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BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application of Rocky Mountain Power to Decrease the Deferred EBA Rate through the Energy Balancing Account Mechanism	**Docket No. 16-035-01**

PREFILED DIRECT TESTIMONY OF KEVIN C. HIGGINS

The Utah Association of Energy Users ("UAE") hereby submits the Prefiled Direct Testimony of Kevin C. Higgins in this docket.

DATED this 18th day of August 2016.

HATCH, JAMES & DODGE

/s/ _____
Gary A. Dodge
Attorneys for the Utah Association of Energy Users

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served by email this 18th day of August 2016 on the following:

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Direct Testimony of Kevin C. Higgins

On Behalf of the

Utah Association of Energy Users

August 18, 2016

I. INTRODUCTION AND SUMMARY

Q. Please state your name and business address.

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

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

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

Q. On whose behalf are you testifying in this proceeding?

A. My testimony is being sponsored by the Utah Association of Energy Users ("UAE").

Q. Please summarize your qualifications.

A. My academic background is in economics, and I have completed all coursework and field examinations toward a Ph.D. in Economics at the University of Utah. In addition, I have served on the adjunct faculties of both the University of Utah and Westminster College, where I taught undergraduate and graduate courses in economics. I joined Energy Strategies in 1995, where I assist private and public sector clients in the areas of energy-related economic and policy analysis, including evaluation of electric and gas utility rate matters.

Prior to joining Energy Strategies, I held policy positions in state and local government. From 1983 to 1990, I was economist, then assistant director, for the Utah Energy Office, where I helped develop and implement state energy policy.

From 1991 to 1994, I was chief of staff to the chairman of the Salt Lake County Commission, where I was responsible for development and implementation of a broad spectrum of public policy at the local government level.

Q. Have you previously testified before the Utah Public Service Commission ("Commission")?

A. Yes. Since 1984, I have testified in thirty-seven dockets before the Utah Public Service Commission on electricity and natural gas matters.

Q. Have you testified previously before any other state utility regulatory commissions?

A. Yes, I have testified in approximately 180 other proceedings on the subjects of utility rates and regulatory policy before state utility regulators in Alaska, Arkansas, Arizona, Colorado, Georgia, Idaho, Illinois, Indiana, Kansas, Kentucky, Michigan, Minnesota, Missouri, Montana, Nevada, New Mexico, New York, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, Texas, Virginia, Washington, West Virginia, and Wyoming. I have also filed affidavits in proceedings before the Federal Energy Regulatory Commission and prepared expert reports in state and federal court proceedings involving utility matters.

Q. What is the purpose of your testimony in this case?

A. My testimony addresses the request by Rocky Mountain Power ("RMP") for recovery of approximately $18.9 million in Energy Balancing Account

("EBA") related costs for the deferral period January 1, 2015 through December 31, 2015. The $18.9 million requested by RMP is comprised of four components: (1) approximately $11.3 million in Actual EBA Costs in excess of Base EBA Costs (after taking into account the 70/30 sharing mechanism), (2) a credit of approximately $2.8 million in coal fuel expense savings at the Hunter and Huntington plants related to the Deer Creek mine closure and not subject to the 70/30 sharing mechanism, (3) approximately $1.3 million in accrued interest, and (4) approximately $9.0 million representing the Utah-allocated Deer Creek mine amortization expense.

Q. Please summarize your primary conclusions and recommendations concerning RMP's proposed EBA rate adjustment.

A. I offer the following conclusions and recommendations:

(1) The Commission should reduce the Utah-allocated EBA costs by approximately $2.9 million to account for the full amount of savings resulting from the settlement of the Energy West Retiree Medical Obligation, including the reduction in FAS 106 expense not otherwise reflected in the cost of coal for the Hunter and Huntington power facilities, as explained in the Confidential Direct Testimony of UAE witness Bradley G. Mullins.

(2) The Commission should adopt the recommendations of Division of Public Utilities ("DPU") witness Artie Powell to disallow the interest expense or accrual on the amortization of the unrecovered investment in the Deer Creek mine, which DPU calculates to be $465,312 for the period January 1, 2016

through October 31, 2016. The Commission should also adopt Dr. Powell's recommendation that the Company not be allowed to collect interest on the unrecovered investment balance over the EBA collection or amortization period, November 1, 2016 through October 31, 2017, approximately $250,216.

(3) In light of RMP's failure to adhere to the terms of the settlement stipulation in the Deer Creek case, the Commission should consider *de novo* the recommendation I made in the Deer Creek case to approve a deferral for the benefit of Utah customers of windfall savings by the Company from the extension of bonus tax depreciation. Specifically, the Commission should order RMP to calculate and defer the monthly difference between the revenues collected from customers based on the test period revenue requirement approved by the Commission in the last general rate case and the revenues that would have been collected from customers if a test period revenue requirement had been set that, all other things being held constant, took into account the effects of the extension of 50 percent bonus tax depreciation through the end of the test period in that case, June 30, 2015.

II. DEER CREEK MINE SETTLEMENT STIPULATION AND THE EBA

Q. What is the relationship between the Deer Creek Mine Settlement Stipulation and the EBA?

A. On April 29, 2015 the Commission approved a settlement stipulation ("Deer Creek Stipulation") in Docket No. 14-035-147, which responded to RMP's

request for approval to close the Deer Creek Mine and a request for deferred accounting treatment for specified components of the associated transaction. The Deer Creek Stipulation was signed by RMP, DPU, the Office of Consumer Services, UAE, and the Sierra Club. The Stipulation has a direct bearing on the EBA because that agreement provides that certain Deer Creek transaction-related costs and benefits would be passed through the EBA. The Deer Creek Stipulation also provides for limited exceptions to the 70/30 sharing mechanism that governed the apportionment of EBA adjustments between customers and the Company since the inception of the EBA pilot until the recent suspension of the sharing mechanism by the legislature effective July 1, 2016.

Q. What aspect of the Deer Creek Stipulation are you addressing in your testimony?

A. I am addressing Paragraph 17 of the Stipulation, which states, in relevant part:

> The Parties agree that the Commission should enter an order authorizing a one-time, non-precedential exception to be made to the 70/30 Energy Balance Account ("EBA") sharing band for the following items, to be recovered by flowing them through the EBA at 100% without applying the sharing band until the rate effective date of the next general rate case….
>
> The Parties agree that the sharing band waiver is non-precedential, and the Company agrees to not request any change or elimination of the EBA sharing band to be effective prior to the end of the EBA pilot.

Q. Why is this passage relevant to this proceeding?

A. As pointed out by DPU witness Artie Powell, RMP did not keep its commitment "to not request any change or elimination of the EBA sharing band

to be effective prior to the end of the EBA pilot." The EBA pilot had been approved through the 2016 deferral period, which ends December 31, 2016. It has been well documented in the press and I know from personal knowledge that RMP engaged in a major lobbying effort during the 2016 session of the Utah Legislature to eliminate the 70/30 sharing band. The legislation that passed, SB 115, eliminated the sharing band for three and one-half years starting July 1, 2016. RMP's instigation of this legislation and its aggressive lobbying efforts to support its passage are clearly inconsistent with the Company's commitment under Paragraph 17 of the Stipulation.

In response to the Company's failure to adhere to its commitments under Paragraph 17, Dr. Powell recommends the disallowance of the interest expense or accrual on the amortization of the unrecovered investment in the Deer Creek mine, which DPU calculates to be $465,312 for the period January 1, 2016 through October 31, 2016. Additionally, Dr. Powell recommends that the Company not be allowed to collect interest on the unrecovered investment balance over the EBA collection or amortization period, November 1, 2016 through October 31, 2017, approximately $250,216.

Q. Do you support Dr. Powell's recommendation?

A. Yes, I do.

Q. Do you have any additional recommendations regarding Paragraph 17?

A. Yes. UAE agreed to enter the Deer Creek Stipulation despite the fact that the Stipulation did not incorporate the argument advanced in my direct testimony

that if deferred accounting is to be used to exempt Deer Creek-related amortization expense from the 70/30 sharing mechanism, then deferred accounting should also be used to capture the benefits to customers of the extension of bonus tax depreciation through the end of 2014. In my opinion, deferred accounting treatment for the extension of bonus tax depreciation would have been – and continues to be – entirely appropriate. However, UAE decided to enter the Stipulation absent this provision in exchange for the total package that was negotiated – specifically including RMP's commitment to leave the 70/30 sharing mechanism in place through the end of the EBA Pilot Program. In light of RMP's failure to adhere fully to the terms of the Deer Creek Stipulation, UAE is now requesting that the Commission consider *de novo* the recommendation I made in the Deer Creek case concerning the extension of bonus tax depreciation. I believe that such consideration at this time is fair and in the public interest.

Q. Why is it reasonable to approve deferred accounting treatment for the extension of bonus tax depreciation?

A. The revenue requirement in the last general rate case was established using a test period ending June 30, 2015, under the assumption that bonus tax depreciation would terminate on December 31, 2013. However, on December 19, 2014, the Tax Increase Prevention Act of 2014 (Public Law No. 113-295), was signed into law. Among other things, this Act extends 50 percent bonus tax depreciation through the end of year 2014. This extension means that bonus tax depreciation was, in fact, applicable to the test period used in the last general rate

case, even though the parties to the proceeding had no way of knowing this would be the case at the time the proceeding was conducted. As a result, the revenue requirement in Utah was established using tax assumptions that initially set the Utah annual revenue requirement approximately $2 million to $3 million too high.

Moreover, bonus tax depreciation was again extended by the Protecting Americans from Tax Hikes ("PATH") Act of 2015, which was signed into law on December 18, 2015. The PATH Act extends 50 percent bonus tax depreciation through December 31, 2017, and includes a phase down to 40 percent bonus tax depreciation in 2018, and 30 percent in 2019.

The PATH Act extension means that test year plant added between January 1, 2015 and the end of the test period on June 30, 2015 *also* qualifies for bonus tax depreciation, unbeknownst to the parties at the time the last general rate case was conducted. This latter development exacerbates the mismatch between the assumptions used regarding Federal tax policy that were used to set rates in Utah using the future test period in the last rate case and the tax policies that actually turned out to be in effect during the test period. In other words, the extension of bonus tax depreciation through the PATH Act further adds to the benefits that should inure to the benefit of Utah customers.

While it is reasonable to consider deferred accounting treatment for the extension of bonus tax depreciation on its own merit, this issue has particular relevance for this proceeding because this proceeding implements the deferrals that were approved in the Deer Creek case. In this case, deferred accounting is

being used to exempt Deer Creek-related amortization expense from the 70/30 sharing mechanism, largely to cure an unintended consequence of ratemaking mechanics. The same principle applies to using deferred accounting to capture the benefits that should be passed on to customers of the extension of bonus tax depreciation through the end of the test period used in the last general rate case. In my direct testimony in the Deer Creek proceeding, I argued that absent such a companion deferral, RMP's request for waiver from the 70/30 sharing should be rejected as unreasonably one-sided. While UAE's recommendation regarding bonus tax depreciation was not included in the Deer Creek Stipulation, RMP's violation of that stipulation in pursuit of its legislative agenda deprives the other parties to the Stipulation, including UAE, of the benefits of their bargain and warrants a fresh examination of UAE's proposal.

Q. What is bonus tax depreciation?

A. Bonus tax depreciation refers to a greatly accelerated tax deduction for depreciation that has been permitted pursuant to several statutes signed into law in recent years to stimulate the economy. Bonus tax depreciation was permitted in the early 2000s and extended for most periods between 2008 and 2013. In their most recent incarnations, these acts permitted a first-year depreciation tax deduction equal to 50 percent of the cost of qualified property. At the time of the most recent general rate case, Docket No. 13-035-184, 50 percent bonus tax depreciation was scheduled to expire on December 31, 2013.

Q. How did bonus tax depreciation factor in to the most recent general rate

case?

A. The most recent general rate case, which was resolved through a Stipulation approved by the Commission on August 29, 2014, used a projected test period ending June 30, 2015. The Company's filing was made on January 3, 2014, and took into account bonus tax depreciation through December 31, 2013, which was the termination date for bonus tax depreciation at the time of the company's filing.

After the last rate case was resolved, on December 19, 2014, the President signed into law the Tax Increase Prevention Act of 2014 (Public Law No. 113-295), an Act which, among other things, extended 50 percent bonus tax depreciation through the end of year 2014. The enactment of this extension means that bonus tax depreciation was, in fact, applicable to the test period used in the last general rate case, even though the parties did not know it at the time the case was conducted. The subsequent enactment of the PATH Act in late 2015 means that bonus tax depreciation was also applicable to the second half of the test period ending June 30, 2015.

Q. How does bonus tax depreciation impact ratemaking for regulated utilities?

A. Bonus tax depreciation is a form of accelerated tax depreciation. This Commission has long recognized that utility depreciation for tax purposes differs from utility book depreciation used in ratemaking. Generally, the tax benefits of accelerated depreciation are not passed through directly to ratepayers; instead, according to the conventions of income tax normalization, the benefit of a utility's

accumulated deferred income tax ("ADIT") is viewed as a source of zero-cost capital to the utility as part of the ratemaking process. Consequently, the ADIT that results from accelerated tax depreciation is booked as a credit against rate base, thereby reducing revenue requirements for customers.

Even though bonus tax depreciation affects rates through the same mechanics as standard accelerated depreciation, its impact is more dramatic than standard accelerated depreciation in the years immediately following the placement of the qualifying plant into service. This is because bonus tax depreciation causes a much greater increase in ADIT, which in turn, produces a much greater credit against rate base for any given amount of new plant in service. This, in turn, typically reduces the revenue requirement relative to what it would have been if bonus tax depreciation were not applicable.

The accounting for bonus tax depreciation in Utah ratemaking is a standard and routine part of the ratemaking process. The fact that 2014 bonus tax depreciation was not included in the determination of revenue requirement in the most recent general rate case is due solely to the fact that the extension was not known or knowable while the rate case was being resolved because it was not enacted until approximately six months after the submission of the Stipulation on June 25, 2014, and approximately four months after the Commission's final order approving that Stipulation on August 29, 2014. Thus, the omission of 2014 bonus tax depreciation from the revenue requirement of the general rate case is the result of the timing of the case and the timing of the passage of the Act, and was subject

to actions that were outside the control of the parties at the time the case was conducted.

Q. Do you have an estimate of the impact of the extension of bonus tax depreciation on the Utah revenue requirement?

A. Yes. On March 5, 2015, the Wyoming Public Service Commission ordered RMP to defer, effective January 1, 2015, the benefits of the extension, through December 31, 2014, of bonus tax depreciation on the Wyoming revenue requirement. Similar to the situation in Utah, the Wyoming Commission had approved rates using a test period ending June 30, 2015 that did not reflect the 2014 extension of bonus tax depreciation, which was signed into law after the record was closed in RMP's 2014 Wyoming general rate case.[1] The deferral for the period January 1, 2015 through December 31, 2015 in Wyoming amounted to $927,000.[2] As the Utah revenue requirement is about 2.7 times that of Wyoming, I estimate the revenue requirement reduction in Utah to be between $2 and $3 million per year for the *initial* extension of bonus tax depreciation through December 31, 2014. [3] The subsequent extension of bonus tax depreciation beyond 2014 implemented through the PATH Act would add to that amount.

Q. How should the benefits of bonus tax depreciation be tracked as part of a deferral approved in this case?

[1] Wyoming Public Service Commission, Docket No. 20000-446-ER-14.
[2] This amount was authorized for recovery through Bonus Depreciation Schedule 92, approved in RMP's 2015 Wyoming general rate case, Docket No. 20000-469-ER-15.
[3] While the impact of bonus tax depreciation is not strictly proportionate to jurisdictional revenue requirement, I believe this estimate provides a useful approximation.

A. The Commission should order RMP to calculate and defer the monthly difference between the revenues collected from customers based on the test period revenue requirement approved by the Commission in the last general rate case and the revenues that would have been collected from customers if a test period revenue requirement had been set that, all other things being held constant, took into account the effects of the extension of 50 percent bonus tax depreciation through the end of the test period in that case, June 30, 2015.

It would be unreasonable and asymmetric to have cured the unintended consequence of ratemaking mechanics associated with the conversion of Deer Creek Mine-related depreciation expense into amortization expense without also recognizing that the last general rate case suffered from a comparable anomaly, in which an unforeseen and unforeseeable change in the tax law applicable to the test period revenue requirement occurred after the disposition of the case.

Q. When should the deferral period begin?

A. In fairness to Utah customers, the deferral reasonably should be calculated starting January 1, 2015, as I proposed in my direct testimony filed in the Deer Creek proceeding. Alternatively, the deferral could start on March 17, 2015, the day on which my direct testimony proposing the deferral was filed in the Deer Creek case. If for some reason the Commission were to conclude that it cannot or chooses not to initiate the deferral on a date in the past, the deferral should under all circumstances be implemented prospectively as soon as reasonably practicable.

Q. Does this conclude your direct testimony?

289 A. Yes, it does.