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BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Complaint 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	Response of the Division of Public Utilities to the Request for Reconsideration filed by Rocky Mountain Power Docket No. 07-035-93
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The Division of Public Utilities (Division) hereby responds to the Petition for Reconsideration (Petition) of Rocky Mountain Power (RMP or the Company) filed in this Docket. The Division supports the Company’s request for reconsideration concerning the increased imputation to the SMUD contract. The Division also supports the Company’s request for reconsideration concerning elimination of the Commission’s property tax adjustment.

SMUD Imputation Adjustment

As explained by the Company in its petition for reconsideration, “the Commission adopted a new and much higher imputed price related to a wholesale sales contract between the Company and SMUD—\$58.46 per megawatt hour (“MWh”).... The effect of the Commission’s adjustment increasing the imputed price to \$58.46 per MWh was to reduce system net power

costs by \$7.52 million and the Company's Utah revenue requirement by \$3.287 million."¹ For two reasons, the Division believes that the Commission's adoption of the higher imputed price in this case is, at least in part, based on an inappropriate calculation.

First, the Division supports reconsideration of the SMUD imputation order because the Commission states in its order that, "It is the sum of the two components of revenue, the lump-sum payment and the ongoing contract revenue, that the Company agreed to accept at the time it executed the contract as compensation for the power provided to SMUD and therefore both sources of revenue must be accounted for in the imputed price for this contract."² The Division agrees that the sum of the two parts as described by the Commission is a fair representation of the value this contract poses for the Company and thus can be used to impute revenues to the SMUD contract. However, the Division asserts, that the Commission's calculation is inappropriate.

As explained in the Commission's order, the higher imputed price is derived by adding two separate prices: \$21.46 and \$37 (\$/MWh).³ The first number, \$21.46, is the SMUD 2008 contract price based on, among other things, PacifiCorp's share of the ongoing fuel and production costs of the Jim Bridger plant. The second price, \$37, is based on the Division's levelization of the \$94 million up-front payment⁴ received by PacifiCorp at the time the contract was executed in 1987. Because the first price is a simple "nominal"⁵ price and the second is an

¹ Petition, pp. 4-5.

² Report and Order, pp. 27-28.

³ Report and Order, p. 28.

⁴ The Commission's order references \$98 million, but the Division's calculations were actually based on \$94 million.

⁵ We use the term nominal here in an economic sense to mean "measured in current dollars" as opposed to being measured in real dollars or purchasing power.

“escalated”⁶ price based on a levelization of the up-front payment, adding the two together is, in the Division’s opinion, like adding apples and oranges and, thus, inappropriate.

An appropriate approach would levelize in a consistent manner both the up-front payment and the SMUD contractual revenues (as determined over the life of the contract). There are, however, at least two different (and equally valid) methods for levelizing the two components or revenue sources of the SMUD contract. A comparison of these two methods underlies our second objection to the Commission’s ordered imputed price.

Second, the Division supports reconsideration of the SMUD imputation issue because there are at least two equally valid ways of levelizing a value like the up-front payment or a series of values like the revenues arising from the SMUD contract: a constant method or an escalated levelization. In its order, the Commission states, “We accept the Division’s 2008 value of \$37 per megawatt hour to serve as the component of the annualized per unit revenue associated with the \$98 million lump-sum payment.”⁷ The Division’s value of \$37 was calculated using the escalated levelization method.

In the constant levelization method, also known as the annuity method, the up-front payment would be represented by an equal or constant annual value over the life of the SMUD contract that has the same present value. Similarly, the unequal annual revenues arising from the SMUD contract prices would be replaced by an equal annual value that over the life of the contract has the same present value. Alternatively, an escalated levelization methodology, sometimes referred to as real levelization, could be applied to both revenue sources to arrive at

⁶ For any given year, the escalated value is found by taking the levelized value of the up-front payment derived using a real interest rate and, starting from year one, escalating to the reference year that value by the inflation rate. Each year’s value is equal to the previous year’s value escalated by a constant rate, an assumed rate of inflation.

⁷ Report and Order, p. 28.

similar per MWh prices. There are three main steps in applying this methodology. First, the present value of the revenue source is determined using a nominal discount rate. Second, given the nominal present value from step one, an equivalent equal annual value, an annuity or constant levelized value, is determined using a real discount rate. Three, inflation is factored back in by escalating year-to-year the real levelized value by the compounded inflation rate.

Note, under the escalated levelization, the year-to-year values vary (increase) at a constant rate depending on the rate of inflation while under constant levelization the year-to-year values remain the same. While both methods are equally valid from a mathematical view, the Division believes that because the year-to-year values under the constant levelization or the annuity method do not change and are thus comparable across years, the annuity method is more appropriate for imputation.

While use of the annuity method may support an increase in the imputation to the SMUD contract, the Division believes that that increase will be far less than the \$58.46 recently ordered by the Commission. Therefore, the Division requests that the Commission reconsider its order on SMUD imputation and either eliminate the adjustment at this time allowing parties to submit further evidence on this matter in the next rate case or accept further evidence on this matter as part of the reconsideration and rehear the issue in a timely manner.

Property Tax Adjustment

The Division supports the Company's request to eliminate the Commission's property tax adjustment of \$2.988 million. The Division believes that the Company is correct in representing that its property tax is based upon primarily the Company's rate base or the book value of its

property, plant, and equipment; and the income of the Company.⁸ The Company's position, expressed in its request for rehearing, is consistent with the position taken by the Division in its direct testimony.⁹

During the review of the Company's filing, the Division studied the Company's proposed revenue requirement for property tax. The Division sent data requests to the Company that the Company answered by stating that updated information indicated a downward adjustment of the 2008 forecast relating to property taxes. The Division proposed an adjustment based on the Company's updated information. The Company accepted this adjustment and revised its revenue requirement for property tax. The Division had no other concerns with the Company's methodology for forecasting revenue requirement for property taxes.

An increase in the property, plant, and equipment amounts from one year to the next will likely result in a directly proportional increase in the property tax amount. This increase is, at least in the short run, independent of the longer-term trends since it is determined by management's planning and budgets. The Division believes that the Company's showing of increases in actual states' assessments is indicative of the direct relationship between changes in the amount of property, plant, and equipment and property tax assessments. This in turn supports the concept that management, at least in some way, influences property tax assessments by being in a build cycle. Therefore the Division believes that the simple trending of historical property tax payments is a poor method for determining the property tax estimate in this particular rate case. However, given a different set of facts, a trending methodology might, at some future time, be more reasonable than it is here. For the above reasons, the Division supports the Company's

⁸ The Utah State Tax Commission Rule R884-24P-62 (6a) directs that the net book value of a regulated utility's taxable property less deferred income taxes is the preferred cost indicator of value. This calculation is an approximation of the utility's rate base.

⁹ See DPU Exhibit 4.0.

request, in this rate case, to reverse the Commission's adjustment relating to the revenue requirement for property tax.

For the reasons set forth above, the Division supports the Company's request for reconsideration regarding the SMUD imputation and the property tax adjustment.

Respectfully submitted this 17TH day of September 2008.

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CERTIFICATE OF SERVICE

This is to certify that a true and correct copy of the foregoing Response of the Division of Public Utilities to the Request for Reconsideration Filed by Rocky Mountain Power was sent by electronic mail or mailed by U.S. Mail, postage prepaid, to the following on September 17, 2008:

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