BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

IN THE MATTER OF THE APPLICATION OF ROCKY MOUNTAIN POWER, A DIVISION OF PACIFICORP, FOR AUTHORITY TO CHANGE IT IS DEPRECIATION RATES EFFECTIVE JANUARY 1, 2021 **&** **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 NOS. 18-035-36 & 20-035-04** **Exhibit No. DPU 9.0 DIR**

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

Direct Testimony of

Gary L. Smith

September 2, 2020

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME, EMPLOYER, AND BUSINESS ADDRESS.

A. My name is Gary L. Smith. I am employed by the Division of Public Utilities (Division), State of Utah. My business address is 160 East 300 South Salt Lake City, UT 84114.

Q. BRIEFLY OUTLINE YOUR BACKGROUND.

A. I am a Technical Consultant for the Division and have testified before the Public Service Commission of Utah (Commission) in water and telecommunications matters. I received a Bachelor of Science degree in Economics from the University of Utah.

Q. ON WHOSE BEHALF ARE YOU TESTIFYING?

A. The Division.

II. SUMMARY

Q. PLEASE SUMMARIZE THE PURPOSE OF YOUR TESTIMONY.

A. The purpose of my testimony is 1) to reaffirm and re-present the recommendation of the Division regarding the Replaced Wind Assets associated with repowered wind facilities as detailed in Charles E. Peterson’s direct testimony dated September 20, 2017 and filed in Docket No. 17-035-39, and 2) to present the recommendation of the Division regarding the Company’s proposed changes to the Energy Balancing Account (EBA) included in the Company’s application to increase its residential rates, Docket No. 20-035-04.

Q. PLEASE PROVIDE A BREIF HISTORY OR BACKGROUND OF THE RELATED DOCKETS.

A. Docket No. 17-035-39

On June 30, 2017, Rocky Mountain Power (the Company) applied for approval of resource decision to repower wind facilities (approximately $1.13 billion in improvements) in Docket No. 17-035-39. Under this docket the Company sought approval to upgrade existing wind resources and requalify them for federal production tax credits (PTCs). On September 20, 2017, Charles E. Peterson submitted Direct Testimony and analysis for the Division. Mr. Peterson's testimony addressed issues including the intergenerational inequity that would arise from the Company's proposed treatment of the retired plant (Replaced Equipment, Replaced Wind Assets) due to wind repowering. In its May 25, 2018 Report and Order, the Commission approved, on a project-by-project basis, the proposed projects and concluded the customer impacts would be addressed as part of the Company's next depreciation study to be filed at a later date.

Docket No. 17-035-40

On June 30, 2017, the Company applied for approval of its Energy Vision 2020 which included repowering existing wind facilities and constructing or procuring new wind and transmission facilities.[1] The Company sought approval to procure and upgrade

[1] Docket Nos. 17-035-39 and 17-035-40.

existing wind resources and requalify them for federal PTCs. Also, the Company sought the approval of a new deferral and cost recovery Resource Tracking Mechanism (RTM),

> The Company proposes to match the costs and benefits of the Combined Projects through a new deferral and cost recovery Resource Tracking Mechanism ("RTM") until the costs and benefits are reflected in base rates. Variances in PTCs would continue to be tracked after all other costs and a base level of PTCs are reflected in base rates. This proposed ratemaking treatment will ensure that the costs and benefits of the Combined Projects are properly matched and customers and shareholders are treated fairly while delivering long-term benefits overall.[2]

In its May 25, 2018 Report and Order, the Commission approved, on a project-by-project basis, the proposed projects and declined to adopt the Company's proposed RTM. "We conclude that PacifiCorp can effectively seek recovery of Repowering Project costs and benefits through available ratemaking mechanisms such as general rate cases, requests for deferred accounting treatment, and/or the EBA."[3]

<u>Docket No. 18-035-36</u>

On September 11, 2018, Rocky Mountain Power filed the Company's new depreciation study with its application for authority to change its depreciation rates effective January 1, 2021 under Docket No. 18-035-36. A stipulation was reached in this docket. The stipulating parties requested the Commission schedule further review of the regulatory

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[2] Docket No. 17-035-40, In the Matter of the Voluntary Request of Rocky Mountain Power for Approval of a Significant Energy Resource Decision and Voluntary Request for Approval of Resource Decision, Rocky Mountain Power Application, June 30, 2017, page 2-3.

[3] Docket No. 17-035-39, In the Matter of the Voluntary Request of Rocky Mountain Power for Approval of Resource Decision to Repower Wind Facilities, Commission Report and Order, May 25, 2018, page 25.

treatment of projected incremental decommissioning costs related to certain coal-fired generation facilities, and the Replaced Wind Assets (Phase II), concurrent with the Company's general rate case in Docket No. 20-035-04.

Docket No. 20-035-04

On May 8, 2020, the Company applied for authority to increase its retail electric utility service rates in Docket No. 20-035-04. On June 9, 2020 the Commission issued a scheduling order under Docket No. 20-035-04 that included a schedule for Phase II of depreciation Docket No. 18-035-36.

Q. PLEASE PROVIDE BACKGROUND INFORMATION ON THE EBA.

A. The current Energy Balancing Account (EBA) was initiated by the Company in Docket No. 09-035-15 as an Energy Cost Adjustment Mechanism (ECAM). The purpose of the EBA is to be

> a rate mechanism designed to allow the Company to collect or credit the differences between the actual net power costs ("NPC") incurred to serve customers in Utah and the amount collected from customers in Utah through rates set in general rate cases. On a monthly basis, the Company will compare the actual system net power costs ("Actual NPC") to the net power costs embedded in rates from the most recent general rate case ("Base NPC"), and defer the differences in a balancing account. An ECAM rate will be calculated annually to collect from or credit to customers the accumulated balance over the subsequent year.[4]

The EBA was approved as a pilot program in 2011 and included a 70/30 sharing band to allocate risk and costs efficiently between the Company and ratepayers. The

[4] Docket No. 09-035-15, Application of Rocky Mountain Power for Approval of its Proposed Energy Cost Adjustment Mechanism, Direct Testimony of Gregory N. Duvall, March 16, 2009, lines 27 through 35.

Company's actual prudently incurred power costs, including fuel, purchased power and wheeling expenses, constituted the components of the EBA. The purpose of the sharing band was explained by the Commission at the time of the EBA's creation

> As in the past, we will continue to rely on prudence reviews during rate setting proceedings to determine the extent to which the Company is providing least-cost, risk-adjusted service to its Utah customers, consistent with integrated resource planning and competitive solicitation analyses. We recognize, however, relying solely on prudence reviews will shift too much of the risk for suboptimal planning and operation currently borne by the Company, who is in the best position to manage this risk, to customers, who are not. Therefore, the balancing account we adopt requires both Company customers and shareholders to remain at risk for a portion of the actual net power cost which deviates from approved forecasts. This decision recognizes the value of Company management having meaningful financial incentives to minimize net power cost in the short-run and long-run, regardless of the extent of net power cost volatility. We find a sharing mechanism is the best method, at this point, to ensure customer and shareholder interests are aligned and the public interest is maintained.[5]

Over time the EBA has changed. Among other things, the 2016 legislation removed the sharing band from the EBA and the program's pilot designation has been removed. What was initially a risk and cost allocator now enables the Company to recover 100% of its net power costs, thus eliminating the Company's net power cost recovery risk.

Q. HOW HAS THE REMOVAL OF THE 70/30 SHARING BAND AFFECTED THE EBA?

A. "The proper alignment of incentives toward the public interest is a major function of regulating a monopoly utility."[6] Comments filed since the removal of the sharing band

[5] Docket No. 09-035-15, In the Matter of the Application of Rocky Mountain Power for Approval of its Proposed Energy Cost Adjustment Mechanism, Commission Report and Order, March 2, 2011, page 69-70.

[6] Docket No. 09-035-15, Comments from the Division of Public Utilities, September 16, 2019, page 3.

have expressed concerns that the Company's incentives are no longer aligned toward the public interest. The Division has previously summarized its view on the effects of the sharing band removal:

> While the Division generally supports the Company's energy balancing account, the Division has recently expressed concern that the EBA is no longer in the public interest… based on the elimination of the sharing band [7]

III. REVIEW AND ANALYSIS

Replaced Wind Assets

Q. WHAT HAS THE COMPANY PROPOSED AS THE ACCOUNTING TREATMENT FOR THE REPLACED WIND ASSETS ASSOCIATED WITH THE REPOWERED WIND FACILITIES?

A. As existing wind generation equipment is replaced through repowering, the remaining value of the Replaced Wind Assets are transferred to an accumulated depreciation reserve, and ultimately included as part of the new plant balance of the repowered assets (Repowered Assets). The Repowered Assets, containing the remaining balance of the Replaced Wind Assets, will be depreciated over the new approved remaining lives assigned to the Repowered Assets.[8]

Q. HOW LONG DOES THE COMPANY PROPOSE TO DEPRECIATE AND RETAIN IN RATE BASE THE REPLACED WIND ASSETS?

[7] Docket No. 09-035-15, Comments from the Division of Public Utilities, March 2, 2020, page 2.

[8] Application of Rocky Mountain Power for Authority to Change its Depreciation Rates Effective January 1, 2021, Direct testimony on issues related to the second phase of the Depreciation Docket (Docket No. 18-035-36), Testimony of Steven R. McDougal, June 19, 2020, lines 75 through 115.

A. Up to 30 years, as proposed by the Company's witness, Steven R. McDougal[9].

Q. COULD THE REMAINING PLANT BALANCE OF THE REPLACED EQUIPMENT BE DEPRECIATED OVER A SHORTEND PERIOD OF TIME THAN PROPOSED BY THE COMPANY?

A. Yes. As testified by Steven R. McDougal, "This could be accomplished by increasing the depreciation rates to effectively pay off the remaining plant balance over a shorter period of time."[10]

Q. DOES THE DIVISION AGREE THAT THE REPLACED EQUIPMENT SHOULD CONTINUE TO BE DEPRECIATED AND REMAIN IN RATE BASE?

A. Yes. The Replaced Wind Assets once removed from service would no longer be considered used and useful, and therefore would not normally continue to be depreciated. However, the "extraordinary retirement" due to otherwise unexpected "economic obsolescence,"[11] creates a scenario in which continued depreciation of the Replaced Equipment appears to be in the public interest.

Q. DOES THE DIVISION HAVE CONCERNS REGARDING THE COMPANY'S PROPOSED TREATMENT OF THE REPLACED WIND ASSETS?

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[9] Ibid.

[10] Ibid, lines 112 through 115.

[11] Docket No. 17-035-39, In the Matter of the Voluntary Request of Rocky Mountain Power for Approval of Resource Decision to Repower Wind Facilities, Division of Public Utilities, Exhibit No DPU 4.0 D, Direct Testimony of Charles E. Peterson, September 20, 2017, lines 95 through 165.

A. Yes. The Division has concerns and does not agree with the Company's proposed accounting treatment and depreciable life of the Replaced Wind Assets.

Q. PLEASE EXPLAIN INTERGENERATIONAL EQUITY.

A. Intergenerational equity is a foundation principle of utility regulation postulating that the customers who use an asset should pay for that asset at the time it is used. Having future customers pay for assets which they do not receive a benefit would be intergenerational inequity.

Q. PLEASE EXPLAIN THE MATCHING PRINCIPLE OF ACCOUTING.

A. The matching principle is one of the basic underlying guidelines in accounting. The principle directs the recording of an expense in the period which the related revenues and benefits are earned.

Q. WHAT CONCERNS DOES THE DIVISION HAVE WITH THE COMPANY'S PROPOSED DEPRECIATION OF THE REPLACED EQUIPMENT?

A. The Company's proposed accounting treatment of the Replaced Wind Assets creates intergenerational inequity. The Company has proposed to depreciate the Replaced Equipment for twenty years beyond the end of receiving the benefit from the last expected production tax credit. As a result, new ratepayers will continue to pay the cost of the Replaced Equipment while receiving no benefit from the PTCs, creating intergenerational inequity. This mis-match of the depreciation of the Replaced Equipment's costs (30 years) to the PTC's benefits (10 years) would not be in line with the matching principal of accounting.

Q. DOES THE DIVISION HAVE A MODEL WITH A SHORTER SCHEDULED DEPRECIATION?

A. No, the Division requests that the Company provide this in rebuttal.

<u>Proposed Changes to the EBA</u>

Q. HAS THE COMPANY PROPOSED CHANGES TO THE EBA IN THIS DOCKET?

A. Yes, the Company's proposed changes to the EBA include 1) determining base EBA in each annual EBA filing,[12] and 2) allowing federal production tax credits (PTCs) to be included in the EBA.[13]

Q. DOES THE UTAH CODE ALLOW THE EBA BASE RATES TO BE DETERMINED OUTSIDE OF A GENERAL RATE CASE?

A. No. Utah Code § 54-7-13.5(2)(c)(i)(A) provides that the EBA may be recovered through base rates and (2)(f)(ii) further allows the EBA collection to "be incorporated into base rates in an appropriate commission proceeding." The only appropriate commission proceeding currently allowed by Utah law is a general rate case. Utah Code § 54-7-12(c) and (d) define a general rate decrease and increase respectively as

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[12] Docket No. 20-035-04, 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 Effective January 1, 2021, Direct Testimony of Robert M. Meredith, May 2020, lines 1351-1357.

[13] Docket No. 20-035-04, 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 Effective January 1, 2021, Direct Testimony of David G. Webb, May 2020, lines 714 – 748, 782-783.

"any direct increase [or decrease] to a public utility's base rates." Section 54-7-12(2) further explains the process for a general rate increase or decrease. Reading these statutes as a whole result in the only current appropriate proceeding being a general rate case. Therefore, the Division recommends the Commission not approve the Company's request to set base EBA rates in the annual EBA filings.

Q. DOES THE UTAH CODE ALLOW THE INCLUSION OF PRODUCTION TAX CREDITS IN THE EBA?

A. Utah Code does not expressly consider tax credits in the EBA.

Utah Code § 54-7-13.5(1)(b) limits the EBA by definition:

> (b) "Energy balancing account" means an electrical corporation account for some or all components of the electrical corporation's incurred actual power costs, including:
> (i)
> (A) fuel;
> (B) purchased power, and
> (C) wheeling expenses; and
> (ii) the sum of the power costs described in Subsection (1)(b)(i) less wholesale revenues.

PTCs are generally considered a non-NPC item and have not been included in the EBA or the approved account list of EBA Schedule 94 since the EBA's inception and have not been included in any prior EBA filings.

Q. PLEASE DETAIL THE EXPECTED BENEFITS OF THE APPROVED WIND FACILITIES AND THE ASSOCIATED TRANSMISSION PROJECTS AS PROVIDED BY THE COMPANY.

A. The benefits of the wind facilities include the following, 1) zero-fuel-cost generation that lowers net power costs 2) "renewable energy certificates (REC) which can be sold in the market and lower net customer costs"[14] 3) additional decarbonization of the Company's resource portfolio, "mitigating long-term risk associated with potential future state and federal policies targeting carbon dioxide emissions reductions from the electric sector,"[15] and 4) generation of PTCs that offset the Company's federal income taxes. The PTC tax benefit is detailed by Company witness Mr. Webb as follows,

> The generation of energy at certain company-owned facilities is eligible for the renewable electricity PTCs, and the credit is included as an offset to the Company's federal income taxes. For each kilowatt-hour of energy generated at eligible wind powered generating facilities, the Company receives a $0.025 credit on its tax return, for a duration of 10 years beginning on the date which the facility became commercially operational. The value of these credits is reflected as a reduction to current income tax expense on the financial statements and for rate-making purposes.[16]

Q. CAN THE COMPANY RECEIVE BENEFITS FROM THE EBA TRUE-UP AND PTCs WITHOUT ANY CHANGES TO THE EBA?

A. Yes, the Company will benefit from the actual PTCs received as an offset to federal income tax. Differences that the Company may encounter between their actual realized PTCs and forecasted PTCs incorporated in rates can be adjusted through the traditional rate-making mechanism of a general rate case.

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[14] Docket No. 17-035-40, Application for Approval of a Significant Energy Resource Decision and Voluntary Request for Approval of Resource Decision, Direct Testimony of Cindy A. Crane, June 2017, lines 47-51.

[15] Ibid, lines 51-55.

[16] Docket No. 20-035-04, 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 Effective January 1, 2021, Direct Testimony of David G. Webb, May 2020, lines 714 – 722.

The Company currently receives 100% of its actual NPC costs through the EBA true-up mechanism. The megawatt hours generated at the wind facilities are included at zero-fuel-cost. If actual generation at wind facilities is less than the forecasted base EBA set in the last general rate case, the Company would recover 100% of the cost of any purchased power to balance the generation deficit. The Company currently has available mechanisms including the EBA and general rate case filings to receive the benefit of the PTCs and the wind facilities without further changes to the EBA.

Q. PLEASE DETAIL THE POTENTIAL RISKS AND BENEFITS IF PTCs WERE INCLUDED IN THE EBA.

A. The repowering and new wind projects represent a significant change to the Company's generation structure and capacity with no historical production to validate the anticipated results. The Company has provided generation assumptions and forecasts to establish base rates. Actual production in future periods could be higher or lower than forecast. With PTCs included in the EBA true-up, if the actual power generation from the repowered and new facilities is less than projected, ratepayers will not receive the anticipated renewable generation or tax benefits built into base rates. The Company will most likely need to purchase additional energy to compensate for the lower than anticipated production from wind generation which would all contribute to an increase in NPC. Since the Company can recover 100% of NPC through the EBA, the risk of lower generation and higher NPC is shifted to ratepayers. With PTCs included in the EBA ratepayers would again be required to assume the additional risk and cost of unrealized PTCs in addition to the risk of lower generation and higher NPC they already bear. Requiring ratepayers to assume virtually all risk associated with unrealized generation, non-receipt of PTCs, and higher than forecast NPC appears to depart from the public interest. Alternatively, if actual wind generation is greater than forecast, ratepayers would benefit from lower NPC. This benefit to ratepayers would be most likely be short lived and would be reset upon the issuance of a Commission order approving a new generation and PTC base in the next general rate case.

Approval in prior dockets for the wind repowering and new wind projects included assumptions and forecasts for power generation and the corresponding PTCs from that generation. The Company received Commission authorization for these projects based on the Company's projected tax benefits of the expected PTCs and the existing recovery mechanisms available to the Company. The Company assumed the risk associated with the PTC tax benefits as part of its analysis. It is uncertain how conservative the Company's projected generation and PTCs are, but inherent pressure can exist to value benefits in at least the higher end of a reasonable range when seeking approval. The Division believes that there is a higher probability and risk of lower actual generation and resulting lower PTC tax benefits than anticipated due to the volatile nature of wind resources. This risk of underrealized PTC tax benefits would be transferred to ratepayers if the PTCs were included in the EBA as the Company has proposed.

Q. DOES INCLUDING THE PTCs IN THE EBA CREATE AN ACCEPTABLE TRANSFER OF RISK TO UTAH RATEPAYERS?

A. No, transferring all of the risk associated with $85,120,454 [17] of Utah allocated PTCs with little chance of receiving any notable benefit for any sustained length of time is an inappropriate transfer of risk. The Company is proposing to include all of its existing and future PTCs in the EBA to true-up its forecasted PTC tax benefits with actual results. If fundamental changes negatively affecting NPC and/or PTCs were to occur, ratepayers would bear the cost and would be captive awaiting the filing of a new general rate case to adjust for the negative changes or needed adjustments.

All investment decisions involve some degree of risk. Prudent investing requires the expected return (or benefit) match the level of assumed risk. The level of potential benefit to ratepayers from including the PTCs in the EBA does not match the level of potential PTC risk and overall NPC risk that they would be allocated. In addition, ratepayers are typically conservative and risk adverse. Thus, the additional transfer of all the PTC risk would not match the ratepayer's tolerance for risk or the ratepayers' potential benefits. Ratepayers are typically captive in regards to most costs and risks, and rely upon the regulatory process to allocate risk and return for risk taking appropriately. Accepted standards of regulation do not insulate utilities from all risk.

[17] Docket No. 20-035-04, 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 Effective January 1, 2021, Redacted Direct Testimony of Steven R. McDougal, June 19, 2020, Exhibit RMP_(SRM-3) page 27 of 467, line 1341.

The Company assumes risk and receives an assigned rate of return according to the level of risk borne by the utility. Given the nature and risks associated with PTCs along with the confidence in meeting PTC targets expressed by the Company when seeking approval of the resources, it appears to be a true business investment risk that should continue to be borne by the Company and its shareholders. The risk of unrealized PTCs should remain with the risks incorporated in the Company's rate of return and not be transferred and borne by ratepayers. The Company is in a much better position to manage risks, including PTC risk, than ratepayers.

IV. CONCLUSION

Q. WHAT DOES THE DIVISION RECOMMEND REGARDING THE TREATMENT OF THE REPLACED WIND ASSETS?

A. As Mr. Peterson addressed in his testimony in Docket No. 17-035-39, either

1) Accelerate the depreciation of the Replaced Wind Assets to match the PTCs.

Or

2) Create a regulatory asset through a differed accounting order and "bank"[18] the PTCs and then amortize the PTCs over the depreciable life of the Replaced Equipment.

These options would more closely match the cost of Replaced Equipment to the benefit received from the PTCs.

[18] Docket No. 17-035-39, In the Matter of the Voluntary Request of Rocky Mountain Power for Approval of Resource Decision to Repower Wind Facilities, Division of Public Utilities, Exhibit No DPU 4.0 D, Direct Testimony of Charles E. Peterson, September 20, 2017, lines 218 through 221.

Q. WHAT DOES THE DIVISION RECOMMEND REGARDING THE PROPOSED CHANGES TO THE EBA.

A. Regarding the Company's proposed changes to the EBA as presented in this docket, the Division recommends:

1) Not approving the Company's proposal to set EBA base net power costs in base rates annually.

2) Not approving the Company's proposal to include PTCs in the EBA based on the following:

a) Utah Code 54-7-13.5(1)(b) does not anticipate tax credits.

b) The EBA currently does not include PTCs. PTCs are generally considered a non-NPC item. The EBA and the Schedule 94 list of accounts has been limited to net power and wheeling costs since inception.

c) The transfer of 100% of the PTC risk to ratepayers would not be in the public interest. PTC risk should remain in the Company's rate of return and should not be reallocated to ratepayers through the EBA.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.