

**Before the
Utah Public Service Commission**

PSC Case No. 01-035-01

Rate Design

PacifiCorp

Rebuttal Testimony of

Alan Chalfant

On Behalf of

Utah Industrial Energy Consumers

Project 7518
August 31, 2001



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1 **Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A Alan Chalfant; 1215 Fern Ridge Parkway, Suite 208; St. Louis, Missouri 63141-2000.

3 **Q WHAT IS YOUR OCCUPATION?**

4 A I am a consultant in the field of public utility regulation with Brubaker & Associates,
5 Inc., energy, economic and regulatory consultants.

6 **Q HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY IN THIS PROCEEDING?**

7 A Yes, I have.

8 **Q ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?**

9 A I am appearing on behalf of the Utah Industrial Energy Consumers (UIEC). The
10 members of UIEC include numerous large customers of PacifiCorp (Company).

1 **Q WHAT IS THE SUBJECT OF YOUR REBUTTAL TESTIMONY?**

2 A My rebuttal testimony will discuss the Division of Public Utilities' (Division) cost of service
3 study, proposed revenue allocation, and certain rate design issues. I will also address
4 the proposals of Dr. Charles Johnson on time-of-use rates and special contracts and Dr.
5 George Sterzinger's proposals concerning revenue allocation and the treatment of
6 special contracts.

7 **Comments on the Division's Direct Testimony**

8 **Q HAVE YOU REVIEWED THE DIVISION'S COST OF SERVICE STUDY PRESENTED**
9 **BY DR. LAURA NELSON IN HER DIRECT TESTIMONY?**

10 A Yes. Dr. Nelson used a Commission Staff COS model, which is based on the PacifiCorp
11 model with certain adjustments. The most important such adjustment was the use of the
12 Division's revenue requirement, which calls for a \$5.8 million rate increase as compared
13 to the \$142 million increase incorporated in the Company's cost of service study. Other
14 changes were to the system loss factors and system overhead costs in particular
15 accounts.

16 **Q DO YOU HAVE ANY COMMENTS ON THESE CHANGES?**

17 A Yes. The changes concerning overhead costs was made because of a concern that the
18 allocation of these costs by the Company was inconsistent with the way PacifiCorp
19 allocates these costs on an inter-jurisdictional basis. In an attempt to correct for this
20 inconsistency, Dr. Nelson applies a plant allocator rather than the Company's proposed
21 labor allocator.

1 **Q IS THIS CHANGE APPROPRIATE?**

2 A While Dr. Nelson's concern that jurisdictional and inter-jurisdictional allocations should
3 be consistent is understandable, that consistency would be more appropriately achieved
4 by changing the allocation of all overhead costs to a labor basis.

5 **Q WHY WOULD USE OF THE LABOR ALLOCATOR RESULT IN A CONSISTENT**
6 **ALLOCATION OF OVERHEAD COSTS?**

7 A Because that is the method of allocating overhead costs which is used by the Federal
8 Energy Regulatory Commission (FERC). The FERC has a long-standing policy of
9 requiring utilities to allocate overhead costs among functions using a labor allocator.
10 This was clearly stated by the FERC as early as 1978 in Opinion No. 20-A regarding
11 Minnesota Power & Light Company (Docket Nos. E-9499 and E-9502) and Superior
12 Water, Light and Power Company, (Docket No. ER76-20). There, the FERC stated with
13 respect to General Plant costs:

14 We now want to make it entirely clear that Opinion No. 20 should be
15 considered a precedent on the question of the functionalization and
16 allocation of General Plant. What we find determinative is that in most
17 cases General Plant is more likely to be associated with labor costs than
18 plant costs." (5 FERC 61,150)

19 The fact that the FERC remains firm on this issue is demonstrated in an Order
20 issued May 28, 1998 in Docket Nos. ER98-2382-000, OA96-199-002, and
21 OA97-679-000 involving Montana Power Company. There, the Commission summarily
22 rejected four proposals with respect to the Company's filed cost of service study,
23 including the failure to use labor ratios to allocate General Plant costs. The FERC
24 requires a corresponding labor allocation of Administrative and General Expenses.

1 **Q ARE THERE REASONS THAT MAKE THE USE OF A LABOR ALLOCATOR**
2 **ESPECIALLY IMPORTANT IN THIS CASE?**

3 A Yes. PacifiCorp has proposed a restructuring of its corporation, which it has filed in Utah
4 in Docket No. 00-035-15. This restructuring has many far-reaching implications, one of
5 which will involve the unbundling of its generation from its other functions. A key issue in
6 that respect will be the proper allocation of overhead costs to each function. In order for
7 any corporate unbundling which could be approved in that proceeding to be done right, it
8 is important that overhead costs be properly allocated to the Company's functions in the
9 cost of service study that is approved in this case.

10 **Q HOW HAS THE DIVISION PROPOSED TO ALLOCATE ITS RECOMMENDED \$5.8**
11 **MILLION INCREASE?**

12 A It has proposed to allocate the increase across-the-board to three classes – Residential
13 Rate 1, Irrigation Rate 10, and Mobile Home Park Rate 25. This is a reasonable
14 application of the Division's cost of service study results to PacifiCorp's revenue
15 requirement.

16 **Q THE DIVISION'S RATE DESIGN WITNESS, REBECCA WILSON, RECOMMENDS**
17 **DECREASING THE CUSTOMER CHARGES IN GENERAL SERVICE TIME OF DAY**
18 **OPTION RATES. DO YOU AGREE WITH THAT PROPOSAL?**

19 A No. The existing customer charges in Rates 6 and 9 are well below cost. For example,
20 the total of customer-related expenses for customer accounts, customer service, and
21 sales in the Division's cost of service study is approximately \$1.5 million. Dividing this
22 by the customer charge billing units equates to a charge of more than \$430 per month.
23 This does not include any allocation of plant costs such as meters. Thus, it appears that
24 a large amount of these costs are already recovered through energy charges. To

1 transfer additional costs from the customer charge to the energy charge would cause
2 additional distortion of the price signals that customers receive.

3 **Q WHAT IS YOUR RECOMMENDATION CONCERNING THIS PROPOSAL?**

4 **A** Any reduction of Rate 6 and 9 customer charges is contrary to cost of service principals.
5 Therefore, I would oppose the proposed changes. If, however, it is decided to reduce
6 customer charges, the resulting lost revenue should be recovered through increases in
7 demand charges not energy charges.

8 **Q WHY IS IT MORE APPROPRIATE TO RECOVER THE LOST CUSTOMER CHARGE**
9 **REVENUE THROUGH DEMAND CHARGES RATHER THAN ENERGY CHARGES?**

10 **A** To the extent that there is controversy about the classification of customer costs, that
11 controversy relates to whether costs should be considered customer-related or demand-
12 related. Both customer- and demand-related costs are fixed costs, which do not vary
13 with the amount of energy consumed.

14 Recovering fixed costs through energy charges has three undesirable
15 consequences. First, it provides customers with poor price signals. Second, it recovers
16 costs from the wrong customers. To the extent that fixed costs are recovered through
17 energy charges, customers with high load factors that use electricity the most efficiently
18 pay more than if these costs were properly recovered through fixed charges. Third,
19 unless actual sales exactly match test year sales, the utility will either over- or under-
20 recover its costs.

21 Although I disagree with the basic principal of setting customer charges below
22 the associated per unit cost, if the resulting revenues are transferred to demand
23 charges, the damage to price signals, allocation of costs to individual customers, and

1 avoiding unnecessary over- or under-recovery of total costs by the utility are all reduced
2 as compared to shifting those costs to the energy charges.

3 **Q DO YOU AGREE WITH MS. WILSON'S PROPOSALS OPPOSING THE CLOSING OF**
4 **RATE 9 TO LARGE CUSTOMERS?**

5 **A**Yes. I also oppose the closing of this rate to large customers for several reasons as
6 discussed in my direct testimony. Moreover, Ms. Wilson's proposed new rate for
7 customers taking delivery at 138 kV is a much more positive solution to the Company's
8 claimed concern that the larger customers do not have similar cost characteristics than
9 simply closing the rate.

10 **Q IS IT POSSIBLE THAT THE COST OF SERVING SPECIAL CONTRACT**
11 **CUSTOMERS COULD BE LESS THAN RATE 9 OR THE NEW RATE PROPOSED BY**
12 **MS. WILSON?**

13 **A**It is both possible and likely. The purpose of special contracts is to better reflect in those
14 contracts the differences in characteristics between individual customers and class
15 averages. Standard tariff rates that are designed to reflect average characteristics
16 cannot possibly recognize the numerous unique characteristics of large industrial loads.

1 **Comments on the Direct Testimony of Dr. Charles Johnson**

2 **Q ARE YOU FAMILIAR WITH THE TESTIMONY OF DR. CHARLES JOHNSON ON**
3 **BEHALF OF THE SALT LAKE COMMUNITY ACTION PROGRAM, THE**
4 **CROSSROADS URBAN CENTER, AND UTAH LEGISLATIVE WATCH CONCERNING**
5 **TIME-OF-USE RATES FOR LARGE CUSTOMERS?**

6 **A** Yes. Dr. Johnson proposes that the peak period for time-of-use rates be shortened to
7 better reflect costs and that large customers which already have the necessary metering
8 be billed on mandatory time-of-use rates.

9 **Q DO YOU AGREE WITH THESE PROPOSALS?**

10 **A** I agree with Dr. Johnson's concept but caution against rushing into the programs he
11 proposes without adequate time for proper development and analysis. Before any time-
12 of-use rates are made mandatory, it is critical that proper cost-based rates that reflect
13 time varying cost differences be developed. The first step in this process is to identify
14 the proper peak hours as Dr. Johnson has recognized. This step involves analysis of
15 load patterns and identification of any trends in those patterns so that, once
16 implemented, customers are not subjected to overly broad peak periods as in the
17 present rate options or to frequent changes in the definition of the peak, which would
18 prohibit meaningful planning on the part of customers.

19 Having determined the proper time-of-use periods, the next step is to assign or
20 allocate costs to those periods. This is not a simple process and requires an unbundling
21 of rates into their separate production, transmission, and distribution components. This
22 is necessary because the extent to which costs vary by time-of-use differs as between
23 the various functions. For example, while production costs will likely vary considerably
24 with time-of-use, distribution costs may not.

1 After determining the costs by period, the specific rates must be designed. This
2 requires an estimate of billing units by time period. Estimating the billing units by time
3 period, in turn, requires forecasting how customers will react to the time-of-use rates
4 based on knowledge or estimates of those customers' demand elasticities.

5 Dr. Johnson has already identified, at pages 27 and 28 of his direct testimony,
6 various other problems that will be encountered in the development of time-of-use rates.

7 **Q WHAT IS YOUR CONCLUSION WITH RESPECT TO DR. JOHNSON'S PROPOSALS**
8 **CONCERNING MANDATORY TIME-OF-USE RATES?**

9 **A**While this is a reasonable goal, Dr. Johnson's proposal that the Company come forward
10 with proposed time-of-use rates in its rebuttal testimony in this proceeding is not
11 reasonable.

12 As Dr. Johnson notes, the Company is the only party with the data required to
13 design proper time-of-use rates and other parties must rely on the Company to make the
14 initial proposal. But, having seen that initial proposal, other parties will want to test it and
15 analyze the data on which it is based. This will require considerable discovery and time
16 to analyze the data once received as well as time to develop alternative proposals. It
17 would be unreasonable to require parties to attempt to do so in response to a proposal
18 that they see for the first time in the Company's rebuttal testimony.

19 **Q DR. JOHNSON ALSO PROPOSES THAT ALL SPECIAL CONTRACT CUSTOMERS**
20 **BE BILLED ON TIME-OF-USE RATES. DO YOU AGREE WITH THAT PROPOSAL?**

21 **A**No. An advantage of special contracts is that the specific rates can be tailored to best
22 take into consideration a specific customer's load characteristics. In some cases,
23 particularly where customers already consume at a constant rate around the clock, there
24 may be other considerations that are more important than reflecting time-of-use in the

1 particular rates charged. In such cases, the contract rate reflects time-of-use as well as
2 other considerations, which, in total, makes the contract beneficial for the Company and
3 its other customers. In other cases, a more specific time-of-use design particularly
4 related to an individual load may be more appropriate than the general design of time-of-
5 use rates. An example of this might be a rate that charges a customer for the demands
6 it places on the system at the time the system actually peaks. In short, it defeats the
7 purpose of special contracts to determine the structure of the rate a priori.

8 **Q DOES DR. JOHNSON MAKE ANY OTHER PROPOSALS WITH RESPECT TO**
9 **SPECIAL CONTRACTS?**

10 A Yes. He recommends that PacifiCorp be required to include in each special contract a
11 provision stating that the Commission can modify the terms and charges of the contract
12 in a general rate case or other proceeding.

13 **Q IS THIS A REASONABLE REQUIREMENT?**

14 A No. An important benefit to customers that enter into special contracts is rate stability.
15 Based on this assurance of rate stability, customers make equipment selections,
16 investment decisions, plant location decisions, and manpower choices. Absent the
17 assurance of rate stability, customers may be unable to make long-term commitments to
18 the Utah economy. Once again, removal of this flexibility in the negotiation of special
19 contracts undercuts the viability of a useful tool that can provide benefits to customers,
20 PacifiCorp, and the Utah economy.

1 **Comments on the Direct Testimony of Dr. George Sterzinger**

2 **Q ARE YOU FAMILIAR WITH THE TESTIMONY OF DR. GEORGE STERZINGER ON**
3 **BEHALF OF THE COMMITTEE OF CONSUMER SERVICES (COMMITTEE)?**

4 **A** I am.

5 **Q WHAT IS DR. STERZINGER'S POSITION ON THE ISSUE OF REVENUE**
6 **ALLOCATION BETWEEN CLASSES?**

7 **A** He proposes that if the Committee's net power costs are accepted, all classes should
8 receive an equal percent decrease except Schedule 23, which should receive a larger
9 decrease. If, on the other hand, the Company prevails on the net power cost issues and
10 receives a large increase, Dr. Sterzinger has an alternative proposal.

11 **Q PLEASE DESCRIBE HIS ALTERNATIVE PROPOSAL.**

12 **A** His "fallback" position is to allocate the increase by using a combination of an equal
13 percent of revenue and an equal per kWh increase. These methods would each receive
14 a 50% weighting.

15 **Q WHAT IS HIS BASIS FOR PROPOSING THIS ALLOCATION?**

16 **A** He argues that because the increase is driven by production function costs, an equal
17 percent increase will over-allocate costs to classes that use the distribution system.

18 **Q IS HE CORRECT?**

19 **A** No. First, his analysis assumes that presents rates accurately reflect costs other than
20 the increase in net power costs. He also ignores the fact that the Company's cost of
21 service study fully reflects the level of net power costs that it is requesting. Based on an

1 analysis of the cost of service results inclusive of the requested net power costs, the
2 Company proposed an across-the-board percentage increase (with limited exceptions)
3 as reflective of those results. As I noted in my direct testimony, that proposal
4 represented a reasonable spread of costs.

5 **Q CAN YOU DEMONSTRATE HOW THE COMPANY'S COST OF SERVICE STUDY**
6 **ALLOCATES ITS REQUESTED INCREASE IN NET POWER COSTS?**

7 A Yes. This can be seen by a comparison of the generation component allocated to each
8 class in the Division's COS to the generation component in the Company's COS. This
9 comparison is shown on Exhibit ____ (AC-4). The difference between the Division's
10 generation component and the Company's is \$117 million. This difference in generation
11 costs results primarily from the Company's position on net power costs. Comparison of
12 the two studies shows that the Company's allocation of increased net power costs adds
13 nearly 21% to the revenue requirement of Rate 9 customers and only 12% to the
14 revenue requirement of the residential class and 15% to the total Utah Jurisdiction
15 revenue requirement. This disproportionate allocation is fully incorporated in the
16 Company's study. Since the disproportionate allocation is already incorporated, there is
17 no basis for allocating to Rate 6 and 9 customers a percentage increase larger than the
18 system average.

19 **Q DO YOU AGREE WITH DR. STERZINGER'S ARGUMENT THAT SPECIAL**
20 **CONTRACTS NOT BE ALLOCATED A PORTION OF THE REVENUE CREDITS**
21 **FROM WHOLESALE SALES?**

22 A No. Unless he would also propose that there be no allocation of wholesale costs to
23 contracts, it would be blatantly unfair to refuse to allocate wholesale revenues to them.
24 Clearly, the costs and the revenues are the two sides of the net power cost issue. As

1 Exhibit ____ (AC-4) shows, the special contracts are already allocated the greatest
2 share of the net power costs at issue in this case as a percent of present revenues. In
3 any event, it seems counter-productive to raise this issue at this time because the
4 Company did not seek to increase special contract rates in this proceeding and no party
5 has proposed such an increase.

6 **Q DOES THIS COMPLETE YOUR REBUTTAL TESTIMONY ON COST OF SERVICE**
7 **AND RATES?**

8 **A** Yes, it does.

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PacifiCorp

Comparison of the Division and Company Allocation of the Generation Cost Component \$(000)

Line	Class	Rate	Generation in		Difference	Present Revenue	Percent Difference
			Division COS	Company COS			
1	Residential	1	\$ 142,362	\$ 180,632	\$ 38,271	\$ 309,892	12.3%
2	General Service - Large	6	\$ 184,191	\$ 233,102	\$ 48,911	\$ 311,675	15.7%
3	Street & Area Lighting	7,11,12,13	\$ 1,150	\$ 1,372	\$ 223	\$ 9,097	2.4%
4	General Service - High Voltage	9	\$ 70,849	\$ 89,736	\$ 18,887	\$ 90,226	20.9%
5	Irrigation	10	\$ 4,568	\$ 5,710	\$ 1,142	\$ 7,284	15.7%
6	Traffic Signals	12	\$ 334	\$ 418	\$ 85	\$ 703	12.0%
7	Outdoor Lighting	12	\$ 125	\$ 148	\$ 22	\$ 576	3.9%
8	Commercial Space Heating	19	\$ 659	\$ 839	\$ 180	\$ 1,651	10.9%
9	Electric Furnace	21	\$ 122	\$ 154	\$ 32	\$ 349	9.3%
10	General Service - Small	23	\$ 30,201	\$ 38,536	\$ 8,335	\$ 61,492	13.6%
11	Mobile Home Parks	25	\$ 332	\$ 421	\$ 89	\$ 590	15.0%
12	Firm Industrial Contracts	SC	\$ 6,008	\$ 7,581	\$ 1,573	\$ 6,913	22.8%
13	Total		\$ 440,900	\$ 558,650	\$ 117,750	\$ 800,447	14.7%