

Docket No. 01-035-01  
Laura Nelson  
Exhibit No. R11.0  
August 31, 2001

-BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH-

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IN THE MATTER OF THE	)	DOCKET NO. 01-035-01
APPLICATION OF PACIFICORP	)	
FOR APPROVAL OF ITS PROPOSED	)	
ELECTRIC RATE SCHEDULES AND	)	
ELECTRIC SERVICE REGULATIONS	)	

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COS REBUTTAL TESTIMONY OF

DR. LAURA NELSON

FOR THE

DIVISION OF PUBLIC UTILITIES

DEPARTMENT OF COMMERCE

STATE OF UTAH

August 31, 2001

**Q. Please state your name, business address, and present position with the Division of Public Utilities.**

A. My name is Laura Nelson and my business address is the Heber Wells Building, 160 East 300 South, Salt Lake City, Utah. My position with the Division is as a Rate Analyst.

**Q. Are you the same Dr. Nelson who previously testified in the Revenue Requirement portion of hearings in this docket and also filed direct testimony on Cost of Service?**

A. Yes.

**Q. What is the purpose of your cost of service rebuttal testimony?**

A. I will present the Division of Public Utilities' (DPU's or Division's) rebuttal to the testimony filed by Mr. Jeff Burks and Dr. David Nichols on behalf of the Utah Energy Office (UEO) and also testimony filed by Mr. James Gilliam on behalf of the Land and Water Fund (LAWF). In particular, I will present the Division's position regarding the proposals made by the parties to fund Demand Side Resource (DSR) expenditures through a tariff rider.

In addition I make a few comments regarding the sales for resale revenue credit issues addressed in the COS testimony filed by Mr. George Sterzinger on behalf of the Committee of Consumer Services (CCS).

**DSR Funding Mechanism**

**Q. Could you please summarize the Division’s understanding of the DSR cost recovery proposal made by the parties?**

A. Yes. The Division understands that UEO is proposing the implementation of a tariff rider as the funding mechanism to collect the increase in DSR spending proposed in the party’s direct revenue requirement testimony. It is proposed that in the first year the estimated \$35 million increase be collected through a rider set at 3.58 mills/kWh on residential bills and 1.64 mills/kWh for non-residential customers. In subsequent years, the tariff rider would be adjusted to reflect changing revenue and expenditure levels.<sup>1</sup> This is in addition to any other tariff increases resulting from the Commission’s decision on revenue requirement in this docket. However, in live testimony, Mr. Burks effectively removed the \$35 million increase from revenue requirement. Rather, he stated that the corrected proposal was for “\$35 million to fund the first year of a multi-year DSM initiative...”<sup>2</sup> Thus, the Division is not certain whether or not any further action is needed from the Commission on this issue at this time. Nevertheless, we assume that the UEO continues to support that some funding mechanism needs to be adopted in order to fund their proposed initiatives. Additionally, we believe that LAWF continues to support the adoption of a tariff rider.

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<sup>1</sup> See Dr. Nichols Direct COS Testimony page 7.

<sup>2</sup> R. 515-517

**Q. Could you please summarize the Division's position regarding the proposals made by UEO and LAWF?**

A. The Division does not recommend that a tariff rider be adopted. A number of our concerns were expressed in my revenue requirement testimony and are also relevant here. In particular, we believe that the adoption of a tariff rider to provide up-front funding for DSR results in rates that are in excess of costs. The implication is that there is not a matching of cost and benefits through time. Moreover, annual adjustments of the tariff rider could be viewed as "single item" rate cases. We also do not believe that a tariff rider is a movement in the direction of analogous treatment of DSR and supply side resources (SSR). Finally, we are concerned about a loss in program flexibility when a certain funding level is adopted in advance and funded in advance via the tariff rider.

**Q. Please explain why the Division considers that up-front funding for DSR results in rates that are in excess of costs.**

A. As stated in my revenue requirement testimony, funding DSR through a tariff rider is inconsistent with the approach of setting forward rates based on historic costs. During a rate case, Division staff carefully evaluates the Company's costs, including those associated with resource acquisition. This process effectively allows for a prudence review of any resource acquisitions taking place during the test period. Once prudence has been established and the appropriate amortization period determined, costs of the resource(s) can be built into rates. The attempt is to match the timing of the benefits of the acquired resource(s) with associated

costs of the resource(s). We recognize that the matching may be imperfect, but a tariff rider may result in a further mismatch of costs and benefits over time.

**Q. On page 8 of his testimony, Mr. Gilliam indicates that a tariff rider would not impede the prudence review process. Do you agree with this suggestion?**

A. Not entirely. The Division has reviewed recent DSM filings made by the Company and recommended approval of those proposals. However, we have recommended that approval not replace a full prudence review, which would take place at the time cost recovery is sought, i.e., during a rate case. The evaluation process incorporates a review of alternatives. It is not clear that a thorough review of least-cost alternatives would take place prior to the implementation of programs. And, as Mr. Gilliam states, “implementation of the approved course of action is still subject to after-the-fact prudence review,” even after “need and desirability” for a project is determined.<sup>3</sup>

**Q. Mr. Gilliam also expressed concern that the past method of expensing DSR provides a disincentive to the Company for such investments. Do you agree with this assessment?<sup>4</sup>**

A. Under some circumstances, it may be the case that expensing DSR could lead the Company to invest in less DSR than may be optimal. Costs that have been expensed for DSR may not be recovered unless they are realized during the test period utilized for setting forward rates. On the other hand, SSR expenditures,

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<sup>3</sup> Mr. Gilliam’s direct COS testimony page 8, lines 7-9.

<sup>4</sup> Mr. Gilliam’s direct COS testimony pages 4-5.

which are carried in the appropriate account(s) with associated carrying cost, provide a greater degree of certainty regarding cost recovery subsequent to a review of the cost-effectiveness of the acquisition.

The Division, however, believes that expensing DSR does not by definition provide a disincentive. Specifically, Company acquisitions of DSR can reduce reliance on market purchases and can also be used to increase sales into the wholesale markets. Between rate cases, this could result in an increase in the Company's profits to the extent that the gains from wholesale savings and/or sales exceed the costs of the program(s). Thus it cannot be determined *a priori* that a disincentive exist.

**Q. On pages 5-6 of his direct COS testimony, Mr. Gilliam indicates that the scenario you describe above is unlikely, thus the disincentive remains. Could you please comment on this issue?**

A. Yes. Mr. Gilliam is correct in stating that there is a difference in the timing of when DSR expenditures are made and when supply cost reductions (i.e., benefits) are realized. However, my assertion is that the Company receives the benefits "in between" rate cases. Thus, DSR expenditures in a single period with benefits realized over subsequent periods are not passed on to ratepayers until there is a rate case. It is possible that the benefits value over the subsequent periods is in excess of costs.

Moreover, the Company may be at risk of not recovering excess power costs if more cost effective means for offsetting both energy and capacity needs, such as DSR, were not pursued.

**Q. How would annual adjustments of the tariff rider result in “single item” rate cases?**

A. As the Division understands the proposals made by the parties, the basic requirement is that only DSR expenses and revenues are to be annually evaluated. The review process would lead to adjustments in the size of the tariff rider (to adjust for both under and over collection of revenues). There would not be additional analysis of other cost-savings aspects of DSR, or of any other cost reductions resulting from the Company’s overall operations. It is also not anticipated that revenues from the Company’s other operations would be evaluated in the process. Thus, rates would be established absent a complete review of both the Company’s overall costs and revenues during the year.

**Q. Dr. Nichols proposed a method for incorporating benefits realized from avoided market purchases in his testimony. What impact does the Division believe this would have on the annual review process?**

A. First, Mr. Brian Hedman testifying on behalf of PacifiCorp expressed that the Company believes it would be very difficult to measure such benefits. The Division agrees with this assessment. Specifically, Mr. Hedman states that “[t]he Company believes there are significant measurement problems with regard to

DSM-related power cost savings.”<sup>5</sup> The Division agrees that it would be difficult to assess the power costs savings *directly related to* DSR investments. In the absence of a full rate case, during which all costs and revenues are evaluated, it would be complicated to determine the overall impact on costs associated with DSM. Furthermore, as I have stated above, there may be additional benefits of DSR investments that are not captured in an annual review process.

**Q. How might the development of a tariff rider result in maintaining or enhancing the divergent treatment of SSR and DSR?**

A. A tariff rider allows for up-front funding of a resource. This is not consistent with the manner in which supply-side resources are funded because it weakens the prudence review process. In the past, this process has preceded the allowance of resource costs into ratebase. While it is still unclear what form of rate recovery DSR may take in the future, the Division supports methods that promote prudent acquisitions coupled with the goal of eliminating any disincentives for DSR acquisition that may exist.

**Q. How might up-front funding result in a loss of program flexibility?**

A. In recent months, the Company has demonstrated that certain demand side strategies can be implemented quickly to respond to volatile market conditions. We recognize, and hope, that the market will not always behave as it has over the last year, but we remain concerned about implementing a block of programs that

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<sup>5</sup> Rebuttal testimony of Mr. Brian Hedman, Docket 01-035-01, page 6, lines 5 and 6.

may not be appropriate under future market conditions. For example, if an excess of dollars is allocated to long-run energy efficiency programs, the Company may be concerned about implementing load curtailment program that could provide immediate, and relatively short-run, benefits at some point in the future. Additionally, some programs may not prove to be cost effective under changing market conditions.

**Q. Are there any additional comments you wish to make regarding DSR at this time?**

A. Yes. I think it is important to restate that the Division has in recent years been supportive of the Company's resource acquisitions on both the supply and demand sides. For example, we have more recently endeavored to work with the Company to develop effective and efficient demand side management programs. In addition, we are interested in pursuing possibilities for DSR funding alternatives that would move the treatment of such resource acquisitions more in line with the treatment of SSR. However, we believe that adoption of a DSR tariff rider is in opposition to the way in which resource acquisitions have been funded historically. In sum, we are concerned that implementation of the tariff rider as a funding mechanism for DSR further displaces the synchronicity of costs and benefits through time, may seriously hamper the prudence review process, and may result in single item ratemaking.

**Sales for Resale Revenue Credit**

**Q. Could you please summarize the Division's concerns regarding the revenue credit issues addressed in the testimony Mr. Sterzinger filed on behalf of the Committee?**

A. Yes, I will address two concerns we have regarding Mr. Sterzinger's testimony. First, we question the appropriateness of Mr. Sterzinger's proposal to adjust the COS allocation of the revenue credit in a manner that is consistent with the IJA allocation of the revenues. Secondly, we are concerned about Mr. Sterzinger's proposal to subtract the revenue credit allocated to special contract customers in the Company's COS study and reallocate it to all other classes, because he does not similarly recommend adjusting the related costs.

**Q. Please describe the Division's concerns regarding a reallocation of the revenue credit in the COS model in a manner consistent with the IJA model?**

A. While the IJA allocation may differ from the COS allocation of the revenue credit, we believe that reassigning the IJA allocation falls under revenue requirement adjustments.<sup>6</sup> Thus, the COS portion of this rate case is not the appropriate venue for addressing that issue. We understand that it is likely that Mr. Sterzinger is not recommending a reallocation on an IJA basis, but rather a reallocation on a COS basis that is consistent with the IJA method. However, his recommendation seems to ignore the way in which the cost to service these wholesale sales was allocated. Essentially, it seems that at this point we can not recommend a reallocation of the revenue credit on an IJA basis. And as I explain

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<sup>6</sup> The revenue credit allocated to Utah is based on a 98% SG allocation and a 2% SE allocation. Under the COS model, it is allocated based on with 87% on an F10 factor and 13% on an F30 factor.

below in my testimony, we also believe that a reallocation on a COS basis is not appropriate.

**Q. Doesn't the Division generally support COS allocations which are consistent with IJA allocations?**

A. Yes, however, in this instance, we consider that an allocation of revenues must also be consistent with the allocation of costs. The allocation of the resale revenue credit on a COS basis is consistent with the allocation of the cost on an IJA basis of servicing those contracts. On a COS basis there is also a close matching of the allocation of costs and revenues. The costs are assumed to be approximated by the purchased power costs allocated in Account 555. The revenue credit carried in Account 447 is allocated on the same basis, which is approximately an 87/13 split between the F10 and F30 factors, respectively.

During the proceedings in Docket 97-035-01 and again in the resultant Allocations Task Force, the Division supported that such a matching was appropriate.<sup>7</sup> Additionally, during the Allocations Task Force meetings we demonstrated that the Company's approach in its 1998 COS model was consistent with our recommendation. In Exhibit COS 10 R.1 to this testimony, I have provided the results of a similar analysis I performed utilizing the Company's COS results for the test period in this docket. The indication of my analysis is

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<sup>7</sup> The Division also understood that during the Task Force meetings the Committee agreed with this approach. On page 13 of the Task Force report file 12/16/01 it is stated that "parties agreed with the principle that the sales for resale revenue should be allocated on the same basis as the cost of making the sales."

that the Company is allocating costs and revenues in an approximately consistent manner.

**Q. Please provide a synopsis of this exhibit.**

A. Utilizing the Company's COS study in this docket, I extracted the amounts allocated under accounts 447 and 555. I then used hourly load and resource data provided by the Company to develop values for PacifiCorp's total generation, total power purchases, and total sales. I subtracted from the total generation the total sales. The remainder I assumed was available for wholesale sales. I added this to the Company's total purchases and utilized this as the total value of power available for resale. The simplifying assumption is that all wholesale purchases are assumed to be made to meet wholesale sales.<sup>8</sup> Utilizing this data I developed F10 and F30 factors. I applied the DPU developed F10 factor to account 447 and determined that approximately \$524 million was allocated on this basis. This represented about 61% of the total. This closely matches the Company's 65% on the F10 factor. Our conclusion is that the Company's method of matching Account 555 allocations with Account 447 allocations generates results that approximately match costs and revenues.

Thus, we consider that the Company's approach of synonymously allocating Accounts 447 and 555 across classes provides an outcome sufficiently close to our more complicated method. We note that the allocation method is not an "exact science" but maintain that approximately allocating costs and revenues in a

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<sup>8</sup> It should also be noted that I did not account for losses, since the data was not available.

similar manner provides for a more fair allocation across classes. It should also be noted that this is consistent with the Commission's Order in Docket 97-035-01 in which the Commission expressly accepted the Division's position. In particular, the Order states

The Division, the Company, and the Committee agree that the allocation of sales-for-resale revenues is consistent with the allocation to classes of purchased power expenses, which primarily serve sales-for-resale load. Analysis performed by the Division shows that approximately 65 percent of sales-for-resale costs and revenues are allocated on the basis of peak demands and 35% on energy usage...We accept the Division's analysis and conclude there is no reason to depart from the existing method of allocating sales-for-resale revenue.

**Q. Does the Division accept Mr. Sterzinger's recommendation that the revenue credit allocated to the Special Contract class should be reallocated to all other classes?**

A. No, we do not. Again, the issue is the consistency between the allocation of costs and revenues across classes. A portion of purchased power costs (Account 555) has also been allocated to this class. For Account 447, \$11,361,430 was allocated under the class "Industrial Contracts."<sup>9</sup> This class was also allocated \$12,368,347 in purchased power costs.<sup>10</sup> Thus, it is not appropriate to simply reallocate the revenue credit without a consideration of the costs allocation.

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

A. Yes.

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<sup>9</sup> Exhibit UP&L DLT 3 Tab 4.1 Page 3 of 18.

<sup>10</sup> UP&L Exhibit DLT 3 Tab 4.1 Page 5 of 18.