

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application of)	Docket No. 09-035-15
Rocky Mountain Power for)	Direct Testimony of
Approval of its Proposed Energy)	Michele Beck
Cost Adjustment Mechanism)	For the Office of
)	Consumer Services

November 16, 2009

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1 **INTRODUCTION**

2 **Q. WHAT IS YOUR NAME, OCCUPATION AND BUSINESS ADDRESS?**

3 A. My name is Michele Beck. I am currently employed as the director of the
4 Office of Consumer Services. My business address is 160 East 300
5 South, Salt Lake City, Utah, 84111.

6

7 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

8 A. I provide the policy recommendations of the Office on Rocky Mountain
9 Power's (Company or RMP) Energy Cost Adjustment Mechanism (ECAM)
10 proposal. I also summarize the analysis, conclusions and
11 recommendations presented in the testimony of other Office witnesses.

12

13 In addition to my testimony, the Office is sponsoring the testimony of two
14 expert witnesses. Lori Smith Schell from Empowered Energy addresses
15 the Company's natural gas hedging policies and Paul Chernick from
16 Resource Insight addresses four main areas: past differences between
17 Utah-allowed and actual NPC, the scope of NPC risks to which RMP is
18 exposed, customer benefits of an ECAM or lack thereof, and the effect of
19 an ECAM on PacifiCorp's incentives for cost control.

20

21 **Q. PLEASE SUMMARIZE THE OFFICE'S RECOMMENDATION**
22 **REGARDING RMP'S ECAM PROPOSAL.**

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23 A. In summary, the Office does not believe that an ECAM would be in the
24 public interest. The Company has not demonstrated a need for such a
25 mechanism and concerns about proper incentives and regulatory review
26 raise additional public interest questions. Finally, the Office has identified
27 two threshold issues, natural gas hedging practices and proper reliance on
28 market energy to meet load requirements, that must be resolved before
29 any ECAM could be found to be in the public interest.

30

31 **Q. WHAT IS THE FOCUS OF THIS PROCEEDING?**

32 A. The primary focus of this proceeding is whether or not an ECAM for RMP
33 would be in the public interest, including the relevant threshold and policy
34 issues; issues relating to design and implementation will only be
35 addressed in Phase 2 if it is necessary based upon the outcome of this
36 phase. The Public Service Commission (Commission) indicated in its
37 Notice of Scheduling Conference and Procedural Order dated June 18,
38 2009 that:

39 The issues to be addressed in Phase I should include the
40 issues identified by the parties' filing comments surrounding
41 the threshold and policy issues regarding the need for an
42 ECAM and the identification of an appropriate regulatory
43 treatment for recovery of net power costs that appropriately
44 balances standard regulatory objectives. (p.9)

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46 The Commission went on to say that:

47 We concur with parties it is the Company's burden to prove a
48 change in rate-making treatment for net power costs is
49 appropriate and in the public interest. We ruled in Docket
50 No. 90-035-06, on December 7, 1990, and October 19,
51 1993, normalization of net power costs, rather than
52 balancing account treatment, was appropriate and in the
53 public interest. We will re-examine this ruling in this
54 proceeding. (p. 10)

55

56 **Q. WHAT IS THE SIGNIFICANCE OF DOCKET 90-035-06?**

57 A. The first phase of that docket addressed inter-jurisdictional allocation
58 issues and the future of a fuel adjustment mechanism referred to as the
59 Energy Balancing Account (EBA), which was in place for the Company¹ at
60 that time. In Docket 90-035-06, the Company requested the
61 discontinuation of the EBA as no longer being in the public interest². The
62 Commission ordered a suspension of the EBA stating in its Report and
63 Order dated December 7, 1990:

64 The Commission's understanding of their argument as to
65 why such a move is in the public interest is based upon three

¹ At the time of 90-035-06, the "Company" was PacifiCorp Electric Operations which was a PacifiCorp subsidiary doing business in the state of Utah as Utah Power & Light.

² In this docket, the predecessor of the Office, the Committee of Consumer Services, originally opposed the elimination of the EBA but later participated in a joint recommendation that supported a suspension of the EBA, among other things.

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66 points. First, parties testify PacifiCorp Electric Operations is
67 a different company, employing different tools and modes of
68 analysis than did the old Utah Power & Light. The implication
69 is that forecasts will be better than before, and examination
70 to-date shows no evidence of pro-shareholder bias in
71 forecasted results. Second, the EBA, as a form of fuel
72 adjustment clause, encourages the Company to load
73 expenses into it for speedy recovery. **This increases**
74 **ratepayer risk because regulatory scrutiny is not and**
75 **cannot be as effective as rate case analysis.** Third, the
76 electric industry is a different animal today than it was when
77 the EBA was adopted. Market characteristics today may
78 necessitate a different set of management prerogatives.

79 (Report and Order, p. 7 emphasis added)

80 The Office particularly notes the Commission's conclusion that "regulatory
81 scrutiny is not and cannot be as effective as rate case analysis." The
82 Office addresses its ongoing concerns about adequate regulatory review
83 of an ECAM in Mr. Chernick's testimony.

84

85 **Q. DID THE OFFICE FRAME ITS ANALYSIS BASED ON THE ISSUES**
86 **FROM THE 1990 DOCKET?**

87 A. No. The Office recognizes that many of the contextual issues are different
88 today than they were almost twenty years ago. The Office evaluated this

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89 case on its own merit considering the facts and circumstances that are
90 present today. Some of the reasons for elimination of the EBA, such as
91 pending competition, no longer exist. On the other hand, many other
92 changes to the regulatory system within which the Company operates
93 have also occurred in the last twenty years. Some of these changes
94 directly improve the Company's ability to recover certain investment and
95 operating costs. For example, future test years are now allowed and
96 regularly used in rate proceedings, which reduces regulatory lag. The
97 Energy Procurement Act established a process whereby the Company
98 can receive pre-approval for investment in new resources outside of a
99 general rate case. And just this year, the legislature approved yet another
100 regulatory process which allows for rate recovery of major plant additions
101 in between general rate cases.

102

103 While the Office focused its analysis on current conditions, the Office also
104 believes it is important to acknowledge the regulatory history that led to
105 current circumstances. The Company's witness Dr. McDermott went to
106 some length to point out that RMP is one of very few utilities in the country
107 not to have some form of energy adjustment mechanism³. However,
108 none of the Company's witnesses addressed the fact that the current
109 absence of some sort of energy adjustment mechanism is a result of the

³ The Office's witness Mr. Chernick provides some important clarifications to Dr. McDermott's analysis.

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110 Company having made a successful case that it was in the public interest
111 to eliminate the EBA back in 1990. In many respects, this background
112 establishes a higher evidentiary standard to be met by the Company in
113 asserting that such a mechanism would now be in the public interest.

114

115 **Q. DOES THE OFFICE HAVE ANY REMAINING CONCERNS STEMMING**
116 **FROM THE 1990 CASE?**

117 A. Yes, the Office has concerns relating to the shifting of risk from utility
118 management to customers and incentives to management to efficiently
119 plan and operate the utility In that case, Mr. Verl R.Topham, who was at
120 that time president of Utah Power & Light and Executive Vice President of
121 PacifiCorp Electric Operations Group, testified on behalf of the Company
122 in support of the elimination of the EBA. His evidence at that time
123 included the following:

124 Q. The EBA is a mechanism which places the risk of
125 fluctuating power costs on the customer. If the EBA were
126 terminated, the risks of fluctuating power costs would be
127 placed on the Company. Why is the Company willing to
128 accept this risk?

129 A. The Company is willing to accept this risk because we
130 believe the risk is manageable. The Company believes in
131 placing the risk of management practices on those that make
132 the business decisions – management – not customers. (p.

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133 13 lines 17 – 26 Prefiled Direct Testimony of Verl R.

134 Topham, 09-035-06)

135

136 The Office agrees with Mr. Topham's testimony that an energy balancing
137 mechanism puts the risk of fluctuating NPC on customers. The Company
138 has not explained why its philosophy has changed such that it now
139 believes the risk should be borne by customers who have no input on
140 management's business decisions, although Mr. Duvall now asserts on
141 behalf of the company that an ECAM would not result in a shift of risks. I
142 will address this issue further in explaining our threshold issues later in
143 this testimony.

144

145 Mr. Topham also addressed how the EBA impacted the management of
146 the Company.

147 Q. Mr. Topham, how does the EBA impact the management
148 of the Company?

149 A. Due in part to competition, the electric business is more
150 dynamic today than ever before. As new or innovative types
151 of transactions are proposed, their impact on the EBA must
152 be considered. Additionally, any new or modified venture
153 must always be viewed in terms of the related EBA
154 treatment. If the EBA continues in its present form, future

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155 transactions will likely be evaluated based, at least in part,
156 on their impact on the EBA.

157 Q. What is the harm in evaluating the EBA impact of
158 potential transactions?

159 A. The harm is that the result of such evaluation may require
160 the Company to reject an opportunity, otherwise beneficial to
161 customers and shareholders, simply because of the related
162 EBA impact. The economics of a proposed transaction
163 should stand on their own. Decisions concerning proposed
164 transactions should be based on economics alone,
165 independent of the impact of the EBA.

166 (p. 14 lines 11 – 26, p. 15 lines 1-6, Prefiled Direct
167 Testimony of Verl R. Topham, 09-035-06)

168

169 The Office remains concerned about the potential incentive problems
170 acknowledged by Mr. Topham on behalf of the Company even though the
171 Company has changed its views toward the incentive problems inherent in
172 energy adjustment mechanisms now that it is requesting one. The Office's
173 critique of the Company's position on this issue is addressed at length in
174 Mr. Chernick's testimony.

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176 **Q. HOW DID THE OFFICE APPROACH ITS ANALYSIS OF THE**
177 **TESTIMONY AND EVIDENCE FILED BY THE COMPANY IN SUPPORT**
178 **OF ITS ECAM PROPOSAL?**

179 A. The Office reviewed the evidence offered by the Company in the context
180 of current available regulatory processes for addressing RMP's cost
181 recovery as well as the operational practices of this utility. We considered
182 whether an ECAM is needed and in the public interest by evaluating the
183 Company's analysis of the volatility of NPC, the Company's assertion
184 regarding how much control they have in managing NPC and the
185 processes currently available to the Company to recover its prudently
186 incurred NPC. In addition, the Office examined other issues relevant to
187 public interest determination including the impact an ECAM would have on
188 management incentives, risk allocation between the Company and
189 consumers and regulatory review of NPC.

190

191 **Q. WHAT WERE THE RESULTS OF THE OFFICE'S ANALYSIS?**

192 A. Dr. Schell concluded that the combined effect of the hedging time horizon
193 and the time-specific hedging targets contributes to accomplishing the
194 goal of [REDACTED]

195 [REDACTED]

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199 Mr. Chernick concluded that:

- 200 ● The Company has failed to provide the explicit and quantitative
201 analysis of the magnitude and nature of the factors driving
202 fluctuations in power costs required by the PSC.
- 203 ● RMP grossly exaggerates the uncontrollable risks to which the
204 Company is exposed by the lack of an appropriately-structured
205 ECAM.
- 206 ● The Company's claims that ECAM provides ratepayer benefits
207 are incorrect.
- 208 ● An ECAM would create incentive problems that would be very
209 difficult to correct.
- 210 ● The Company has not demonstrated that an ECAM is needed
211 or that it would be in the public interest.

212

213 **Q. WOULD IT BE POSSIBLE TO RESOLVE THE OFFICE'S CONCERNS**
214 **IN PHASE TWO OF THE CASE THROUGH THE DESIGN ELEMENTS?**

215 A. No. Certainly some jurisdictions have implemented specific design
216 elements in energy adjustment mechanisms to address the some of the
217 issues raised by the Office, such as the impact on management incentives
218 and regulatory review.⁴ However, there are at least two threshold issues
219 that would have to be remedied prior to consideration of any design
220 elements. An ECAM cannot be found to be in the public interest until
221 these threshold issues are satisfactorily addressed and resolved.

⁴ The Office has not done a thorough review of these design elements to be able to speak to their successes and failures. We would intend to incorporate that type of review in phase two of this case if it becomes necessary.

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223 **Q. WHAT ARE THE THRESHOLD ISSUES TO WHICH YOU REFER?**

224 A. If an ECAM is implemented, it would shift some of the risks associated
225 with NPC. Currently, the Company is at risk for NPC that exceed the
226 projections included in base rates until the time NPC is adjusted in the
227 next rate case. Under an ECAM, customers would bear the risk of actual
228 NPC being higher than forecasted NPC. If such a shift in cost
229 responsibility were to occur, it should be accompanied with increased
230 input regarding the management of those costs. This is particularly true
231 for two specific types of costs: natural gas fuel costs and electric market
232 energy costs.

233

234 **Q. PLEASE EXPLAIN HOW NATURAL GAS FUEL COSTS ARE A**
235 **THRESHOLD ISSUE IN THIS DOCKET.**

236 A. The Office's witness Dr. Schell provides a detailed review of the
237 Company's adherence to its hedging policy. This hedging policy largely
238 protects the Company from uncertain costs of natural gas fluctuation, but
239 does not provide the opportunity for consumers to benefit when natural
240 gas costs are lower than projected. The Office has not completed its
241 investigation to have a full understanding of the overhead and premium
242 costs associated with this hedging policy. However, one would
243 reasonably expect that the reduced volatility does come at a premium. It
244 would not be in the public interest for consumers to both share the risk of

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245 natural gas costs and pay a premium for price stability, unless that
246 premium price had been reviewed and approved by the Commission after
247 receiving input from the Division, the Office and other interested parties.
248 Conversely, one could envision a situation in which the Company changed
249 its hedging practices once it received an ECAM that shifted to consumers
250 the risk associated with fluctuating natural gas prices. Taken to the
251 extreme, the Company could decide to pursue very little or no hedging,
252 exposing consumers to considerable price fluctuation. This also would not
253 be in the public interest unless it had been reviewed and approved by the
254 Commission after receiving input from the Division, the Office and other
255 interested parties. Thus, the Office views the hedging policies with respect
256 to natural gas fuel costs as a threshold issue that must be determined
257 apart from and in advance of any discussion of design or implementation
258 of an ECAM.

259

260 **Q. WHAT IS THE OFFICE'S RECOMMENDATION FOR DEALING WITH**
261 **THIS THRESHOLD ISSUE?**

262 A. The Office recommends that the Commission reject the Company's
263 current application for an ECAM and decline to consider any future
264 requests until the issue of natural gas hedging has been resolved in a
265 manner that assigns only appropriate costs and risks to consumers.

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267 **Q. PLEASE EXPLAIN HOW ELECTRIC MARKET ENERGY COSTS ARE A**
268 **THRESHOLD ISSUE IN THIS DOCKET.**

269 A. Currently, customers pay normalized NPC as forecasted and included in
270 base rates. These NPC include a projected amount of energy that is
271 expected to be purchased from the market, as opposed to generated by
272 the Company. The costs of that electric market energy are based on
273 forecasted market prices under normal conditions. Thus, any higher
274 market prices incurred when the Company is purchasing during abnormal
275 conditions (e.g. market shortage, extreme weather, or loss of significant
276 generating or transmission resources) are borne by the Company.
277 Whether or not it is in the public interest for the Company to have this
278 exposure to the higher than forecast costs must be considered in an
279 appropriate context.

280

281 In determining the appropriate allocation of market energy costs,
282 regulators must examine the causes of the costs and the causes of the
283 quantities of the market energy being purchased. For many years, the
284 Office and other stakeholders have expressed concern about the
285 Company's over-reliance on the market within the integrated resource
286 planning (IRP) process. Compounding the problem is the fact that the
287 Company's last two efforts using the energy procurement act have not yet
288 resulted in any new generating resources.

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290 Since NPC are currently set based on expected costs under normal
291 conditions, the Company has appropriately borne the risk of its decision to
292 rely so heavily on the market instead of constructing or acquiring more
293 generating resources. If an ECAM were to be implemented, this risk
294 would be shifted inappropriately to consumers. If consumers were to
295 share the risks associated with electric market energy costs, then
296 consumer advocates' views towards the appropriate reliance on the
297 market must be taken into greater consideration. One of the Office's
298 greatest concerns is for large market price spikes in the near future as a
299 result of inadequate resources in the region. Consumers should not be
300 exposed to price risks associated with planning decisions, unless those
301 decisions have been approved by the Commission after receiving
302 appropriate input from regulators and consumer advocates. The
303 Company's current IRP is still under consideration by the Commission and
304 its previous IRP was not acknowledged. Furthermore, a simple
305 acknowledgment of a resource plan does not ensure that the resource
306 decisions implied by the plan will be followed.

307

308 This underlying issue of the appropriate level of reliance on market energy
309 is a threshold issue that must be determined apart from and in advance of
310 any discussion of design or implementation of an ECAM. The Company's
311 current IRP indicates a growing resource deficit that is expected to total
312 about 2,000 MW t in 2012. Without a determination by the Commission of

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313 appropriate reliance on the market, the implementation of an ECAM
314 cannot be found to be in the public interest since it would put consumers
315 at risk for extremely high power costs.

316

317 **Q. CAN THE ISSUE OF THE APPROPRIATE LEVEL OF RELIANCE ON**
318 **MARKET ENERGY BE PROPERLY ADDRESSED IN DESIGNING AN**
319 **ECAM?**

320 A. Not very easily. One could conceive of a multi-tiered design in which
321 different price caps or overall percentages of market costs were allowed
322 depending on what percentage of overall energy needs are served from
323 the market. However, some Utah regulators have expressed a great
324 reluctance and distaste for overly complicated regulatory mechanisms in
325 other recent regulatory proceedings. Thus, the Office does not believe
326 that it is realistic to assume that ECAM design could remedy the problems
327 associated with over-reliance on the market.

328

329 **Q. WHAT IS THE OFFICE'S RECOMMENDATIONS FOR DEALING WITH**
330 **THIS THRESHOLD ISSUE?**

331 A. The Office recommends that the Commission reject this application for an
332 ECAM and decline to consider any future requests until the Company has
333 constructed or acquired sufficient resources such that its over-reliance on
334 the market is remedied.

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336 **Q. PLEASE SUMMARIZE THE OFFICE'S POLICY AND**
337 **RECOMMENDATIONS REGARDING AN ECAM.**

338 A. The Company has not demonstrated the need for an ECAM. This lack of
339 compelling evidence, along with concerns about proper management
340 incentives and regulatory review clearly show that the Company's
341 proposal would not be in the public interest. Further, no energy
342 adjustment mechanism could be found to be in the public interest until two
343 threshold issues of natural gas hedging and appropriate reliance on
344 market energy have been satisfactorily addressed and resolved by the
345 Commission. This is because an ECAM would shift risk to consumers
346 and consumers have no management control over these threshold issues,
347 nor has the Commission approved or endorsed the Company's approach.
348 Thus, the Commission should reject the Company's request for approval
349 of its ECAM proposal and decline to consider any future ECAM or similar
350 requests unless these two threshold issues of natural gas hedging and
351 appropriate reliance on market energy have been resolved by the
352 Commission through an appropriate regulatory process.

353

354 **Q. DOES THIS COMPLETE YOUR DIRECT TESTIMONY?**

355 A. Yes.