

In the Matter of the Petition of US Magnesium LLC for Determination of Long-Term
Economic Development Rates and Conditions of Interruptible Service

Docket 03-035-19

DPU Exhibit 1

Surrebuttal Testimony of Andrea Coon
Division of Public Utilities

November 12, 2004

1 **Q. Please state your name and employer.**

2 A. My name is Andrea Coon; I work for the Division of Public Utilities.

3

4 **Q. Have you previously filed testimony in this docket?**

5 A. Yes, I filed direct testimony on behalf of the Division.

6

7 **Q. What is the purpose of this surrebuttal testimony?**

8 A. The purpose of this testimony is to respond to issues discussed in the rebuttal
9 testimony of Mr. Lee Brown and Mr. Roger Swenson as well as firm up the
10 rate for US Mag that I derived in my direct testimony. I will first firm up the
11 rate, and then I will address issues brought up by Mr. Brown and Mr.
12 Swenson.

13

14 **Q. In your direct testimony, you were unable to reach a definitive rate
15 because you were missing information. Have you since received this
16 information?**

17 A. Yes. In my direct testimony, I was unable to define a value for interruptibility
18 that is provided for system integrity because such a value was not specifically
19 delineated in any special contract in my possession. I have since had a chance
20 to examine the value for system integrity interruption as provided by
21 PacifiCorp in Mr. Griswold's rebuttal testimony. I further discussed the matter
22 with Mr. Griswold and got a better understanding of the manner in which this
23 rate was justified. My understanding is that the rate was determined using the

1 same methodology as was used for the previous physical curtailment offer.
2 The Division has seen no evidence that would justify an alternate method, and
3 so will provisionally accept the rate reduction of \$0.10/MWh, subject to
4 review if further information is provided by US Mag. Accepting this
5 reduction, and also removing the reduction associated with the physical
6 curtailment due to US Mag's refusal of the physical curtailment option, leads
7 to a rate of \$25.84 based upon six months of interruption, four hours per
8 non-holiday weekday.

9
10 **Q. Both Mr. Swenson and Mr. Griswold address the value for operating**
11 **reserves in their respective rebuttal testimony. Have you examined both**
12 **of the arguments and reached a conclusion?**

13 A. I have. Upon adopting the same MWh and contract terms proposed by the
14 Division in direct testimony, Mr. Griswold reaches the same per MWh
15 reduction as that reached by the Division. Mr. Swenson argues that the model
16 used by PacifiCorp is not accurate and that actual prices show a higher value
17 for reserves. The Division is not convinced that the value for reserves in Utah
18 should be based upon prices from the California ISO. The Division believes
19 that the value for reserves in Utah should be based upon prices from the
20 closest or most readily accessed market, which is probably Palo Verde. The
21 Division has requested that Mr. Swenson rework his numbers based upon Palo
22 Verde numbers, but only received this information on the day that this
23 testimony was due and has been unable to review it as yet. The Division will

1 examine this analysis prior to the hearing and will address it at that time. Until
2 such analysis can be completed, the Division continues to accept the number
3 put forth by both our analysis and PacifiCorp's, \$2.64/MWh. The rate can
4 then be summarized as follows:

5	COS for outlined interruption period:	\$25.94
6	Discount for system integrity:	(0.10)
7	Payment for operating reserves:	(2.64)
8	Rate per MWh	\$ 23.20

9
10 **Q. Mr. Brown's testimony states that the Division should not be willing to**
11 **support such a large price change for US Mag if for no other reason than**
12 **in the name of gradualism. What is the Division's position on this issue?**

13 A. The Division believes that the rate increase is in keeping with the principle of
14 gradualism. We founded that belief on a past Commission order for a previous
15 US Mag contract case. In Docket 01-035-38, the Commission order stated that
16 the 16.7% rate increase taking US Mag from \$18/MWh to \$21/MWH was a
17 gradual increase.¹ The Commission ruling did not appear to take any market
18 exposure costs as part of the rate being paid by US Mag. A similar 16.7%
19 increase in US Mag's current rate would bring the rate to \$24.51, which is
20 above the rate being suggested by the Division outlined above. The problem
21 with using gradualism as a justification is that the term will probably mean
22 something different to various parties depending upon whether the party is
23 administering the increase or paying it.

¹ Commission Order, Docket 01-035-38, Page 9

1 **Q. Even though the Division believes that it is applying the principle of**
2 **gradualism in its rate recommendation, did it still propose or accept**
3 **accommodations that further mitigate the possible rate impact for US**
4 **Mag?**

5 A. It did. Like the Commission ruling from 2002, the Division does recognize
6 that US Mag will choose to buy-through its periods of interruption, and have
7 taken this into account. The Division believes that keeping the total number of
8 hours of interruption somewhat consistent while spreading the hours into two
9 months that are typically lower cost should lower the dollars that US Mag will
10 have to spend on market exposure. Also, the shorter interruption period should
11 allow US Mag to more readily curtail all or a portion of its load, if the
12 operating characteristics still prohibit long physical curtailments as in the past.
13 All of these accommodations are in keeping with the principle of gradualism,
14 in that the accommodations are intended to act as a moderating influence on
15 the total price that US Mag will pay should it choose to buy-through its
16 interruption periods rather than interrupt.

17
18 **Q. Mr. Brown’s testimony points out that in the past, the Division has**
19 **supported the use of incremental energy costs to price “special**
20 **contracts”. Has the Division’s position on this issue changed?**

21 A. Not recently. Mr. Brown seems to be looking at the more distant past rather
22 than the recent past. As pointed out in 2002 testimony for a prior US Mag
23 contract case, the Division supports the use of embedded cost when

1 incremental cost is higher than embedded, as it is at the current time.² The
2 conditions that were described to justify such cost treatment still exist and so
3 similar treatment is warranted. Moreover, the Commission also accepted the
4 embedded cost analysis as being “consistent with prior Commission rulings.”³
5 Therefore, not only is the Division’s analysis in the current docket consistent
6 with past Division practices, it is also consistent with past Commission
7 acceptance.

8
9 **Q. Mr. Brown states that Average Variable Costs (AVC) have been equated**
10 **with incremental costs in the past. What is the Division’s position on this**
11 **matter?**

12 A. While the Division realizes that a recommendation was put before the
13 Commission that would have made AVC one method of determining
14 incremental cost, the recommendation was not accepted. Furthermore, since
15 that time, at least one other recommendation has been made as to the method
16 of calculating incremental cost. The most recent recommendation that I have
17 found is that from the *1999 Report of the Special Contracts Task Force to the*
18 *Utah PSC* which suggested that incremental cost be determined based upon
19 avoided costs, both approved and updated.⁴ This being the case, the Division
20 sees no reason why it should fall back upon outdated recommendations.
21 Current Division personnel and management do not see AVC as an acceptable
22 proxy for incremental costs.

² Dr. Laura Nelson, direct testimony 01-035-38, Page 5 lines 5-11

³ Commission Order, Docket 01-035-38, Page 9

⁴ Report, Page 6

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Q. Mr. Brown states that meeting incremental costs, defined by him as AVC, and a portion of fixed costs should be a sufficient rate. What circumstances have changed in order to convince the Division otherwise?

A. Well, the idea behind AVC and fixed costs being preferable to not having the customer on the system was that the system was in a time of surplus, during which other customers would receive rate relief by having some of the spare capacity paid for even in part. This guaranteed rate relief is no longer the case as we are now in a resource deficit or constraint situation. A small portion of fixed costs, along with AVC, no longer appears to make other ratepayers substantively better off. It also does not appear that the long term surplus of the past will reemerge at any time in the near future, particularly not during the time period that the proposed contract covers.

Q. Mr. Brown’s testimony refers to your statement in direct testimony that the five-year contract term recommended by the 1999 Task Force Report referenced above was still good policy. He further states that other recommendations in the report are also good policy such as use of incremental costs. Do you agree or disagree with his reasoning?

A. While I agree with his reasoning, it is important to look further into the report to see just what incremental costs were being recommended. The decision criteria were initially listed on page 3, but on page 6 the report outlines just how the incremental costs should be determined: PSC approved avoided costs

1 and PacifiCorp filed avoided costs. This being the case, I doubt that, based
2 upon the most recent avoided cost filing, Mr. Brown would still be eager to
3 pay incremental costs for US Mag's service because avoided costs are much
4 higher than the rate recommendation being made by the Division.

5
6 **Q. Mr. Brown also references criteria that should be used to determine the**
7 **rates for a Special Economic Incentive Contract (SEIC). Does the**
8 **Division agree with his reasoning?**

9 A. In a word, no. Mr. Brown has selectively taken pieces out of context and is
10 using them to try to prove that the Division is being inconsistent. Again, he
11 cites the criteria without referencing the recommendations as to what type of
12 customer would even be eligible to receive this type of contract. The 1999
13 report that he cites clearly states that the criteria for awarding a SEIC are as
14 follows: (1) Customer has the ability and incentive to reduce or eliminate
15 purchases at tariff rate, but will maintain or increase load at a special non-
16 tariff rate; (2) An enterprise will not locate in Utah in the absence of special
17 non-tariff rates; or (3) PacifiCorp serves competitors to a customer at special
18 non-tariff rates in Utah or elsewhere in its service territory.⁵ Let's deal with
19 these criteria one by one. First, the Division does not see that US Mag has
20 either the ability or incentive to reduce its purchases from PacifiCorp. This is
21 illustrated by US Mag's use of its self-generated electricity. Rather than use
22 the power that it produces to reduce its usage from PacifiCorp, it has not only
23 elected to sell its self-produced power to PacifiCorp in the past, it continues to

⁵ Report, page 3

1 ask for a QF purchase agreement for the future. The numbers that the Division
2 has seen show that US Mag, even with the rate increase currently being
3 sought, still pays less for power from PacifiCorp than it would cost to produce
4 its own. This comes from the fact that US Mag is benefiting from the low cost
5 coal resources on the system while US Mag's generation facility is a more
6 expensive to run gas fired facility. Therefore, the first criterion is not met.

7 The second criterion notes that the location of the enterprise depends on
8 the offered rate. US Mag is already in Utah and has been receiving reduced
9 rates for more than 30 years. Therefore, criterion two is also not met.

10 The third criterion deals with how well competitors within the service
11 territory are being treated. US Mag does not have any competitors in the
12 service territory, so it fails the test for criterion three as well. All this does not
13 mean that the Division is against giving US Mag a special contract with a
14 special rate based upon its uniqueness and value offers to the system. It just
15 serves to illustrate that in citing recommendations as "good policy." Mr.
16 Brown ignores the facts and situations underlying the cited recommendations.
17 By comparison, although the Division also cited a specific recommendation as
18 good policy, we were careful to explore the facts and situations underlying the
19 original recommendation and ensure that the policy still suited the current
20 situation even though it differed from that outlined in the original document.

21

1 **Q. Mr. Brown asks that if US Mag is offered a five-year contract, then no**
2 **form of price adjustment should be included in the contract. What is the**
3 **Division’s position on this request?**

4 A. The Division believes that failing to include an adjustment clause in a five-
5 year agreement could return US Mag to rates seriously lagging cost of service.
6 Utah’s load is growing, and in consequence, it is an area that is and will be
7 experiencing higher costs. Ignoring the probability of these higher costs by not
8 including adjustments based on rising costs would force other Utah ratepayers
9 to pick up all of the cost changes for US Mag’s load over the next five years,
10 which seems to me to be patently unfair. Therefore, the Division recommends
11 that the Commission order the previously proposed adjustment mechanism. If
12 the Commission determines that no adjustment mechanism should be applied,
13 then the Division would advocate that the contract term be shortened to no
14 longer than two years. This would ensure that a timely review of US Mag’s
15 rates as compared to its costs could be conducted.

16
17 **Q. Mr. Brown’s testimony states that the Division has ignored its statutory**
18 **obligations due to its recommendations in this case. How does the**
19 **Division see its statutory duties and its fulfillment of the same?**

20 A. The Division rejects this statement by Mr. Brown. As outlined in the statute
21 governing the objectives of the Division, Section 54-4a-6, the Division has
22 several objectives as follows: promote safe, healthy, economic, efficient, and
23 reliable operation of public utilities, etc.; provide for just, reasonable, and

1 adequate rates, etc.; and make the regulatory process as simple and
2 understandable as possible, etc. It is my understanding that the piece of the
3 statute that US Mag is calling into question is the piece dealing with just,
4 reasonable, and adequate rates. The statute further clarifies this piece,
5 however, by stating that the Division must work to maintain the financial
6 stability of the utility, in this case PacifiCorp, in addition to protecting the
7 long-range interests of all customers. Mr. Brown seems to feel that the
8 Division should primarily look out for the interests of his client first, and
9 everyone else as a second thought.

10 What the Division has tried to do in this case is ensure that the financial
11 stability of the utility as well as the well being of other customers are
12 maintained by asking this customer to pay the costs incurred to serve it as
13 other customers are asked to do, so as not to thrust those costs onto other
14 ratepayers. In the interest of rate stability, we have proposed that a five-year
15 contract be granted, with a well-defined adjustment clause to help ensure that
16 rates adjust with costs in the future, rather than lagging far behind costs as
17 they have in the past. This should help ensure that US Mag would experience
18 much smaller price shocks in the future. Nowhere in the statute, however,
19 does the Division read that it should protect the interests of one customer, at
20 whatever cost to the many.

21
22 **Q. Mr. Brown seems to imply that policies espoused by the Division have**
23 **changed over time. Does the Division agree with this assessment?**

1 A. Yes. The system in which we function is dynamic. The situations that we face
2 change over time, which necessarily means that the policies that we use to
3 deal with situations must also evolve. Access to more information also adds to
4 the evolution of policy. It is unconscionable that any agency would refuse to
5 change policies in the face of an evolving world for the sole reason of being
6 consistent. Changes must occur in order to refine and improve the regulatory
7 process and to make it effective in a changing world.

8

9 **Q. Mr. Brown's testimony seems to imply that by adopting the cost of**
10 **service approach for this case, the Division is going against its recent**
11 **statement that no definitive approach has been identified for quantifying**
12 **interruptible value. What is the Division's position on this issue?**

13 A. The Division does not believe that it is contradicting itself in any way by
14 deciding to use the cost of service approach, which is admittedly imperfect, in
15 this case because no clearly preferable methodology has been presented. Part
16 of the problem behind using many of the other methods outlined in the
17 Division's memo is that US Mag is not strictly an interruptible customer
18 because it does not want to be physically interrupted, but demands a buy
19 through option. Many of the values shown in the Division memo were found
20 by assuming that the load would be **physically curtailed**. US Mag has even
21 refused an offer that would have lead to physical interruption of only five days
22 per year on average. This tells me that the customer does not want to loose its
23 status as an interruptible customer, but would really rather not be interruptible.

1 This creates problems for finding value in an area that is already overwhelmed
2 by valuation problems. Therefore, the Division adopted for this case a method
3 that actually gives credit for physical interruption, even when physical
4 interruption does not take place because we found no better alternative.
5

6 **Q. In the same vein, Mr. Swenson’s testimony expresses concern at the**
7 **physical interruptions of up to 100 hours per year that could occur due to**
8 **US Mag’s willingness to supply operating reserves. Has the Division**
9 **considered this problem?**

10 A. Yes. After reading Mr. Swenson’s testimony, I obtained and reviewed actual
11 interruption hours for other large commercial customers providing operating
12 reserves. Five years of data showed that not only were the customers not
13 interrupted for all 100 hours, the level of interruption actually taken was never
14 even close to that. In fact, the highest number for either of the customers in
15 any of the five years was less than half the number of interruptions allowed
16 and less than 40 minutes interruption on average.
17

18 **Q. Does the Division have any other concerns about Mr. Swenson’s rebuttal**
19 **testimony?**

20 A. Yes. In requesting a five-year contract with no escalation clause, Mr. Swenson
21 adds the caveat that the no escalation term should at least remain in effect
22 until “the average rate increases absorbed by other Utah ratepayers equal the

1 percentage rate increases that US Magnesium has seen.”⁶ The Division again
2 must reiterate what it stated in its direct testimony. Rates for any customer or
3 customer class should be based upon that customer or class’ costs, not just on
4 what is happening with everyone else.

5

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

7 A. It does.

⁶ Rebuttal Testimony of Roger J. Swenson, page 7