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BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application of PACIFICORP for an Investigation of Inter- Jurisdictional Issues	TESTIMONY OF KEVIN C. HIGGINS ON BEHALF OF THE UAE INTERVENTION GROUP
	Docket No. 02-035-04

The UAE Intervention Group hereby submits the testimony of Kevin C. Higgins in this docket.

DATED this 15th day of July, 2004.

HATCH, JAMES & DODGE

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TESTIMONY

Of

KEVIN C. HIGGINS

On behalf of the UAE Intervention Group

In the Matter of the Application of PACIFICORP for an
Investigation of Inter-Jurisdictional Issues

Utah Public Service Commission Docket No. 02-035-04

July 15, 2004

1 **Introduction**

2 **Q. Please state your name and business address.**

3 A. Kevin C. Higgins, 39 Market Street, Suite 200, Salt Lake City, Utah, 84101.

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

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

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

9 A. My testimony is being sponsored by the Utah Association of Energy Users
10 Intervention Group (“UAE”).

11 **Q. Please describe your professional experience and qualifications.**

12 A. My academic background is in economics, and I have completed all coursework
13 and field examinations toward a Ph.D. in Economics at the University of Utah. In
14 addition, I have served on the adjunct faculties of both the University of Utah and
15 Westminster College, teaching undergraduate and graduate courses in economics from
16 1981 to 1995. I joined Energy Strategies in 1995, where I assist private and public sector
17 clients in the areas of energy-related economic and policy analysis, including evaluation
18 of electric and gas utility rate matters.

19 Prior to joining Energy Strategies, I held policy positions in state and local
20 government. From 1983 to 1990, I was economist, then assistant director, for the Utah
21 Energy Office, where I helped develop and implement state energy policy. From 1991 to
22 1994, I was chief of staff to the chairman of the Salt Lake County Commission, where I

1 was responsible for development and implementation of a broad spectrum of public
2 policy at the local government level.

3 **Q. Have you previously testified before this Commission?**

4 A. Yes. I first testified before the Utah Public Service Commission in 1984, and over
5 the years have testified in over a dozen proceedings before this Commission.

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

7 A. Yes. Overall, I have testified in over forty proceedings on the subjects of utility
8 rates, terms, and conditions before state utility regulators in Arizona, Colorado, Georgia,
9 Idaho, Indiana, Michigan, Nevada, New York, Ohio, Oregon, South Carolina, Utah,
10 Washington, and Wyoming.

11 A more detailed description of my qualifications is contained in Exhibit KCH-1,
12 attached to this testimony.

13

14 **Overview and conclusions**

15 **Q. What is the purpose of your testimony in this proceeding?**

16 A. The purpose of my testimony is to:

17 (1) recommend Commission ratification of the MSP stipulation;

18 (2) explain UAE's reasons for signing the stipulation, and articulate UAE's
19 understandings and assumptions in signing; and

20 (3) identify UAE's ongoing concerns.

21

22 **Support for the MSP stipulation**

1 **Q. Do you believe the Commission should ratify the MSP Stipulation and associated**
2 **Revised Protocol?**

3 A. Yes. Taken as a package, I believe the MSP Stipulation and associated Revised
4 Protocol are in the public interest and should be ratified by the Commission.

5 **Q. Why do you believe the MSP Stipulation and associated Revised Protocol are in the**
6 **public interest?**

7 A. In recent years, various jurisdictions in PacifiCorp's territory have adopted
8 interjurisdictional cost allocation methods that are not consistent with one another. This
9 problem is particularly significant in the cases of Utah and Oregon, which are the two
10 largest jurisdictions in which PacifiCorp serves. PacifiCorp has maintained that the lack
11 of a consistent interjurisdictional cost allocation method deprives the Company of a
12 reasonable opportunity to fully recover its prudently-incurred costs, and thus is harmful
13 to the Company's financial integrity. Also, PacifiCorp has been reluctant to invest money
14 in necessary infrastructure improvements and facilities because of its fear that not all of
15 its investment will be recovered. UAE recognizes that the perception of financial harm
16 may have negative consequences for PacifiCorp customers, particularly in the form of
17 increased costs to the Company in capital markets. Also, ratepayers will be harmed to
18 the extent the utility refuses to make necessary infrastructure investments.

19 At the same time, it must be remembered that, at the time of the PP&L/Utah
20 Power merger, PacifiCorp explicitly accepted the risk that inconsistent interjurisdictional
21 cost allocation methods might be used by various state commissions. The Company's
22 explicit agreement to accept this risk must be factored into any fair and reasonable

1 resolution of the interjurisdictional allocation problems.

2 I conclude that the MSP Stipulation and associated Revised Protocol, taken
3 together, are in the public interest. The Revised Protocol, if followed by most or all of the
4 states, should largely eliminate the inconsistency in interjurisdictional allocation
5 methods. The Stipulation provides a transition period during which the impact and risks
6 associated with the change in interjurisdictional allocation method is mitigated for Utah
7 customers. Also, the Stipulation and associated rate caps effect a sharing of the financial
8 impacts of the change to Revised Protocol between PacifiCorp's Utah ratepayers and its
9 shareholders.

10 **Q. What is the underlying set of issues that the Revised Protocol is intended to**
11 **address?**

12 A. In general, the purpose of the Revised Protocol is to provide a consistent
13 interjurisdictional cost allocation method among the PacifiCorp jurisdictions. At the same
14 time, there is a very pronounced subtext underlying the Revised Protocol. This subtext
15 reflects a negotiated resolution of a number of sensitive issues among the states,
16 particularly issues between Oregon and Utah.

17 Specifically, Oregon parties asserted a desire to allocate virtually all of the hydro
18 benefits of the integrated system to the Northwest states, primarily Oregon and
19 Washington, while insulating themselves, to the maximum extent possible, from the cost
20 consequences of load growth in any other state, particularly Utah. I note that Utah is the
21 largest PacifiCorp jurisdiction, and currently has the highest growth rate of the
22 PacifiCorp jurisdictions.

1 Utah parties, on the other hand, have consistently expressed a preference that the
2 PacifiCorp system be planned, operated and otherwise treated as an integrated whole,
3 inclusive of cost allocation, and thus have advocated for a “rolled-in” allocation method.
4 Utah parties have also maintained that the rolled-in approach is the most reasonable
5 approach for fairly allocating the cost consequences of load growth.

6 The resulting Revised Protocol is a compromise. It recognizes a special hydro
7 allocation that benefits Oregon and Washington to the detriment of Utah. At the same
8 time, jurisdictions are required to take cost responsibility for existing QF contract costs
9 that are above system embedded costs, a significant share of which becomes the cost
10 responsibility of Oregon. The Revised Protocol also recognizes a new category of
11 resource for allocation purposes – so-called “seasonal resources” – which has been an
12 important consideration for Oregon, and to which UAE does not object in concept.

13 **Q. How does the rate mitigation feature in the Stipulation work?**

14 A. In moving to the Revised Protocol method, it is generally expected that Utah will
15 be allocated more costs than under the Rolled-In method, at least for the next several
16 years. According to PacifiCorp’s projections, the impact of the methodology change will
17 increase costs to Utah by more than 2 percent in Fiscal Year 2006,¹ and will result in a
18 higher allocation of costs through Fiscal Year 2010. Starting in Fiscal Year 2011,
19 PacifiCorp projects that the Revised Protocol method will result in fewer costs being
20 allocated to Utah than under the Rolled-In method. This reversal is expected to occur
21 because, under the Revised Protocol method, Utah will avoid much of the considerable

¹ Fiscal Year 2006 extends from April 1, 2005 to March 31, 2006.

1 projected costs of hydro re-licensing that is anticipated to occur after Fiscal Year 2010.

2 The rate mitigation provisions in the Stipulation limit the impact to Utah of
3 switching to the Revised Protocol method over a multi-year period. Starting with the rate
4 effective period applicable to the next general rate case, the rate increase to Utah from
5 moving to the Revised Protocol method is capped at a 1.50 percent increase relative to
6 the Rolled-In method until March 31, 2007. Similarly, from April 1, 2007 through March
7 31, 2009, the rate increase to Utah from moving to the Revised Protocol method is
8 capped at a 1.25 percent increase relative to the Rolled-In method. And, from April 1,
9 2009 through March 31, 2014, the rate increase to Utah from moving to the Revised
10 Protocol method is capped at a 1.00 percent increase relative to the Rolled-In method.
11 However, in this latter period, if PacifiCorp projects that the revenue requirement to Utah
12 from moving to the Revised Protocol method would otherwise exceed a 1.00 percent
13 increase relative to the Rolled-In method, the Company may propose a new
14 interjurisdictional cost allocation method, and the Parties to the Stipulation have agreed
15 to consider alternative methods in good faith and to use their best reasonable efforts to
16 come to agreement on an amended Revised Protocol within 12 months.

17 In addition, for the period from April 1, 2009 through March 31, 2012, if the rate
18 impact to Utah from moving to the Revised Protocol method is less than 1.00 percent
19 increase relative to the Rolled-In method, then a premium of .25 percent will be added to
20 the Revised Protocol revenue requirement, subject to the 1.00 percent cap described
21 above.

22

1 **UAE's reasons for signing the Stipulation**

2 **Q. Why has UAE agreed to support the Stipulation?**

3 A. From the beginning of the Multi-State Process, UAE committed to work with
4 other parties in good faith in an effort to reach a just and reasonable resolution of the
5 interjurisdictional cost allocation problems discussed above, and has participated actively
6 in that process. UAE has concluded that, on balance, the Stipulation and Revised
7 Protocol should produce reasonable results. Had the parties been unable to reach a just
8 and reasonable resolution, UAE would not have signed the Stipulation. UAE would have
9 opposed, in whatever forum was appropriate, the imposition of terms that were unfair and
10 unreasonable on Utah customers, and on UAE members, in particular.

11 UAE supports the Stipulation, because taken together, the Stipulation and the
12 Revised Protocol appear to be in the public interest, for the reasons described above.

13 Of particular importance to UAE are the rate mitigation provisions in the
14 Stipulation. Absent these provisions, UAE would not have signed the Stipulation. An
15 important aspect of these provisions is that they protect Utah customers whether or not
16 PacifiCorp's forecast of impacts on Utah under the revised Protocol relative to Rolled-In
17 is accurate.

18 **Q. Please explain.**

19 A. As I stated above, according to PacifiCorp's projections, the impact of the
20 methodology change will increase costs to Utah by more than 2 percent in 2006, and will
21 result in a higher allocation of costs through Fiscal Year 2010. But, starting in Fiscal
22 Year 2011, PacifiCorp projects that the Revised Protocol method will result in fewer

1 costs being allocated to Utah than under the Rolled-In method, due to the expected
2 incurrence of hydro re-licensing costs. If this forecast is correct, Utah will be at the
3 1.50/1.25/1.00 percent caps for about four to five years. Then, starting in Fiscal Year
4 2011, Utah would be better off under the Revised Protocol, and would pay a .25 percent
5 premium in that year. From that point onward, although the caps would be in place, they
6 would not be expected to be invoked.

7 However, in the event that PacifiCorp's forecast is wrong, the rate mitigation
8 provisions continue to play an important role. If, for example, Utah turns out to be *worse*
9 off under the Revised Protocol relative to Rolled-In for any year after fiscal year 2011,
10 then the caps can still be invoked through 2014, subject to the provision that allows
11 PacifiCorp to propose a new interjurisdictional cost allocation method. And it is
12 significant that that provision places the filing burden on PacifiCorp; until such time as
13 the interjurisdictional cost allocation method changed by the Commission, Utah
14 customers are protected by the cap through 2014.

15 **Q. What happens if PacifiCorp's forecast turns out to have been too conservative from**
16 **Utah's perspective, and the Revised Protocol turns out to better for Utah than**
17 **Rolled-In sooner than fiscal year 2012?**

18 A. In that case, the Revised Protocol will set Utah's rates. If this occurs between
19 April 1, 2009 and March 31, 2012, Utah will pay a premium of .25 percent over the
20 Revised Protocol method. In my opinion, this premium would be reasonable, as it would
21 be paid based on a cost allocation method that made Utah better off than we would have
22 otherwise been. Plus, Utah would have had the security of the applicability of the caps in

1 other years, and under different outcomes.

2 **Q. Will you summarize your assessment of the rate mitigation provisions in the**
3 **Stipulation?**

4 A. The rate mitigation provisions in the Stipulation provide Utah the lower of the
5 Revised Protocol or the cap through 2014, subject to the .25 premium provision, and
6 subject to the provision that allows PacifiCorp to propose a new interjurisdictional cost
7 allocation method under limited circumstances. Taken as a whole, this is a balanced
8 outcome for PacifiCorp and Utah customers.

9 **Q. Are there any other provisions of the Stipulation and/or Revised Protocol that are**
10 **necessary for UAE's support?**

11 A. Yes. For example, Section III of the Revised Protocol states, in part, that "All
12 Resource Fixed Costs, Wholesale Contracts and Short-term Purchases and Sales will be
13 classified as 75 percent Demand-Related and 25 percent Energy-Related." This provision
14 preserves the current Demand/Energy split associated with fixed production costs.
15 Retaining this provision is a necessary condition for UAE's support of the Revised
16 Protocol. UAE would not have agreed to a deal that reduced the weighting of the demand
17 classification below the current level.

18 In Utah, the *intra*-jurisdictional cost allocation has traditionally been tied closely
19 to the *inter*-jurisdictional methodology. Reducing the demand classification would have
20 shifted costs *within* Utah to General Service customers, resulting in a double penalty for
21 these customers from the Revised Protocol. This would have resulted in an unreasonable
22 impact to these customers, and would not have been acceptable to UAE.

1 In addition, the “Reservation of Rights” section at the end of the Stipulation is
2 critical to UAE’s support of the Revised Protocol. That section makes it clear that neither
3 support of the Revised Protocol nor execution of the Stipulation will bind or be used
4 against a party in the event that unforeseen or changed circumstances cause continued use
5 of the Revised Protocol to produce unjust or unreasonable results. This is particularly
6 important to UAE because the only projections of impacts to Utah ratepayers stemming
7 from the Revised Protocol that we have seen have been prepared by PacifiCorp.

8 Throughout the MSP process, UAE repeatedly expressed concern that the only
9 projections of rate impacts resulting from changes in interjurisdictional allocation
10 methods were produced by complicated “black box” models created and operated
11 exclusively by PacifiCorp. To UAE’s knowledge, no one outside of PacifiCorp has ever
12 attempted to analyze, run or validate the models used by PacifiCorp to project impacts, or
13 the inputs or outputs of the models. Also, while there several requests were made for
14 “back casts” or other validation results, we have never seen any attempt at validation.

15 Significant concessions are being requested of Utah ratepayers through the
16 Revised Protocol. UAE has argued that no commitments should be made absent
17 thorough outside testing and validation of PacifiCorp’s projected impacts. No such
18 outside testing or validation has ever been done. For that reason, both the rate mitigation
19 measures and each party’s ability to withdraw support without recrimination are critical
20 to UAE’s support of the Revised Protocol. Should PacifiCorp’s projected impacts prove
21 to be significantly wrong, PacifiCorp will have an incentive, at least during the period of
22 the rate caps, to re-address interjurisdictional allocation issues, leaving all parties free to

1 advocate whatever approach makes the most sense. As the end of the rate mitigation
2 period approaches, if actual experience or then-current projections show that PacifiCorp's
3 initial projections of ratepayer impacts are significantly wrong, then any Utah party will
4 be free to abandon support of the Revised Protocol and advocate a different interstate
5 allocation method.

6
7 **UAE's ongoing concerns**

8 **Q. Notwithstanding its support, does UAE have ongoing concerns about the Stipulation**
9 **and the Revised Protocol?**

10 A. Yes, we still have several concerns. We support the Stipulation and the Revised
11 Protocol based on our good faith belief that they will produce just and reasonable results
12 for Utah ratepayers. However, we continue to have concerns, including the following:

- 13 • It appears that certain MSP participants from other states, particularly Oregon,
14 have different perceptions about the Revised Protocol than most Utah parties. For
15 example, Oregon participants continue to seek confirmation that the "hydro
16 endowment" will be "permanent." Utah parties have been unwilling to concede
17 to such a claim, and for good reason. In the event the Revised Protocol fails to
18 produce just and reasonable results for Utah ratepayers over time, any party will
19 be free to advocate for any reasonable interjurisdictional allocation method,
20 including a fully rolled-in approach or some other that may not, to the satisfaction
21 of the Oregon parties, recognize the claimed "permanence" of the hydro
22 endowment. This concern is heightened even more by the fact that Oregon

1 participants are requesting a commitment from PacifiCorp outside of the Revised
2 Protocol to the permanence of the “hydro endowment.” UAE is concerned that
3 PacifiCorp may be asked to make inconsistent commitments to different states in
4 order to secure “agreement;” if this occurs, the Company may in the future have
5 to seek relief from the consequences of such commitments.

- 6 • The algebraic depictions of protocol and rolled in allocation factors as reflected in
7 Appendix C to the Revised Protocol and Exhibit C to the Stipulation are
8 extremely complex. I have reviewed these formulations and they appear
9 conceptually consistent with my understanding of how the Rolled-In method
10 should be applied, but I have not attempted to replicate independently the Rolled-
11 In allocations using these formulations. The intent of the Stipulation is that the
12 Rolled-In method will be determined for purposes of enforcing rate caps in the
13 same manner it has been determined by the Commission in the past. UAE is
14 acting in reliance on PacifiCorp’s representations that Exhibit C to the Stipulation
15 accurately captures the current rolled-in methodology. To the extent it does not,
16 the current rolled-in methodology should be used for purposes of calculating rate
17 caps.

- 18 • A witness in the Oregon MSP proceedings has opined that the rate mitigation caps
19 contained in the Stipulation apply only to the Revised Protocol and not in the
20 event the Revised Protocol is amended. That is certainly not UAE’s expectation
21 or understanding. UAE understands that the rate caps will continue to apply
22 notwithstanding any potential amendments to the Revised Protocol, unless and

1 until the rate caps themselves are changed by stipulation or Commission order.

- 2 • Certain parties in the Northwest continue to maintain that structural mechanisms
3 are necessary to protect against cost shifting due to load growth in Utah, and the
4 Standing Committee is directed to analyze that issue, among others, in the
5 immediate future. To the extent requested structural mechanisms continue to
6 involve an accounting segregation of the utility into different divisions, UAE will
7 likely continue to express significant concerns. In addition, any proposed
8 structural mechanisms that may cause significant additional cost shifts to Utah
9 ratepayers will likely be resisted as unreasonable.

- 10 • It is not entirely clear what will happen if four states ratify the Revised Protocol,
11 but the two other states do not. Similarly, it is not clear how the Commission or
12 the parties will proceed in the event another state imposes material new terms or
13 conditions on ratification of the Revised Protocol.

- 14 • It is not clear to UAE exactly what is the legal import of Commission
15 “ratification” of the Revised Protocol and Stipulation or how such ratification will
16 impact Utah ratepayers, particularly those who are not participants in the MSP
17 process, in future rate cases.

18 **Q. Do you recommend ratification of the Revised Protocol notwithstanding these**
19 **concerns?**

20 A. Yes. On balance, and everything considered, I believe the Revised Protocol, with the
21 added protections offered to Utah ratepayers by the Stipulation, is in the public interest.
22 Results will need to be carefully monitored over the coming years, however, and

1 adjustments made, if necessary, to ensure that the public interest of the State of Utah is
2 adequately protected.

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

4 A. Yes, it does.