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**BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH**

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<p>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</p>	<p><b>Docket No. 07-035-93</b></p>
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**PREFILED SURREBUTTAL TESTIMONY OF KEVIN C. HIGGINS**

**[REVENUE REQUIREMENT]**

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The UAE Intervention Group (UAE) and Wal-Mart Stores, Inc. (“Wal-Mart”) hereby submit the Prefiled Surrebuttal Testimony of Kevin C. Higgins on revenue requirement issues.

DATED this 23<sup>rd</sup> day of May, 2008.

/s/ \_\_\_\_\_  
Gary A. Dodge,  
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Holly Rachel Smith,  
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## CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served by email this 23<sup>rd</sup> day of May, 2008, on the following:

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**BEFORE**  
**THE PUBLIC SERVICE COMMISSION OF UTAH**

**Surrebuttal Testimony of Kevin C. Higgins**

**on behalf of**

**UAE and Wal-Mart**

**[Revenue Requirement]**

**May 23, 2008**

1                                   **SURREBUTTAL TESTIMONY OF KEVIN C. HIGGINS**

2                   **Introduction**

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

4           A.             Kevin C. Higgins, 215 South State Street, Suite 200, Salt Lake City, Utah,  
5                           84111.

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

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

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

11          A.             My testimony is being jointly sponsored by the Utah Association of  
12                           Energy Users Intervention Group (UAE) and Wal-Mart Stores, Inc. Wal-Mart  
13                           Stores, Inc. is a member of UAE that has intervened separately in this proceeding.

14          **Q.     Are you the same Kevin C. Higgins who previously filed direct testimony on  
15                           behalf of UAE and Wal-Mart Stores, Inc. in this phase of this proceeding?**

16          A.             Yes, I am.

17

18                   **Overview and Conclusions**

19          **Q.     What is the purpose of your surrebuttal testimony in this phase of the  
20                           proceeding?**

21          A.             My surrebuttal testimony responds to the rebuttal testimony of RMP  
22                           witnesses Gregory N. Duvall, Steven R. McDougal, Mark R. Tallman, and

1 Jonathan D. Hale regarding my recommended adjustments to the Company's  
2 proposed revenue requirement. I do not respond to adjustments that were accepted  
3 by the Company.

4 **Q. Please summarize your surrebuttal testimony.**

5 A. My surrebuttal testimony is summarized in Table KCH-1 SR, on the  
6 following page.

7

1  
2

**Table KCH-1 SR  
Summary of UAE-WM Adjustments**

	UAE-WM Direct Testimony (Utah RR impact)	RMP Rebuttal Testimony	UAE-WM Surrebuttal Testimony (Utah RR impact)
Net Power Costs Adj:			
Currant Creek Minimum Run Level	Set to 115 MW per RMP CC&N testimony.	GRID unable to model plant to allow multiple configurations. “Commitment Logic Workaround” addresses 80% of UAE adjustment.	Accept that RMP’s “Commitment Logic Workaround” proposal addresses minimum run level issue in this case.
=====	=====	=====	=====
Nebo Heat Rate Option Contract	Contract expired. Remove cost from test period.	Contract extended into test period.	Accept RMP contract extension clarification, but include adjustment for uneconomic dispatch in GRID model.
=====	=====	=====	=====
Constellation Call Option Contracts	Uneconomic dispatch in GRID model.	Contracts not uneconomically dispatched.	Adjusted for uneconomic dispatch in GRID model.
Combined Net Power Cost Impact	(\$2,602,444)	(\$0)	(\$81,458) to (\$424,558) for options contracts, depending on NPC scenario.
Corrected 2008 Labor Expense	(\$243,098)	(\$190,753)	(\$190,753)
Glenrock/Seven Mile Wind O&M	(\$537,342)	(\$550,445)	(\$550,445)
Marengo Wind O&M	(\$263,418)	(\$0)	(\$0)
Lakeside O&M	(\$361,500)	Subsumed in plant overhaul adjustment.	Subsumed in plant overhaul adjustment.
Sunnyside Contract	(\$1,570,000) [in NPC]	(\$1,570,000) [in NPC]	(\$1,570,000) [in NPC]
SO <sub>2</sub> Sales Amortization Period	(\$2,923,167)	(\$0)	(\$1,859,962)
Section 199 Domestic Production Activities Tax Deduction (DPAD)	(\$2,155,932)	(\$0)	Up to (\$995,604)
Total of Adjustments	(\$10,556,991)	(\$2,311,198)	(\$5,248,222) to (\$5,591,322)

1 **Response to of Gregory N. Duvall (Net Power Cost)**

2 **Q. What is Mr. Duvall's response to your recommendation to utilize a minimum**  
3 **operating level of 115 MW for Currant Creek?**

4 A. As I discussed in my direct testimony, the GRID model constrains the  
5 Currant Creek facility's operation such that the facility is not operated below 340  
6 MW. This minimum run level is significantly higher than the minimum run level  
7 of 115 MW that RMP represented to the Commission in the Currant Creek  
8 certification proceeding in 2003. Such a constraint increases the net power cost  
9 charged to customers, because when lower-cost generation is available, and the  
10 Currant Creek facility is otherwise running in the model, the operation of the plant  
11 is not reduced below 340 MW. Instead, the plant stays in operation at this level in  
12 the model, displacing lower-cost resources (often coal-fired generation) resulting  
13 in higher net power costs for customers.

14 Mr. Duvall disagrees with my recommendation. He states that operating  
15 Currant Creek at 115 MW requires operating in a one-by-one configuration,  
16 whereas GRID is only set up to handle a two-by-one configuration and cannot  
17 switch from one configuration to the other when calculating net power costs. Mr.  
18 Duvall acknowledges that Currant Creek can operate in a one-by-one mode.

19 Mr. Duvall goes on to reference RMP's proposal to implement a  
20 "commitment logic workaround," which is intended to prevent systematic  
21 uneconomic dispatch of the West Valley, Currant Creek, and Lake Side units, in  
22 response to criticisms of Committee of Consumers Services ("CCS") witness



1           Randall Falkenberg. Mr. Duvall indicates that implementing this workaround will  
2           obviate 80 percent of my recommended adjustment for Currant Creek.

3           **Q.    What is your response to Mr. Duvall’s rebuttal on this point?**

4           A.           For purposes of this proceeding, I accept that the proposed workaround  
5           may address my concerns about the minimum operating level of Currant Creek.  
6           However, in future proceedings I will reserve my argument that for regulatory  
7           normalized ratemaking, the GRID model should calculate net power costs using  
8           the same 115 MW minimum operating level for Currant Creek that RMP relied  
9           upon in selecting itself as the winning bidder to its RFP 2003A and which the  
10          Company represented in justifying its selection decision to the Commission.

11          **Q.    What is Mr. Duvall’s response to your recommendation to remove the Nebo  
12          Heat Rate Option contract from the net power cost calculation?**

13          A.           In my direct testimony, I pointed out that the documentation provided  
14          with the GRID model indicates that this contract expired in 2007, and that the  
15          removal of this contract reduces net power costs.

16                        Mr. Duvall states that I am in error regarding the termination of the  
17          contract, as apparently the contract was extended.

18          **Q.    What is your response to Mr. Duvall’s rebuttal on this point?**

19          A.           Given that this contract apparently has been extended, it is necessary to  
20          make adjustments for the fact that, as is the case with the Constellation 257677  
21          and 257678 call option contracts, the GRID model dispatches the Nebo Heat Rate  
22          contract at times when it is “out of the money”, i.e., this resource is sometimes

1           dispatched at times when doing so increases net power costs. This problem should  
2           be corrected, which I address below.

3           **Q.    What is Mr. Duvall’s response to your recommendation to remove the**  
4           **Constellation 257677 and 257678 call option contracts in months in which the**  
5           **GRID model’s dispatch of these contracts results in higher net power costs?**

6           A.           Mr. Duvall states that he agrees that the contracts should not be dispatched  
7           in a manner that increases net power costs. He goes on to state, though, that the  
8           Company’s preliminary analysis suggests that a screen of the call option contracts  
9           would not have a significant impact on net power costs in this case, and that  
10          further, when the Company screened the contracts I identified, net power costs  
11          increased.

12          **Q.    What is your response to Mr. Duvall’s rebuttal on this point?**

13          A.           I acknowledge Mr. Duvall’s concurrence that the contracts should not be  
14          dispatched in a manner that increases net power costs; however, he is incorrect  
15          with respect to the impact of properly screening the Constellation 257677 and  
16          257678 call option contracts and the Nebo Heat Rate contract. I do not know  
17          exactly how RMP treated these three contracts in coming to its conclusion that  
18          screening them increases net power costs, as the documentation I requested from  
19          the Company to support its rebuttal on this point was not produced.<sup>1</sup> However, as  
20          I show in UAE-WM Confidential Exhibit 1.1SR-RR, removing these contracts  
21          from dispatch in selected months causes net power costs to decrease. Therefore, it

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<sup>1</sup> This information was requested in UAE Data Request 6.1. RMP’s response was that UAE can produce the

1 is proper to remove these contracts for months in which failure to remove them  
2 causes net power costs to increase. I note that removal of these contracts on a  
3 monthly basis produces a conservative (i.e., low) adjustment, as there may be  
4 periods within a removed month in which operation on a given set of days would  
5 have been economic. Screening the contracts on a more granular basis (e.g., daily)  
6 would likely produce a larger reduction in net power costs than I am representing  
7 below.

8 The reduction in net power cost from my recommended adjustment varies  
9 with the GRID scenario run and the underlying forward price curves. If the  
10 adjustment is made to the Company's original GRID run, it reduces net power  
11 cost by \$870,024. If the adjustment is made to RMP's Rebuttal Alternative 1  
12 GRID results (\$1.044 billion), the adjustment reduces net power cost by  
13 \$1,025,065. If made to RMP's Rebuttal Alternative 2 (\$1.047 billion), the  
14 adjustment reduces net power cost by \$196,675.

15  
16 **Response to Stephen R. McDougal**

17 **Q. What is Mr. McDougal's response to your correction of pro-forma labor**  
18 **expense?**

19 A. Mr. McDougal accepts this change, but modifies it to apply only to the  
20 portion charged to expense. The result of this modification is a \$446,194

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requested information itself. The requested information was the same information that RMP asked me to provide in support of my adjustments and which I provided in full.

1 reduction in total company labor expense, rather than the \$568,633 reduction that  
2 I had recommended in my direct testimony.

3 **Q. What is your response to McDougal's rebuttal on this point?**

4 A. I accept Mr. McDougal's modification to my adjustment. I estimate that  
5 this results in a revenue requirement reduction of \$190,753 on a Utah  
6 jurisdictional basis.

7 **Q. What is Mr. McDougal's response to your recommendation to reduce the**  
8 **amortization period for sales of SO<sub>2</sub> allowances from four years to three**  
9 **years?**

10 A. Mr. McDougal opposes this change. Mr. McDougal states that my  
11 argument that such a change would allow customers to realize the benefits from  
12 these sales sooner is not sufficient justification to depart from the precedent in the  
13 last several cases of a four year amortization period. In addition, Mr. McDougal  
14 makes a correction to the revenue requirement impact of my recommendation, if  
15 it is adopted by the Commission.

16 **Q. What is your response to McDougal's rebuttal on this point?**

17 A. I agree with Mr. McDougal that the amortization of the SO<sub>2</sub> allowance  
18 sales acts as a smoothing mechanism for including related revenue in results of  
19 operations. However, this function would also be accomplished using a three-year  
20 amortization period – and this change would provide the additional benefit of  
21 allowing customers to realize the benefit of these sales sooner.

1 I accept Mr. McDougal's correction of the input error that impacted my  
2 calculation of the Utah revenue requirement adjustment. The corrected calculation  
3 is presented in UAE-WM Exhibit 1.2SR-RR, which shows a \$1,859,962 reduction  
4 in Utah revenue requirement.

5 **Q. What is Mr. McDougal's response to your recommendation to reduce Lake**  
6 **Side O&M expense by \$617,082 (total company)?**

7 A. In my direct testimony, I pointed out that RMP forecasted a Lake Side  
8 O&M expense for Calendar Year 2008 that was considerably higher than its  
9 forecast for its original test period ending June 2009. Absent a reasonable  
10 explanation, this level of forecasted expense appears implausible. I recommended  
11 setting the Lakeside O&M expense no greater than what was projected for the test  
12 period ending June 2009.

13 Mr. McDougal explains that the higher O&M cost in the Calendar Year  
14 2008 test period is related to the timing of overhauls for the plant.

15 **Q. What is your response to Mr. McDougal's rebuttal on this point?**

16 A. Plant overhaul expense is best treated on a normalized basis, rather than  
17 by projecting specific costs for specific plants in a specific test period. This point  
18 was made by CCS witness Donna DeRonne, and was accepted, with modification,  
19 by Mr. McDougal. The adoption of Ms. DeRonne's recommendation subsumes  
20 my recommendation with respect to Lake Side O&M expense, making any further  
21 adjustment unnecessary.

22

1 **Response to Mr. Tallman**

2 **Q. What is Mr. Tallman's response to your adjustment to Marengo O&M**  
3 **expense?**

4 A. In my direct testimony, I stated that it appeared that the reduced period of  
5 operation of the Marengo Expansion (Marengo II) project in Calendar Year 2008  
6 relative to the test period ending June 2009 was not being fully reflected in the  
7 updated O&M expense. Accordingly, I proposed an adjustment based on the per-  
8 MW reduction in overall Marengo capacity in service for the test period.

9 Mr. Tallman disagrees with my adjustment based on apportioning the  
10 expenses on a per-MW basis, and points out that the Marengo (I) contract has a  
11 higher-pre-turbine cost than that of Marengo II. He also provides confidential  
12 contractual information in support of his response.

13 **Q. What is your response to Mr. Tallman's rebuttal on this point?**

14 A. The expense adjustments and workpapers prepared by RMP for the two  
15 Marengo projects in its filing did not distinguish between the Marengo facility  
16 and the Marengo Expansion project, even though they have different operational  
17 dates. (See for example, Exhibit RMP (SRM-1S), p. 4.12.1.) Given that the  
18 Company chose to treat these projects as a single resource, I believe the  
19 adjustment I made in my direct testimony was reasonable. It also appears to me  
20 that the higher O&M costs for Marengo (I) are not necessarily indicative of the  
21 ongoing O&M costs for this facility.

1                   However, in light of the additional information provided by Mr. Tallman I  
2                   am willing to withdraw my recommended adjustment for this facility in this  
3                   proceeding.

4

5                   **Response to Jonathan D. Hale**

6                   **Q.     What is Mr. Hale's response to your adjustment to the Domestic Production**  
7                   **Activities Deduction?**

8                   A.           In my direct testimony, I recommended using a Domestic Production  
9                   Activities Deduction (or Section 199 deduction) of \$12.1 million based on the  
10                  Company's workpapers that showed a projected Section 199 deduction of this  
11                  amount for the twelve months ending June 2008. I pointed out that the Company  
12                  projected very similar Section 199 deductions for the two periods on either side of  
13                  the year ending June 2008: \$12.0 million for the test period ending June 2009,<sup>2</sup>  
14                  and \$12.6 million for the twelve months ending June 2007.<sup>3</sup> Thus, the Company's  
15                  proposed Section 199 deduction of only \$3.8 million for Calendar Year 2008  
16                  struck me as highly implausible.

17                  Mr. Hale disagrees with my use of the Company's projected Section 199  
18                  deduction for the period ending June 2008. Then he goes on to state that:

19                  As updated in the Company's rebuttal filing, the appropriate level of Total  
20                  Company Net Taxable Income for this case before the final Commission's  
21                  order in this case is now the \$86.6 million as shown in Exhibit  
22                  RMP\_\_ (SRM-1R-RR), p. 2.20, Line 1287. Once the final number, as  
23                  determined by this Commission, is known, the Domestic Production

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<sup>2</sup> RMP Exhibit (SRM-1), p. 7.1.11, line 112.

<sup>3</sup> RMP Response to MDR 1.4 (Original).

1 Activity Deduction will need to be calculated again based on the final  
2 ordered number.<sup>4</sup>  
3

4 But then Mr. Hale also goes on to state that the Company is updating its  
5 filing to incorporate the effects of Tax Bonus Depreciation. He states that after  
6 this is taken into account, it creates a loss for federal income tax purposes in this  
7 case, as the Section 199 deduction cannot be taken if taxable income is zero or  
8 less. Mr. Hale concludes that the proper level of the Domestic Production Activity  
9 Deduction has become moot in this case.

10 **Q. What is your response to Mr. Hale's rebuttal on this point?**

11 A. I agree with Mr. Hale's statement that incorporating the effects of Tax  
12 Bonus Depreciation has implications for the Domestic Production Activity  
13 Deduction. I also agree with his statement that once a final revenue requirement is  
14 determined by this Commission, the Domestic Production Activity Deduction will  
15 need to be calculated again based on the final ordered number.

16 However, I disagree with Mr. Hale's statement that the proper level of the  
17 Domestic Production Activity Deduction has become moot in this case, as I  
18 explain below.

19 Mr. Hale's statement that the effects of Tax Bonus Depreciation creates a  
20 loss for federal income tax purposes makes is not consistent with the Federal  
21 income tax obligation charged to Utah customers in Exhibit RMP\_\_(SRM-1R-  
22 RR), p. 2.20, cited by Mr. Hale. That exhibit includes effects of the Tax Bonus  
23 Depreciation and shows a Federal income tax obligation charged to Utah

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<sup>4</sup> Rebuttal testimony of Jonathan D. Hale, p. 5, lines 97-102.



1 customers of \$4,012,922 (line 1302) – before any rate increase. However, in light  
2 of the Company’s renewable energy production credits attributable to wind  
3 generation, it could be argued that none of this \$4 million tax obligation paid by  
4 customers is attributable to generation-related activity.

5 Nevertheless, even if that is the case, to the extent there is a rate increase  
6 in this proceeding, the Federal income tax obligation charged to Utah customers  
7 will equal 35 percent of the additional revenue requirement. A significant portion  
8 of such an increase would be attributable to generation-related income and, once  
9 generation-related income becomes positive for tax purposes, it would qualify for  
10 the Domestic Production Activity Deduction.

11 **Q. What do you recommend?**

12 A. I estimate that the Domestic Production Activity Deduction would become  
13 applicable at a revenue increase of \$15.8 million or greater. I also estimate that if  
14 the full revenue requirement increase now requested by RMP of \$84.4 million is  
15 approved, there should be a reduction in Utah revenue requirement attributable to  
16 the Domestic Production Activity Deduction of \$995,604. These calculations are  
17 presented in UAE-WM Exhibit 1.3SR-RR.

18 In summary, if a revenue requirement increase is awarded to RMP that is  
19 less than \$15.8 million, then the Domestic Production Activity Deduction would  
20 not be applicable in this case (to the extent that RMP or its corporate affiliates are  
21 not otherwise eligible for this deduction as a result of PacifiCorp generation-  
22 related activity).

1           Alternatively, if RMP is awarded the full revenue requirement increase of  
2           \$84.4 million it now requests (before consideration of the Domestic Production  
3           Activity Deduction), then this amount should be reduced by \$995,604 to account  
4           for the tax benefit of the Domestic Production Activity Deduction.

5           For a revenue requirement increase that is between \$15.8 million and  
6           \$84.4 million (before consideration of the Domestic Production Activity  
7           Deduction), the revenue requirement adjustment associated with the Domestic  
8           Production Activity Deduction should be set between zero and \$995,604 on a pro-  
9           rata basis.

10       **Q. Do you have any other comments on the treatment of the Domestic**  
11       **Production Activity Deduction in this proceeding?**

12       A.           Yes. In response to Mr. Hale's rebuttal testimony, UAE has asked RMP to  
13       state whether the tax benefit of the Domestic Production Activity Deduction  
14       associated with PacifiCorp generation will be realized elsewhere in RMP's  
15       corporate family. That response is not yet due. Depending on that response, it  
16       may be necessary for me to supplement my surrebuttal testimony.

17       **Q. Does this otherwise conclude your surrebuttal testimony in this phase of the**  
18       **proceeding?**

19       A.           Yes, it does.