BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application of	)	
PACIFICORP for Approval of an IRP	)	
Based Avoided Cost Methodology For QF	)	Docket No. 03-035-14
Projects Larger than 1 Megawatt	)	

REBUTTAL TESTIMONY OF MAHENDRA B. SHAH

September 8, 2005

Q. Are you the same Mahendra Shah who previously filed direct testimony in this proceeding?

A. Yes.

Q. What is the purpose of your rebuttal testimony?

A. I am responding to the testimony submitted by Dr. Artie Powell on behalf of the Division of Public Utilities, Mr. Roger Swenson on behalf of U.S. Magnesium, LLC, and Mr. Scott A. Gutting on behalf of the UAE Intervention Group. My testimony explains how debt equivalence costs actually impact the costs to customers and the risk factor currently applied to PacifiCorp in determining imputed debt costs.

Q. What are the conclusions drawn by your rebuttal testimony?

A. The debt-like nature of QF Power Purchase Agreements (PPAs) increases the cost of capital to Utah customers. Failure to factor the debt aspects of QF contracts in calculating avoided cost payments can result in customers paying more than the avoided cost. The revenue requirement impact on customers should be calculated using the published S&P methodology.

Q. Has any party presented evidence that a long-term power purchase contract classified as a capital lease is not a liability to the utility?

A. No. Dr. Powell, at direct page 11, indicates that a QF contract classified as a capital lease imposes a cost on the utility.

Q. The DPU takes issue with the risk factor used by PacifiCorp. What is a "risk factor" and how is it determined?

A. "Risk factor" is a term used by S&P that "takes several variables into consideration, including the economics of the power and regulatory treatment, the overwhelming factor in selecting a risk factor has been a distinction in the likelihood of payment by the buyer." It is an assessment by the rating agency of how much risk an off-balance sheet obligation imposes on the purchaser. The credit rating agencies believe utilities are not financially compensated for the risks they assume in purchasing power. To factor this transfer of risk to the power purchaser a risk factor is determined. Risk factors applied to PPAs range from 10% to 100%. When multiplied by the present value of the fixed capacity payments associated with a PPA, the risk factor has the effect of lowering the amount of debt equivalence attributed to such contracts. A small risk factor results in a low level of debt equivalence, while a large risk factor produces the opposite result. The amount of total debt equivalence is added to the balance sheet debt to help determine the credit strength of a company.

Q. The DPU agrees with the recommendation to apply the S&P calculation of debt equivalence. What is the point of disagreement?

A. The applicable risk factor component of the calculation is the only point of dispute. Dr. Powell suggests a risk factor of only 15%, That risk factor is inconsistent with S&P's published statement. In May 2005, S&P specifically said it applies a 50% risk factor to PacifiCorp off-balance sheet obligations.[1]

Q. Dr. Powell suggests that passage of SB 26 will lower the risk factor for PacifiCorp. Is that an accurate assumption?

A. Not entirely. PacifiCorp has discussed SB 26 with S&P in an attempt to convince

[1] Standard & Poor's, Ratings Direct Research Summary: PacifiCorp, 5 May 2005.

the rating agency that the new legislation will positively impact the risk factor for PacifiCorp. In its May 2005 report S&P said, “The passage of SB26 implies that a lower risk factor will be utilized for future Utah PPAs that fall under the protection of the new legislation.”[2] S&P does not say how much lower the risk factor will be. But they do say the lower risk factor will apply only to PPAs “under the protection of the new legislation.” Not all QF power will be acquired “under the protection of the new legislation.”

Q. Why did PacifiCorp talk to S&P about SB 26?

A. It was a noteworthy change. It is in everyone’s interest for the rating agency to apply a lower risk factor to PacifiCorp. PacifiCorp believes the new legislation may reduce risks to the utility and that should be recognized in the risk factor that applies to debt equivalence. For contracts processed under the SB 26 rules, a lower risk factor could be applied in the future after S&P reassesses the risk. PacifiCorp continues to discuss with the rating agencies opportunities to enhance its credit profile cost-effectively, including minimizing the impact of debt imputation through initiatives such as the implementation of Utah SB 26.

Q. What if S&P changes the risk factor for PacifiCorp in the future?

A. I recognize that the risk factor could change in the future. For example a PCAM (Power Cost Adjustment Mechanism) may help to reduce the risk factor and the amount of imputed debt. PacifiCorp is willing to adjust the calculation to reflect the published S&P risk factor. PacifiCorp’s proposal is not to use 50% regardless, but to use the risk factor then being used by S&P.

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[2] Ibid.

Q. **Dr. Powell argues a 15% risk factor is a "conservative" number for a complex problem. What would be the impact on customers if the risk factor were understated?**

A. To set the risk factor lower than the actual level used by the credit rating agency will miscalculate the amount of debt equivalence and result in customers paying more than the avoided cost, as the impact on the cost of capital will be artificially understated. I recommend the Commission use the risk factor currently published by S&P, which is 50%. This recommendation is intended to protect customers.

Q. **Parties suggest that small QF contracts are too small to require the utility to rebalance the capital structure. Does PacifiCorp plan to issue equity every time it signs a QF contract?**

A. No. To minimize the cost of acquiring capital, typically debt and equity financings are issued in large blocks, often hundreds of millions of dollars. PacifiCorp could issue equity to rebalance the capital structure every time it signs a PPA. However, that approach would increase the costs of such transactions. To be efficient, PacifiCorp plans to steadily strengthen its credit ratios by issuing large blocks of capital. During FY 2006 ScottishPower will invest $500 million of new equity. The result will be a growing equity amount to fund new construction and offset the impact of PPAs and QF contracts.

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

A. Yes, it does.