company
224 recovery of, at least, the majority of its actual costs, not of its historical costs, or even of its
225 forecast costs.

226

227 To this point, the base NPC has been based upon a forecast of a future test year in a general
228 rate case. Once that forecast is set for the general rate case, it, in essence, becomes "cast in
229 stone." However, the Company's operations managers make changes and update their plans
230 as actual loads unfold, as prices for goods and services change, as people join or leave the
231 Company, etc. The forecast NPC, not to mention all other parts of the Company's cost
232 structure, is not expected to ever be exactly what actually occurs. Therefore, there is, and

233 always will be, a certain amount of “apples to oranges” comparison between the base NPC,
234 i.e. what is “in rates,” and the actual NPC. This includes so-called fixed costs as well as those
235 costs classified as variable. That there is a difference is just one of the risks taken by the
236 Company and ratepayers when dealing with forecast test years. Thus the true-up in the EBA
237 to actual NPC is a mechanism whereby the Company is able to recover a portion (at least) of
238 its actual NPC, regardless of what originally went into the forecast base NPC.

239

240 **Q. In addition to the comments from the Commission in the EBA Docket cited above, what**
241 **is the Division’s understanding of the purpose of the sharing bands?**

242 A. The Division understands the purpose of the sharing bands as primarily two-fold, both of
243 which were alluded to by the Commission in its Order. First, the sharing bands prevent the
244 complete shifting of risk to customers the inevitable variability in NPC. If PacifiCorp were
245 not a price regulated company, then it would not, in general, always be able to pass through
246 changes in its cost structure to its customers on a dollar-for-dollar basis, sometimes it might
247 not be able to pass through any cost changes. Since PacifiCorp is being compensated through
248 its authorized return on equity to assume at least some business risk, it is entirely appropriate
249 that its shareholder assume some of the risk in changes to its cost structure, even in NPC.

250 Second, cost recovery under regulation is not simply a pass through of costs to ratepayers,
251 rather the Company is given a reasonable opportunity to cover its costs and earn a fair return.
252 It is incumbent upon the Company to manage that opportunity to so as to actually earn that
253 fair return. As noted by the Commission above, Company management in the first instance
254 needs to continue to have incentives to keep costs as low as reasonably possible. All of these

255 arguments were previously made in the EBA Docket, and they remain equally applicable
256 today.

257

258 With regard to management incentives, the Division understood the sharing bands to be one
259 mechanism to encourage the Company to find ways to keep NPC at, or even below, the base
260 NPC between rate cases. If the Company's management found cost savings, then the
261 Company could keep a portion of those savings at least through the effective date of the next
262 general rate case.

263

264 In this docket, as set forth in its application, the Company has apparently found a way to
265 lower a portion of its NPC including through its proposed coal supply contract and closure of
266 the Deer Creek Mine. Within the context of the EBA, it was originally contemplated that any
267 such NPC savings would flow through the EBA mechanism and the Company would reap its
268 share of the savings. This is as it should be.

269

270 Therefore, the Division recommends that the Commission make no *ad hoc* changes to EBA,
271 but rather the Commission should allow the EBA to simply function as it was set up to
272 function.

273

274 **Q. The Company will likely raise several objections to this proposal, the first being that it**
275 **will be unable to recover the cost of its stranded investment. What is your response to**
276 **such a concern?**

277 A. The Division agrees that the Company has a reasonable claim to recover the stranded
278 investment costs. However, the Division does not accept that this recovery needs to or should
279 go through the EBA. The Division believes that another mechanism should be found for that
280 recovery.

281

282 The Division recommends that the Commission issue a deferred accounting ordered related
283 to the stranded investment that would allow the Company to bring forward the net book
284 value of the stranded investment for inclusion as part of its next general rate case, which is
285 expected to be filed in January 2016. The Division is not opposed to the December 31, 2014
286 net book values of the stranded investment being kept in place until the recovery of those
287 amounts can be determined in the next general rate case.

288

289 **Q. The Company may assert that it should earn a carrying charge on the stranded**
290 **investment until at least recovery begins. Would you care to comment?**

291 A. The Division believes that it has been earning a return on the stranded investment in its
292 current rates, and will continue to do so separately from any EBA adjustments until rates are
293 reset at the end of the next rate case. The replacement coal contract does not add anything to
294 rate base, and thus does not affect the Company's current earnings on rate base. Therefore,
295 there should be no carrying charge accrual to the stranded investment balance through the
296 end of the next rate case. In the rate case the Company is free to propose an incremental
297 portion of the return on investment that it may feel it is not recovering for Commission
298 consideration.

299

300 **Q. The Company may also object that a portion of the NPC related to the Hunter plant is**
301 **passed on to third parties, the minority owners of the plant. By not running the**
302 **stranded investment amortization through the EBA, the Company may argue that it is**
303 **not be able to pass on to those third parties a share of the stranded investment that it**
304 **otherwise would be able to pass on to them. The Company may be concerned that it**
305 **may not be able to find an alternative mechanism to pass those costs to the third party**
306 **to benefit ratepayers, or that the Commission may not allow the Company the full**
307 **recovery of those costs that were not passed on. Do you have a comment on these**
308 **concerns?**

309 A. Yes. As suggested above, between rate cases there are a myriad of occurrences that result in
310 actual outcomes not corresponding to the forecast of the test year in the general rate case.
311 Some of these actual outcomes potentially would have benefited ratepayers had there been a
312 dollar-for-dollar pass through mechanism for everything, some of these outcomes would
313 have benefited the Company and its shareholder. This is one of the risks of using a forecast
314 test year. The Division does not at this time see this potential issue as different from these
315 many other changes that occur between rate cases.

316

317 **V. CONCLUSIONS AND RECOMMENDATIONS.**

318

319 **Q. What is your conclusion?**

320 A. Making changes to the EBA, especially now, are inappropriate. The Company has not set
321 forth compelling reasons to change the EBA. The EBA should be allowed to run as it has
322 been set up. Changes to the EBA or its elimination may be proposed by the Company and
323 other parties at the conclusion of the EBA pilot period in a docket devoted to exploring
324 those issues. There are other avenues of recovery available to the Company for full
325 recovery of the stranded investment. As noted above, the Company could seek recovery in
326 the next rate case.

327

328 **Q. What is the Division's recommendation?**

329 A. The Division recommends that the Commission not make any adjustments to the EBA as it
330 currently stands. Specifically, there should be no costs run through the EBA outside of the
331 sharing bands.

332

333 With respect to the stranded investments, the Division recommends that the Commission
334 issue a deferred accounting order that would allow the Company to bring forward the
335 stranded investment amount and include it in its next general rate case that is anticipated to
336 be filed in January 2016. Recovery of the stranded investment amount can be determined
337 then.

338

339 **Q. Does this conclude your testimony?**

340 A. Yes.