

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application of Rocky Mountain Power for
Authority to Increase its Retail Electric Utility Service Rates in
Utah and for Approval of its Proposed Electric Service Schedules
and Electric Service Regulations, Consisting of a General Rate
Increase of Approximately \$161.2 Million per Year, and for
Approval of a New Large Load Surcharge

| Docket No 07-035-93
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RATE OF RETURN DIRECT TESTIMONY OF

ROGER J BALL

31 MARCH 2008

1 Q Are you the same Roger J Ball who filed Test Year Direct Testimony in this Docket on 25
2 January 2008?

3 A Yes. It was admitted into evidence as Exhibit RJB 1.0, together with a statement of my
4 academic and professional qualifications and professional experience as Exhibit RJB 1.1
5 and my 4 February Test Year Rebuttal Testimony as Exhibit RJB 2.0. On 7 February I
6 appeared and testified during the Test Year hearing, and on 13 February I filed Test Year
7 Closing Argument.

8 Q What is the purpose of your Rate of Return Testimony?

9 A To comply with the requirement in the Commission's 27 December 2007 Scheduling
10 Order in this proceeding that non-Company parties file direct testimony regarding rate of
11 return by 31 March 2008.

12 Q Have you read the Application filed by Rocky Mountain Power (RMP, or PacifiCorp, or
13 Company, or utility) on 17 December 2007 in this Docket?

14 A Yes. RMP bases its request for an increase in its retail rates in Utah upon "a return on
15 equity ... of 10.75 percent" which it claims "reflects recent market circumstances, interest
16 rate increases, and reasonable investor expectations."¹

17 Q What had Rocky Mountain Power to say in its Application about its Return on Equity?

18 A In Paragraph 10, RMP states that: "In recent years, (it) has consistently under-earned the
19 authorized ROE established by the Commission",² and projects that its "ROE under

¹ *Application*, 17 December 2007, in Docket 07-035-93 *In the Matter of the Application of Rocky Mountain Power for Authority to Increase its Retail Electric Utility Service Rates in Utah and for Approval of its Proposed Electric Service Schedules & Electric Service Regulations, Consisting of a General Rate Increase of Approximately \$161.2 Million per Year, and for approval of a New Large Load Surcharge* (hereinafter *Application*): paragraph 5, second sentence; and paragraph 10, second sentence.

² *Application*: paragraph 10, first sentence; and paragraph 11, second sentence.

20 current rates will be 5.8 percent during (a July 2008 – June 2009) test year, which is well
21 below the ... 10.25 percent”³ that was part of the Stipulation entered into by PacifiCorp
22 and many other parties to settle the Company’s last rate case, Docket 06-035-21.

23 Q When did the Commission last examine PacifiCorp’s RoE in detail?

24 A The last occasion on which the Commission determined most aspects of a PacifiCorp rate
25 case, including authorised RoE, based upon the litigation of contending positions, was in
26 Docket 99-035-10. On 20 September 1999, PacifiCorp (dba Utah Power and Light)
27 sought to increase its rates by \$67M, or 9.9%.

28 Included in the Company’s request was an RoE of 11.25%, within a range of 10.2 to
29 13.2%. The Utah Division of Public Utilities recommended 11%, mid-point of a range of
30 10.8 to 11.2%, and the Utah Committee proposed 10.5%, the mid-point of its range of 10
31 to 11%.

32 In its 24 May 2000 Report and Order, the Commission awarded PacifiCorp an increase of
33 \$17M, a little over 25% of its request. An Appendix listed 41 revenue requirement issues
34 that had been undisputed. Remarking that, in its 4 March 1999 Report and Order in
35 Docket 97-035-01, it had found an authorised RoE of 10.5% fair and reasonable, the
36 Commission concluded that 11% would be appropriate going forward.

37 Q What happened in the next PacifiCorp rate case?

38 A On 12 January 2001, in Docket 01-035-01, PacifiCorp requested a rate increase of
39 \$141M together with interim rate relief. On 2 February, the Commission granted an
40 interim increase of \$70M.

³ *Application*: paragraph 10, second sentence.

41 PacifiCorp, the Division, and the Committee resolved some 100 contested revenue
42 requirement issues, including an 11% authorised RoE, in a stipulation approved by the
43 Commission on 10 September 2001. Net Power Cost issues were hotly contested,
44 however, and taken to hearing. Overall, the Commission awarded a rate increase of
45 \$41M, or about 29% of the \$141M the Company had requested, and ordered PacifiCorp
46 to refund the balance of the \$70M interim increase that had been granted in February. ⁴

47 Q The Utah Legislature changed the Public Utilities chapter of Utah Code during its 2003
48 General Session, didn't it?

49 A Yes. Then-Senate Majority Leader Valentine sponsored SB61. HB320, which passed in
50 2000, but was repealed in its entirety in 2001, was an omnibus bill containing a shopping
51 list of the utilities' wishes to tilt the regulatory playing field dramatically in their favour.
52 Despite the eventual failure of the 2000 Bill, those provisions remained on the utilities'
53 wish list, and those that have not been passed since are still on their agenda. SB61
54 resurrected two provisions of HB320: the end of purely historic test years and their
55 replacement with aggressive future test years going out up to 20 months from the date of
56 filing a rate increase request; and a mandate for the Commission, Division and Committee
57 to favour private negotiation over public litigation of utility cases.

58 Q How has that impacted subsequent cases?

59 A On average, PacifiCorp has received about 54% of the increases it has requested since
60 SB61 was passed.

⁴ In my Test Year Testimony in this Docket, I wrote that PacifiCorp "was granted an average of just 42% of the amounts sought" in 99-035-10 and 01-035-01, and described those cases as "litigated". This testimony clarifies the extent to which they were actually litigated: 99-035-10 was mostly litigated, just 41 revenue requirement issues were undisputed between the parties; 01-035-01 was mostly settled. I had used the \$70M interim increase in my calculation of 42%. Using \$41M, the average awarded over these two cases was just 28%.

61 On 15 May 2003, in Docket 03-2035-02, PacifiCorp petitioned for a \$125M rate increase.
62 The Company, Division, Committee, and four other parties agreed to a Revenue
63 Requirement Stipulation including a 10.7% authorised RoE. On 9 December 2003,
64 PacifiCorp moved the Commission to approve that agreement, and on 7 January 2004 to
65 approve a Revenue Spread and Rate Design Stipulation settling all but one of the
66 remaining issues in the Docket. The 30 January 2004 Order of the Commission granted
67 PacifiCorp a \$65M increase, 52% of its request, almost twice as large a fraction as the
68 average in the two preceding cases.

69 On 4 August 2004, PacifiCorp filed for a \$111M rate increase in Docket 04-035-42. The
70 Company, Division, Committee, and four other parties agreed to a 10.5% authorised RoE.
71 On 14 February 2005, PacifiCorp asked the Commission to approve a Stipulation
72 including that provision and a \$51M rate increase, saying that its terms were “just and
73 reasonable and otherwise in the public interest.”⁵ The Company was the first-named
74 signatory and Paragraph 12b of the Stipulation recorded that “PacifiCorp agrees that its
75 next Utah general rate case will be filed no earlier than March 1, 2006.”⁶ The Stipulation
76 was uncontested, and the Commission approved it in a 25 February 2005 Order. The
77 Company received 46% of its opening bid.

78 Q And what about the Company’s most recent past rate case?

79 A On 6 March 2006, in Docket 06-035-21, PacifiCorp (still dba Utah Power and Light)
80 requested a \$197M increase. The Company’s policy witness and Utah Power President
81 Walje first testified that the Company was requesting an October 2006 – September 2007

⁵ *Motion for Approval of Stipulation*, 14 February 2005, in Docket 04-035-42 *In the Matter of the Application of PacifiCorp for Approval of its Proposed Electric Rate Schedules & Electric Service Regulations*: paragraph 3.

⁶ *Stipulation Regarding Revenue Requirement, Rate Spread and Rate design*, 14 February 2005, in Docket 04-035-42 *In the Matter of the Application of PacifiCorp for Approval of its Proposed Electric Rate Schedules & Electric Service Regulations*: paragraph 2.

82 test year and an ROE of 11.4%, saying that “(a)t current rate levels the Company’s return
83 on equity will drop to an estimated 3.9 percent by September 2007.”⁷

84 On this occasion, PacifiCorp, the Division, the Committee, and seven other parties agreed
85 to an increase of \$115M – 58% of the amount requested – including an authorised
86 10.25% RoE. On 26 July 2006, PacifiCorp (now dba Rocky Mountain Power) petitioned
87 the Commission to approve a settlement including that provision:

88 As specified in the Stipulation, the Parties agree that the Stipulation is in the public
89 interest and that all of its terms and conditions, considered together as a whole,
90 will produce fair, just and reasonable results.⁸

91 On the same day, the Company filed the Stipulation, to which it was the first-named party:

92 PacifiCorp agrees that it will not file another Utah general rate case before December
93 11, 2007, which would result in an anticipated rate effective date no earlier than
94 August 7, 2008.⁹

95 Q What do you conclude from this history?

96 A Perhaps most importantly, it has been 8 years since the Commission last had RoE
97 litigated before it. I recommend that the Commission reject any proposal that it approve
98 another stipulated number and insist on seeing and hearing all the testimony that parties
99 and members of the public want to offer on this topic. No public witness hearing has been
100 scheduled in conjunction with the 20 May 2008 Rate of Return Hearing. It is by no means
101 too late for the Commission to add such a hearing, and I recommend that it do so
102 immediately.

⁷ *Direct Testimony of A Richard Walje*, filed 6 March 2006, in Docket 06-035-21: lines 309, 171, and 147-148.

⁸ *Motion for Approval of Stipulation*, 26 July 2006, in Docket 06-035-21 *In the Matter of the Application of PacifiCorp for Approval of its Proposed Electric Rate Schedules & Electric Service Regulations*: paragraph 5.

⁹ *Stipulation Regarding Revenue Requirement and Rate Spread*, 26 July 2006, in Docket 06-035-21 *In the Matter of the Application of PacifiCorp for Approval of its Proposed Electric Rate Schedules & Electric Service Regulations*: paragraph 12.

103 Q Please explain why you believe it is so important for the Commission to hear objective
104 and comprehensive information, evidence and recommendations regarding RoE?

105 A PacifiCorp has established a very consistent track record, considering the present decade
106 alone, of asking for much larger increases than it seems to require. How else to explain
107 that, in its last four cases, the Company has not only freely entered into agreements, but
108 has taken the lead in advocating them to the Commission, that have resulted in its getting
109 increases amounting to less than half of what it requested.

110 The utility has similarly agreed to nominal authorised rates of return on equity markedly
111 lower than it initially requested, and the rate increases it has freely agreed to accept and
112 has taken the lead in representing to the Commission would result in just and reasonable
113 rates have effectively prevented PacifiCorp from realising even those reduced RoEs.

114 It is hard to imagine that management was unaware that it could not possibly attain the
115 attenuated RoEs it had agreed to, given that the stipulated rate increases were so much
116 smaller a fraction of the amounts requested than the settlement RoEs were of the rates
117 sought.

118 But on top of that, the Company voluntarily accepted stay-out provisions, restricting its
119 ability to file further petitions for rate relief when it became beyond doubt that it was not
120 achieving the RoEs it had stipulated to.

121 Q In your opinion, what insight should the Commission and non-Company parties glean
122 from these realities?

123 A PacifiCorp doesn't need and cannot justify either the \$99.8M rate increase in its revised
124 application or the 10.75% RoE in its original application, and it doesn't expect to get either
125 from these proceedings. It hopes to find a settlement, with enough of the other parties to

126 these proceedings to satisfy the Commission, in the region of half the dollars it has asked
127 for, with an RoE in a range between 10.4 and 10.8%.

128 Any RoE in a settlement is clearly meaningless to the Company, except insofar as it
129 provides a basis for complaining that it isn't being realised. It may offer others a security
130 blanket, in the sense that, in the extremely unlikely event that the utility should exceed
131 that number, it may provide cause for seeking a reduction.

132 What is of real concern is that meaningful hearings, during which the Commission hears a
133 objective and comprehensive testimony from a wide range of interests, are more likely to
134 produce a dollar increase in a range between 20 and 35% of PacifiCorp's request.

135 Consequently, parties' representatives should alert their principals to the risks associated
136 with settlement, which may help contain participation costs, but is likely to carry a much
137 greater price tag down the road.

138 And the Commission should brace itself to require a full examination of the Company's
139 finances prior to determining rates going forward. Only in that way can it hope to fulfill its
140 mandate to ensure that they will truly be just and reasonable. If that means rejecting
141 another black-box settlement and demanding that the Division and Committee do what
142 ratepayers pay them to do, so be it.

143 Q Where do you currently stand with regard to the transfer of risk from stockholders to
144 ratepayers that you wrote about in your Test Year Testimony?

145 A Although PacifiCorp has filed for the use of a future test year in its past three rate
146 increase applications, the issue was part of black box settlements in each case. Whilst
147 Utah statute was amended by SB61 in 2003 to prohibit the use of the historic test years
148 upon which the Commission has based its determinations for years, it has nothing to say

149 about treatment of the shift of risk that the use instead of a 19-month projected test year
150 will inevitably produce.

151 My Test Year Testimony is uncontroverted that:

152 If the Commission, in selecting a test year in this proceeding in accordance with
153 revised UCA 54-4-4(3), chooses to adopt anything other than an historic test year,
154 it should balance this shift of risk by commensurately reducing RoE.

155 Q Does the move from an historic to a projected test year carry any monetary value?

156 A In its 14 February 2008 Order on Test Period, the Commission determined that the test
157 period for this docket shall be calendar 2008 rather than the July 2008 to June 2009
158 requested by PacifiCorp. On 6 March 2008, Rocky Mountain Power test year witness
159 McDougal filed his Exhibit RMP SRM-1S, revaluing the forward projection at \$27,583,763.

160 Q Do you have a recommendation for the Commission?

161 A The Commission should adjust RoE downwards by no less than \$27,583,763 to restore
162 the balance of risk arising from the change in test year basis.

163 Q What is PacifiCorp's approach to risk?

164 A During Utah Power & Light Company's major generation and transmission construction
165 and acquisition programme prior to its takeover by PacifiCorp, it apparently found the
166 financial risk associated with building and purchasing all or part of several power stations
167 and high-voltage lines to be acceptable, despite rates being based upon historic test
168 periods.

169 PacifiCorp has been highly risk-averse ever since it bought Utah Power and Light. Mr
170 Walje now testifies that:

171 There are several proposals in this application intended to *reduce the Company's*
172 *financial risk.* (Emphasis added.)

173 When PacifiCorp bought Utah Power and Light it acquired surplus generation and
174 transmission capacity that fuelled load growth in Oregon throughout the decade of the
175 1990s. The Company milked its Utah cash cow to fund speculative ventures in Australia,
176 Turkey, the United Kingdom and the mid-west power market. It lost millions and was
177 eventually taken over by ScottishPower. In the meantime, the Company wanted
178 deregulation, and focused on its efforts to recover so-called "stranded costs". It reduced
179 its IRP staff in numbers and influence almost to invisibility. Very little was built or acquired
180 to serve its core service area. Indeed, plans were afoot to sell the Company's large share
181 in a coal-fired plant in the northwest because investment in scrubbers was required and
182 its co-owners were uncooperative.

183 Instead of buying those co-owners out and increasing its generation capacity, PacifiCorp
184 persuaded ScottishPower to proceed with the sale to a Canadian company, reducing the
185 utility's ability to supply ratepayers from its own power stations and increasing its
186 exposure ahead of the western market melt-down. Under Scottish Power's control,
187 PacifiCorp could only think of building gas turbine generation and purchasing wind
188 resources. Throughout the 1990s and well into the present decade, PacifiCorp has found
189 one excuse after another to avoid building coal-fired base-load generation. Now it is
190 shying away from the concerns of the emissions lobby and a potential carbon tax.

191 Mr Walje also testifies that:

192 the Company is in a period in which it must make generation and transmission
193 investments, and the Company's required ongoing level of investment far exceeds
194 both its net operating income and depreciation expense. As a result, the
195 Company requires substantial levels of new financing to fund the investment
196 necessary to meet its customers' power needs. As I previously described, another
197 significant challenge facing the Company is the combination of volatility and

198 escalating wholesale energy prices. In Utah, Rocky Mountain Power faces these
199 risks without any type of power cost adjustment mechanism.¹⁰

200 Whatever risks PacifiCorp may be exposed to pale into insignificance in comparison with
201 the risks it has exposed its ratepayers to: rapidly increasing power costs (for natural gas
202 and for purchased power) due to the failure to build or acquire reasonable-cost generation
203 or enter into sufficient long-term contracts; higher costs when it eventually gets off its
204 thumbs and builds; and the very real risk of simply not being able to purchase enough
205 power in a tight market to meet demand, forcing brown-outs or black-outs.

206 Mr Walje has told the Commission that:

207 The Company does not currently own sufficient resources to meet our customers'
208 peak power needs and, therefore, we must buy and sell power in the wholesale
209 market to meet our load requirement and to balance hourly, daily and seasonal
210 load fluctuations. Net power costs continue to trend upward, remain volatile and
211 are one of the primary cost drivers in this general rate case. The combination of
212 higher fuel prices and wholesale market volatility has produced a more volatile
213 environment for all participants in the wholesale energy markets, including
214 regulated utilities.¹¹

215 It is more than twenty years since Utah had an investor-owned utility it could be proud of
216 and have confidence in. All that while, ratepayers have been subject to rates higher than
217 they should have been and that have given PacifiCorp plenty of opportunity to earn a
218 healthy rate of return on equity.

219 Q Why do you suppose Mid-American bought PacifiCorp?

220 A If you want to make a profit, buy a poorly-run company with low earnings, run it better and
221 drive its earnings up. Of course, Mid-American is no more an independent company than
222 PacifiCorp is. Berkshire Hathaway needed to be satisfied that its money would be better

¹⁰ *Direct Testimony of A Richard Walje*, filed 17 December 2007, in this Docket 07-035-93 (hereinafter *Walje*): lines 144-152.

¹¹ *Walje*: lines 278-285.

223 used to buy PacifiCorp than in some other venture such as Hanes or Dairy Queen. That
224 means Warren Buffet, who didn't get where he is today by not being a shrewd investor,
225 needed to be satisfied. Now we learn that a few hundred million in additional capital have
226 been provided to PacifiCorp, which hasn't sent any dividends up the line in return yet.

227 Mr Walje wrote that:

228 While the Company has benefited from its ownership by MEHC, which has
229 invested a total of \$415 million in cash contributions while not receiving any
230 dividends from PacifiCorp since the acquisition on March 21, 2006, the Company
231 relies on external parties for its significant debt financing needs. The debt
232 securities markets are competitive, and to the extent investors perceive higher risk
233 in Rocky Mountain Power because of regulatory uncertainty, they will require a
234 greater return through higher interest rates. Higher interest rates on debt will result
235 in higher rates for our retail customers.¹²

236 A billion or more in investment annually, and a fairly stable debt to equity ratio, means
237 that retained earnings are playing a significant role. Fair enough, but ratepayers are
238 entitled to reassurance that all this investment, largely financed from their rates, is being
239 wisely directed towards long-term reliability of service and reasonable rates. We aren't
240 there yet.

241 Mr Walje testifies that:

242 The Company's owners are entitled to a fair opportunity to earn a reasonable
243 return commensurate with the risks involved in making these required
244 investments.¹³

245 Yes, but it is increasingly ratepayers, and decreasingly stockholders, who are bearing the
246 risks of this business, while the Company says it wants increasing RoEs.

247 Q Do you have any concluding remarks?

¹² *Walje*: lines 224-231.

¹³ *Walje*: lines 175-177.

248 A PacifiCorp should receive a fair RoE. But ratepayers need a fair deal, too. PacifiCorp's
249 rate case behaviour does not lend credibility to its pleas of poverty, either in dollar or in
250 RoE terms. Nor does its investment strategy imbue us with confidence that all will be well
251 going forward. The Company is too readily swayed by opinion in the north-west and the
252 emissions lobby for ratepayers to feel that they will be paying the lowest long-term rates.
253 The Commission should bear all these factors in mind in determining future RoE.
254 That concludes my pre-filed written direct rate of return testimony, thank you.

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing Rate of Return Testimony of Roger J Ball in Docket 07-035-93 was served upon the following by electronic mail on 31 March 2008:

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