

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

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)	DOCKET NO. 09-035-15
)	Exhibit No. DPU 1.0R
In the Matter of the Application of Rocky)	
Mountain Power for Approval of Its)	
Proposed Energy Cost Adjustment)	Rebuttal Testimony for Phase I of
Mechanism)	Charles E. Peterson
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**FOR THE DIVISION OF PUBLIC UTILITIES
DEPARTMENT OF COMMERCE
STATE OF UTAH**

**Rebuttal Testimony for Phase I of
Charles E. Peterson**

December 10, 2009

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Rebuttal Testimony of Charles E. Peterson

Q. Have you previously filed testimony in this docket?

A. Yes, I filed direct testimony on behalf of the Division of Public Utilities (Division, or DPU) as DPU Exhibit 1.0 with attached Exhibits on November 16, 2009.

Q. What is the purpose of your testimony in this matter?

A. My rebuttal testimony is in response to the direct testimony filed by the intervenors (or Parties) in this case including Mr. Kevin C. Higgins testifying for the Utah Association of Energy Users (UAE), Ms. Nancy L. Kelly testifying in behalf of Western Resource Advocates (WRA), Mr. Steve W. Chriss for Wal-Mart, Ms. Elizabeth A. Wolf who provides testimony for Salt Lake Community Acton Program (SLCAP); and Ms. Michele Beck, Dr. Lori Smith Schell, and Mr. Paul Chernick supplying testimony in behalf of the Office of Consumer Services (Office).

Q. Please outline your approach in providing Rebuttal Testimony.

A. I intend to discuss some of the issues raised by various Parties rather than necessarily respond in detail to the testimonies of each individual Party. The fact that I do not mention a specific issue raised by a Party should not be construed to mean either agreement or disagreement with that Party's position on that issue.

23 There are two issues identified by the Office as “threshold” issues: PacifiCorp’s (the
24 Company) hedging policies and practices; and the Company’s reliance on wholesale market
25 purchases to supply a significant portion of its power resources. I will be commenting on
26 these specific issues.

27

28 **Q. Do you have a general observation regarding the pre-filed direct testimonies of the**
29 **Parties?**

30 A. Yes. All of the Parties appear to reject PacifiCorp’s proposed ECAM. Generally, though, the
31 Parties appear to conflate the specifics of the Company’s ECAM proposal and the broader
32 question of whether some sort of ECAM for PacifiCorp may be in the public interest. It is
33 this broader question that the Division understands to be the principal issue in Phase I of this
34 Docket, and not so much whether or not Parties support the specific features of the
35 Company’s proposed ECAM. Many of the issues raised by the Parties relate to design issues
36 of the proposed ECAM and are issues that possibly could be resolved by a different ECAM
37 structure. For its part, as indicated in my Direct Testimony, the Division also has concerns
38 with the Company’s specific ECAM proposal.

39

40 Given the primary focus on concerns regarding the proposed ECAM, the Division does not
41 believe that the Parties have presented compelling reasons that an ECAM is necessarily not
42 in the public interest. On the contrary, the Division continues to believe that there are good
43 public policy reasons to consider an ECAM as part of the regulatory mechanisms that help to
44 keep the Company financially viable.

45

46 **Q. Can you give a few specific examples as to what you are referring?**

47 A. Yes. One major issue is that nearly all Parties, and the Division, raise concerns regarding
48 incentives.¹ That is, with the proposed ECAM, the Company would have incentives to reduce
49 its efforts to provide one sort of service or other. For example, the Company would face
50 reduced incentives to make least cost-least risk power purchases in the wholesale markets,
51 since it would be protected by the proposed ECAM from any mistakes it makes, at least in
52 the short run. WRA witness Ms. Kelly argues that the ECAM will reduce incentives to
53 promote demand side management (DSM) or other efficiency programs and increase
54 incentives to use fossil fuel.²

55
56 Nearly all of the Parties, and the Division, cited the shift in risk from the Company to
57 customers as a concern. Ms. Kelly and Office witness Ms. Beck include quotations from
58 Company witnesses in Docket No. 90-035-06 to support their concerns.³ The Division does
59 not dispute that there would be likely a shift in risk with an ECAM from the Company to
60 customers. The question is whether or not such a risk is reasonable and in the public interest.
61 The Division believes that the Company's proposed ECAM shifts an unreasonable amount of
62 risk to customers. However, the Division believes that there are risks that customers should
63 reasonably bear, such as the likely higher costs that may result from carbon legislation due to
64 the Company's legacy of fossil fuel plants—to date, the Company has never been
65 compensated to assume that level of risk. Likewise, significant and unforeseen increases in

¹ For examples, see Kevin C. Higgins, Pre-filed Direct Testimony at lines 52-55; Nancy L. Kelly, Direct Testimony pages 2-5; Elizabeth A. Wolf, Direct Testimony, p. 4, lines 13-15; Paul Chernick, Direct Testimony, Section VI, beginning on p. 34.

² Ibid., also see Higgins, lines 157-162. The Division believes that the threat of carbon legislation will continue to provide strong incentives to move away from fossil fuels with or without an ECAM. Furthermore, the Company's DSM programs are well established and interested parties are not likely to quit pushing for more DSM.

³ For examples, see Higgins, lines 127-172; Kelly, pp. 9-11; Steve W. Chriss, Phase I Direct Testimony and Exhibits, pp. 3, 5-7; Beck, lines 72-75, 87-101, 138-140.

66 long-term fuel costs should not be the burden of the Company to shoulder—again, it has not
67 been compensated to assume such risks—just as retail service stations cannot be expected to
68 “eat” a doubling in the price of oil.

69

70 The Parties are properly critical, in the Division’s view, of any Company claims that
71 customers will receive better price signals from the proposed ECAM.⁴ The Division believes
72 that an ECAM, in theory, could be structured to give better price signals to customers than
73 they are currently receiving, such as monthly or even weekly price adjustments, though this
74 would create obvious practical difficulties, for example, too frequent rate changes.

75

76 There are other comments made by Parties’ witnesses that the Division believes go to the
77 design issue as opposed to the public policy issue. Some of the comments of these Parties
78 include that in an ECAM, net power costs (NPC) are often considered in isolation, as they
79 would be in a single item rate case. Considering something in isolation means you may not
80 consider some countervailing item. (Higgins, lines 87-97). Furthermore, Utah customers
81 should not be subject to hydro power risks (Higgins, lines 377-385). ECAMs in other states
82 already contribute to the Company’s reluctance to acquire new generation resources due to
83 an apparent ease of recovery of front office transactions (Kelly, pp. 11-13). Reducing risk to
84 the Company through an ECAM should reduce its allowed rate of return—but this is difficult
85 to quantify (Higgins, lines 140-144; Chriss, p.14). It will be difficult for regulators to
86 administer and audit an ECAM (Higgins, lines 145-146; Wolf, pp. 6-7; Chernick, pp. 45-50).

87

88 **Q. How do these differ from what you and the Division presented?**

⁴ For example see: Higgins, lines 98-104, 118-125; Chriss, p. 10-12; Wolf, p. 7.

89 A. We presented areas where an ECAM could be in the public interest if it could be designed to
90 reduce or mitigate the kinds of problems that other parties identified. We did not identify
91 specific designs but rather attempted to point the Commission toward areas where it could
92 address design issues that affect the public interest.

93

94 **Q. What specific comments do you have regarding the list of “other comments” you**
95 **highlighted above?**

96 A. The comments of Mr. Higgins related to the problems of considering one item in isolation
97 and not considering other, offsetting, factors is clearly a design issue. Specifically, I
98 identified in my Direct Testimony the need to consider incremental revenues as well as
99 incremental costs; Mr. Chernick made the same point in his testimony.⁵

100

101 As to the issue that, perhaps, Utahns should not be subject to hydro risks due to the MSP’s
102 Revised Protocol, this is another design issue. An ECAM could be designed to exclude such
103 risks. For example, changes in NPC due to fluctuations in hydro conditions could be
104 monitored and excluded from Utah’s ECAM. Alternatively, Revised Protocol might be
105 revised to give Utahns more of the benefits (and costs) of the hydro facilities in the
106 Northwest.

107

108 Ms. Kelly’s claim that the Company’s ECAMs in other states makes it reluctant to build new
109 generation capacity is not proven and is not a compelling argument against an ECAM, *per se*.

⁵ Chernick, lines 427-429.

110 But assuming that her contention is correct only means that policies should be put in place,
111 possibly within an ECAM, that would promote the acquisition of Company owned
112 generation; perhaps even the type of generation Ms. Kelly desires.

113

114 Mr. Higgins may be correct that it is difficult to quantify the theoretical reduction in return
115 on equity (ROE) that should accompany the reduction in risk to the Company that an ECAM
116 should supply. However, based on my experience, such a reduction in ROE is likely well
117 within the error range of cost of equity estimates, making such an adjustment an effort at
118 precision that may not be practical. Furthermore, one should not be so myopic with respect to
119 the potential risk reduction to the Company of an ECAM to miss the point that some risks
120 may be appropriate for ratepayers to share. Potential carbon legislation, for example, is one
121 case in point. As James C. Bonbright explains, “With an important qualification, the
122 legitimate interests of investors may be regarded as amply protected by the allowance of rates
123 sufficiently high to maintain corporate credit and hence to assure the maintenance of
124 adequate service.”⁶ According to Mr. Bonbright, the important qualification “lies in the
125 obligation of commissions to protect the interests of investors who may have committed their
126 funds in reliance on rules of rate making no longer accepted.” Certainly, the passage of
127 current potential legislation will change the rules that investors originally relied upon.
128 Again, when the Company began to acquire its current generation portfolio, the level of
129 allowed compensation was not necessarily commensurate with the level of risk that potential
130 carbon legislation now imposes.

131

⁶ James C. Bonbright, *Principles of Public Utility Rates*, Columbia University Press: New York, New York, 1961, p. 39.

132 The Division has raised the issue of the potential difficulty in satisfactorily auditing an
133 ECAM. In my Direct Testimony I made suggestions that might mitigate such concerns such
134 as fewer general (or single-item) rate cases, or having an ECAM that focuses on certain,
135 relatively unusual circumstances. Also, similar to the way adjustments to Questar's 191
136 account are treated, rates initially could be effective on an interim basis allowing more time
137 for auditing the ECAM and its associated accounts. These suggested mitigations would free-
138 up time for Division auditors to either spend more time on ECAM audits (e.g. fewer rate
139 cases), or will need to spend less time auditing an ECAM (e.g. more narrowly defined
140 ECAM adjustments). While it is possible that auditing needs may expand well beyond
141 regulatory resources, necessitating a policy decision to eliminate an ECAM, preliminarily
142 this auditing issue could be just a design issue.

143

144 **Q. What are the significant areas in which you agree with the Parties?**

145 A. I agree that the Company's proposed ECAM is seriously flawed and should be rejected. This
146 agreement is based upon its encompassing all components of the Company's NPC and not
147 just those components truly beyond the control of the Company⁷; the failure of the proposed
148 ECAM to consider mitigating revenues; the ECAM shifting all NPC risk to customers who
149 are likely not as well positioned to understand and mitigate these risks as is the Company; as
150 demonstrated in my Direct Testimony, if implemented in all PacifiCorp states, the proposed
151 ECAM may completely recover, and possibly over-recover, the Company's earnings
152 shortfall, implausibly suggesting in essence that NPC is the sole reason for all profitability

⁷ In the end, the Commission may find that balancing interests and objectives may require the inclusion of all components of the Company's NPC in an ECAM. At this point, however, the Division believes that an ECAM that is limited to specific items is more likely to reasonably balance these objectives and still be consistent with the public interest. Appropriately, this debate is reserved for the second phase of this docket.

153 difficulties the Company experiences; and the proposed ECAM, at best, provides poor price
154 signals to customers. I agree that proper incentives need to be maintained for the Company
155 and, I might add, customers. I agree that the Company has inadequately specified the
156 problem it is actually facing that is best solved by its proposed ECAM. (For example, that
157 spot prices are volatile, everyone else has an ECAM, and NPC have in recent years been
158 higher than expected, are interesting but not compelling facts). I agree that the Company's
159 hedging practices, future test years, special rate cases to include major plant additions in
160 rates, and pre-approval of major plant additions, all mitigate potential losses by the
161 Company, but I do not agree that they necessarily eliminate the need for an ECAM.

162

163 **Q. You mentioned earlier the “threshold” issues set forth by the Office. Please describe**
164 **your understanding of these “threshold” issues.**

165 A. The Office, through the testimony of Ms. Beck, presents two “threshold” issues that must be
166 resolved before continuing further consideration of an ECAM. The first issue is the
167 Company's hedging policies and practices. Ms. Beck correctly points out that customers,
168 through the Commission, have had no opportunity for input into the Company's hedging
169 activities. She argues that before an ECAM can be implemented and risks shifted to
170 ratepayers, the costs and benefits of the Company's hedging program need to be examined by
171 the Commission to ensure that customer interests in the hedging activities are protected and
172 risks to customers are minimized.⁸ The second issue is the Company's market power
173 purchase activities. Similar to the hedging issue, Ms. Beck argues that the level of the
174 Company's power purchases from the market be examined and approved by the Commission

⁸ Op. Cit. lines 236-258.

175 in order to protect customers' interests before the risks of the market power purchases be
176 shifted to ratepayers.⁹

177

178 **Q. What are your comments regarding the hedging and the purchased power issues raised**
179 **by the Office?**

180 A. Ms. Beck raises a legitimate concern regarding the Company's hedging program. At this time
181 the Commission has a docket open to investigate the Company's hedging policies and
182 practices (Docket No. 09-035-21) and the Division has proposed that the Commission also
183 address future hedging policy in the pending rate case (Docket No. 09-035-23). Since the
184 costs (and benefits) of the Company's hedging practices and market purchases have
185 heretofore been included in rates, the prudence of any such costs are a legitimate area of
186 regulatory concern and investigation. Likewise, as Ms. Beck points out, some parties in the
187 Company's Integrated Resource Plan (IRP) dockets¹⁰ have expressed reservations about the
188 level of market power purchases made by the Company and have recommended to the
189 Company that it move away from market power purchases due to a perceived risk to
190 customers due to a possible over-reliance on such purchases.

191

192 The Division is not convinced that we should not proceed to an ECAM design phase before
193 these issues are resolved. The Division believes that it is possible to design an ECAM that
194 would be flexible enough to deal with changes in hedging and market power purchases as
195 they might occur. This does not mean, however, that the Division believes that these issues
196 raised by the Office are not important. Indeed the Division is one of the parties that has

⁹ Ibid., lines 269-334.

¹⁰ For example, see Docket No. 09-2035-01, and Docket No. 07-2035-01

197 expressed concern with the level of market power purchases in the IRP process and
198 consequently supports resolution of this issue. The Division also supports the Commission
199 examining and giving direction to the Company regarding the Company's hedging program.
200 But the Division believes these issues can be pursued independently of, or at least parallel
201 with, an ECAM.

202

203 **Q. What are your conclusions?**

204 A. The Parties have presented facts and arguments to support rejection of the Company's
205 proposed ECAM. However, the Parties have not presented a compelling case that no ECAM
206 is in the public interest. Indeed, the Division believes that many of the issues raised by parties
207 in this Docket are design related and can be addressed in Phase II. In addition, the Division's
208 argument that an ECAM may be in the public interest as a mechanism to support the
209 Company's financial viability, supports the Division's recommendation to move on to Phase
210 II and examine possible ECAM designs.

211

212 **Q. Are you modifying any recommendations that you made in your Direct Testimony?**

213 A. No. As indicated above and in my Direct Testimony, the specific Company ECAM proposal
214 has many flaws, and the Company could have done a better job in specifying the exact
215 problem it is facing with net power costs that is best solved by an ECAM. However, the
216 Division continues to believe that some form of ECAM may be in the public interest and
217 recommends that the Commission move this Docket to Phase II wherein a satisfactory
218 ECAM might be designed.

219

220 **Q. Does this conclude your testimony?**

221 **A. Yes.**