

Gary A. Dodge, #0897
Hatch, James & Dodge
10 West Broadway, Suite 400
Salt Lake City, UT 84101
Telephone: 801-363-6363
Facsimile: 801-363-6666
Email: gdodge@hjdllaw.com

Attorneys for Utah Association of Energy
Users

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application of Rocky Mountain Power for Approval of Its Proposed Energy Cost Adjustment Mechanism	Docket No. 09-035-15
---	-----------------------------

PREFILED SURREBUTTAL TESTIMONY OF KEVIN C. HIGGINS

PHASE I

The Utah Association of Energy Users (“UAE”) hereby submits the Prefiled Surrebuttal Testimony of Kevin C. Higgins in this docket on Phase I policy issues.

DATED this 5th day of January, 2010.

/s/ _____
Gary A. Dodge,
Attorneys for UAE

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served by email this 5th day of January, 2010, on the following:

Mark C. Moench
Yvonne R. Hogle
Daniel E. Solander
Rocky Mountain Power
201 South Main Street, Suite 2300
Salt Lake City, Utah 84111
mark.moench@pacificorp.com
yvonne.hogle@pacificorp.com
daniel.solander@pacificorp.com

Michael Ginsberg
Patricia Schmid
Assistant Attorney General
500 Heber M. Wells Building
160 East 300 South
Salt Lake City, UT 84111
mginsberg@utah.gov
pschmid@utah.gov

Paul Proctor
Assistant Attorney General
160 East 300 South, 5th Floor
Salt Lake City, UT 84111
pproctor@utah.gov

F. Robert Reeder
William J. Evans
Vicki M. Baldwin
Parsons Behle & Latimer
One Utah Center, Suite 1800
201 S Main St.
Salt Lake City, UT 84111
BobReeder@pblutah.com
BEvans@pblutah.com
VBaldwin@pblutah.com

Arthur F. Sandack
8 East Broadway, Ste 510
Salt Lake City, Utah 84111
asandack@msn.com

Peter J. Mattheis
Eric J. Lacey
Brickfield, Burchette, Ritts & Stone, P.C.
1025 Thomas Jefferson Street, N.W.
800 West Tower
Washington, D.C. 20007
pjm@bbrslaw.com
elacey@bbrslaw.com

Gerald H. Kinghorn
Jeremy R. Cook
Parsons Kinghorn Harris, P.C.
111 East Broadway, 11th Floor
Salt Lake City, UT 84111
ghk@pkhlawyers.com
jrc@pkhlawyers.com

Steven S. Michel
Western Resource Advocates
227 East Palace Avenue, Suite M
Santa Fe, NM 87501
smichel@westernresources.org

Michael L. Kurtz
Kurt J. Boehm
Boehm, Kurtz & Lowry
36 East Seventh Street, Suite 1510
Cincinnati, Ohio 45202
mkurtz@bkllawfirm.com
kboehm@bkllawfirm.com

Betsy Wolf
Salt Lake Community Action Program
764 South 200 West
Salt Lake City, Utah 84101
bwolf@slcap.org

Holly Rachel Smith, Esq.
Russell W. Ray, PLLC
6212-A Old Franconia Road
Alexandria, VA 22310
holly@raysmithlaw.com

Sarah Wright
Utah Clean Energy
1014 2nd Avenue
Salt Lake City, UT 84103
sarah@utahcleanenergy.org

Mr. Ryan L. Kelly
Kelly & Bramwell, PC
11576 South State Street Bldg. 203
Draper, UT 84020
ryan@kellybramwell.com

/s/ _____

BEFORE
THE PUBLIC SERVICE COMMISSION OF UTAH

Surrebuttal Testimony of Kevin C. Higgins

on behalf of

UAE

Docket No. 09-035-15

Phase I

January 5, 2010

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

2

3 **Introduction**

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

5 A. My name is Kevin C. Higgins. My business address is 215 South State
6 Street, Suite 200, Salt Lake City, Utah, 84111.

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

8 A. I am a Principal in the firm of Energy Strategies, LLC.

9 **Q. Are you the same Kevin C. Higgins who previously filed direct testimony on**
10 **behalf of UAE in this proceeding?**

11 A. Yes, I am.

12 **Q. What is the purpose of your surrebuttal testimony?**

13 A. My surrebuttal testimony responds to various arguments presented in the
14 rebuttal testimonies of RMP witnesses Gregory N. Duvall, Karl A. McDermott,
15 and Frank C. Graves, and DPU witness Charles E. Peterson.

16 **Q. Have the rebuttal arguments offered by the RMP witnesses and DPU witness**
17 **Mr. Peterson caused you to modify the primary conclusion in your direct**
18 **testimony that RMP's cost structure is not sufficiently volatile to justify**
19 **adoption of an ECAM at this time?**

20 A. No. My review of the Parties' rebuttal testimony has not caused me to
21 modify my conclusions or recommendations in the proceeding.

23 **Response to Gregory N. Duvall**

24 **Q. In your direct testimony you stated that placing hydro-related risk on Utah**
25 **customers through an ECAM is not appropriate because Utah does not**
26 **receive a proportionate benefit from the PacifiCorp hydro resources. On**
27 **pages 17-18 of his rebuttal testimony, Mr. Duvall disagrees with your**
28 **position. How do you respond?**

29 A. Mr. Duvall states that he would partially agree with me if Utah rates were
30 set directly using the Revised Protocol methodology. However, Mr. Duvall
31 states that he disagrees with my conclusion because Utah rate increases continue
32 to be constrained by the application of the MSP rate mitigation cap. The MSP rate
33 mitigation cap is calculated using the Rolled-in methodology, and the Rolled-in
34 methodology recognizes hydro-related costs and benefits.

35 Contrary to Mr. Duvall's argument, the application of the MSP rate
36 mitigation cap does not make it appropriate for Utah customers to be assigned
37 PacifiCorp system hydro risk through an ECAM. The MSP rate mitigation cap
38 does not set the Utah revenue requirement equal to the revenue indicated by the
39 Rolled-in methodology, but rather it sets the Utah revenue requirement equal to
40 the Rolled-in methodology *plus a premium*. The premium is entirely attributable
41 to the removal of a substantial portion of the net benefit of the PacifiCorp hydro
42 system from Utah's allocation of system costs pursuant to the Revised Protocol.
43 Consequently, even when the MSP rate mitigation cap is in effect, Utah does not
44 receive a proportionate benefit from PacifiCorp's hydro system.

45 Moreover, the MSP rate mitigation cap is currently scheduled to be in
46 effect only through March 2014. Absent a change in the methodology for
47 allocating inter-jurisdictional costs, Utah would receive no net benefit at all from
48 PacifiCorp-owned hydro resources located on the west-side of the system if the
49 MSP rate mitigation cap is removed. Adopting a mechanism that forces Utah to
50 share in the risks of west-side hydro resources under these circumstances would
51 be fundamentally unreasonable.

52 **Q. Do you have any additional observations on the topic of sharing hydro-**
53 **related risk through an ECAM?**

54 A. Yes. My disagreement with Mr. Duvall on this point underscores an
55 important conceptual and practical difficulty in attempting to apply an ECAM in
56 RMP's Utah jurisdiction at this time. A fundamental premise of an ECAM is that
57 an underlying "system" net power cost is included in base rates, which is subject
58 to deviations that are recovered (or refunded) to customers. However, under the
59 Revised Protocol, "system" net power cost as applicable to Utah is not really as
60 straightforward as may first appear. On the one hand, net power cost is treated as
61 a standalone computation applicable to the entire PacifiCorp system, inclusive of
62 hydro benefits and costs. This is the "net power cost" addressed at length in Utah
63 rate cases. At the same time, each Utah rate case includes a separate computation
64 in which an "embedded cost differential" extracts from Utah customers the net
65 benefits of west-side hydro resources. This second calculation increases Utah's

66 revenue requirement.¹ Conceptually, this increase in revenue requirement is
67 tantamount to an increase in Utah's net power cost, even though the embedded
68 cost differential adjustment is not labeled as being a change to net power cost per
69 se. Thus, the system net power cost that would be the basis of the ECAM is not
70 identical to the *effective* net power cost charged to Utah under the Revised
71 Protocol.

72 Theoretically, the embedded cost differential calculated in a given rate
73 case is applicable only to the specific net power cost which is also determined in
74 that case. If net power cost turns out to be different after the fact, then the
75 embedded cost differential is also different, ex post. Of particular relevance to the
76 discussion of hydro risk, if net power cost increases because of below-average
77 hydro production, then all things being equal, the embedded cost differential
78 charged to Utah would have been set too high in the first instance.² If an ECAM
79 is adopted that assigns hydro risk to Utah, then during below-average hydro years,
80 Utah customers would be charged a pro-rata share of the incremental costs of
81 replacing the reduced hydro output, while paying base rates that incorporate an
82 embedded cost differential based on a normal hydro year. This is fundamentally
83 inequitable.

84 **Q. Couldn't this problem be resolved by simply re-computing the embedded**
85 **cost differential at the time an ECAM adjustor is levied?**

¹ This increase in Utah revenue requirement is then partially mitigated through the MSP rate mitigation cap discussed above.

² This would occur because the unit cost of hydro is higher for a below-normal hydro year than for a normal hydro year.

86 A. No. I do not think this problem would be equitably resolved with a
87 simple, embedded-cost-differential “do over.” First of all, the exercise of
88 isolating the hydro-related component in such a calculation would not be a trivial
89 matter. Further, such an exercise would not likely capture the secondary effects
90 of a poor hydro year, e.g., the upward pressure on market and fuel prices in the
91 Northwest that would be applicable to the replacement power. But even more
92 importantly, even if an embedded-cost-differential “do over” could be performed,
93 I fail to see why Utah customers should be subjected to any west-side hydro risk
94 at all, given that the Revised Protocol already requires Utah customers to “pay” to
95 have the west-side hydro net benefits removed from their rates. Having “paid” to
96 remove the net benefits of west-side hydro, it would not be reasonable to assign
97 Utah customers higher costs associated with below-average hydro production
98 through an ECAM under the justification that the embedded cost differential is
99 also recalculated after the fact.

100 **Q. What is the implication of this discussion?**

101 A. It may be that the one of the unintended consequences of the MSP Revised
102 Protocol is that it has made the applicability of an ECAM in Utah conceptually
103 and practically more difficult than would otherwise be the case.

104 **Q. On page 8 of his rebuttal testimony, Mr. Duvall states that you concluded**
105 **that the Company’s cost structure is not sufficiently volatile to justify**
106 **adoption of an ECAM, without indicating how volatile the Company’s cost**

107 **structure would have to be to change this recommendation. Do you wish to**
108 **respond?**

109 A. Yes. In discovery, RMP asked me to quantify how high volatility would
110 have to be such that RMP would be placed at “undue risk,” as referenced in my
111 direct testimony. UAE provided the following response:

112 Absent consideration of all relevant circumstances in a specific context, it is not
113 possible for UAE to state or quantify in the abstract the level of volatility that
114 would be required for UAE to consider RMP at “undue risk,” as that concept is
115 used in the referenced testimony. In the specific context of Mr. Higgins’ analysis
116 of RMP’s current net power cost risk in this docket, Mr. Higgins would not have
117 considered RMP to be at “undue risk” sufficient to justify consideration of single-
118 item ratemaking at this time absent strong evidence that price volatility could
119 reasonably be expected to cause RMP’s net power costs to drive variation in
120 RMP’s return on equity by more than 200 basis points within the first 12 months
121 after the start of the rate-effective period following the pending general rate case.
122

123 So while it is correct that I have not reached a conclusion as to the amount
124 of volatility necessary to change my recommendation, given the speculation
125 required about the combination of circumstances necessary to justify an ECAM, I
126 have, nevertheless, provided RMP with parameters that I would consider in such
127 an evaluation.

128

129 **Response to Karl A. McDermott and Frank C. Graves**

130 **Q. In his rebuttal testimony, Dr. McDermott takes issue with your assessment of**
131 **RMP’s fuel price volatility. Do you wish to respond?**

132 A. Yes. In my direct testimony, I presented a table that shows the hedged
133 cost of RMP’s natural gas generation in comparison to the market cost, for the

134 past five rate cases. I noted that, except for one discrete jump, the hedged cost
135 has remained relatively stable across these cases. Dr. McDermott responds by
136 declaring that this information “misses the point” on the grounds that “volatility is
137 relative” and that RMP’s net power cost “is more volatile than other costs
138 typically included in rates.”³ I do not find Dr. McDermott’s emphasis on
139 “relative volatility” to be a persuasive argument for adopting an ECAM.

140 While dismissing the importance of examining changes in the hedged cost
141 of RMP’s natural gas generation, Dr. McDermott focuses on the movement in
142 RMP’s total fuel cost plus purchased power expenses over time, which is
143 presented in Figure 1 of his rebuttal testimony. Dr. McDermott’s Figure 1
144 purports to show the greater volatility of net power cost in relation to non-net
145 power cost expenses, but it does not. Net power cost is not equal to the sum of
146 fuel plus purchased power expenses shown in Figure 1, but the *difference* between
147 this sum and off-system sales revenues. As shown in Dr. McDermott’s Figure 1,
148 off-system sales revenues and the sum of fuel plus purchased power expenses
149 have moved in approximate tandem over time; thus, the difference between the
150 two (net power cost) is not as spiky as are the individual components of
151 fuel/purchases and off-system sales.

152 Moreover, total fuel cost is highly sensitive to the volume of off-system
153 sales in a period. Greater off-system sales volume will increase total fuel cost, all
154 other things being equal. But with margins being earned on each incremental off-
155 system sale, increases in total fuel cost by itself does not translate into net power

³ Direct testimony of Karl A. McDermott, lines 53-58.

156 cost volatility, as inferred by Dr. McDermott; indeed, given the prominence of
157 off-system sales in the RMP system, changes in total fuel cost and net power cost
158 may not even be in the same direction at the same time.

159 **Q. Dr. McDermott also takes issue with your assessment that an ECAM is not**
160 **justified on the grounds of fuel price volatility in light of RMP's aggressive**
161 **hedging program. How do you respond?**

162 A. Dr. McDermott states his disagreement with my assessment on lines 46-53
163 of his rebuttal testimony, but defers to the rebuttal testimony of Mr. Graves for
164 explanation. However, Mr. Graves' discussion of hedging focuses on the
165 difficulties of forecasting RMP's short term purchases and sales, and to a certain
166 extent, on the variability in RMP's use of natural gas generation. Mr. Graves'
167 discussion does not refute my direct testimony. Among other things, my
168 testimony related my experience in RMP's previous rate case (Docket No. 08-
169 035-08) in which I found that a \$77 million reduction in the market cost of fuel
170 for RMP's gas generating units resulted in a mere \$5.9 million change to RMP's
171 net power cost. This small impact was directly attributable to RMP's aggressive
172 hedging program. It is convincing evidence that RMP is not subject to fuel cost
173 volatility sufficient to justify an ECAM.

174 **Q. Do you agree with Mr. Graves' observation that RMP's off-system sales and**
175 **purchase volumes are subject to considerable variability?**

176 A. Yes. I am aware of this variability due to my regular involvement in the
177 Company's rate cases. As RMP makes decisions at the margin with respect to

178 sales opportunities or purchases to displace its own generation, the volumes of
179 these transactions are certain to vary from projected amounts, and may vary
180 markedly from year to year. But changes in the mix of purchases/sales/fuel are a
181 function of the Company responding rationally to opportunities to dispatch its
182 system in a least-cost manner; it does not imply that net power cost per MWH is
183 volatile or that an ECAM is needed to protect the Company from fuel cost or
184 market price volatility.

185 **Q. An area of emphasis in your direct testimony is the issue of fuel price**
186 **volatility, whereas RMP rebuttal witnesses have focused on total dollar**
187 **measures of net power costs and constituent components, such as off-system**
188 **sales, purchases, and natural gas expenditures. Do you wish to comment on**
189 **this distinction?**

190 A. Yes. No party is disputing that net power cost and its constituent
191 components change over time. That is not sufficient cause for an ECAM.
192 ECAMs are typically justified on the basis of fuel price volatility; yet when
193 ECAMs are adopted they typically bring many other types of risk transfers –
194 weather-related, resource-portfolio-related, and performance-related,⁴ to name but
195 a few.

196 In the case of RMP, adoption of an ECAM is not justified on the basis of
197 fuel price volatility, given the aggressive design of the Company's hedging
198 program. Thus, the Commission is faced with the following threshold policy

⁴ An example of performance-related risk is risk associated with forced outages.

199 question: should weather-related, resource-portfolio-related, and performance-
200 related risks be transferred from RMP to customers through an ECAM when the
201 case for an ECAM on the grounds of fuel price volatility is as weak as it is?

202 In addressing this question, the Commission's task is not made any easier
203 by the rebuttal testimony of RMP's witnesses on this point, as their tendency has
204 been to deny that RMP's risk is being reduced and to argue against recognizing
205 any reduction of risk in RMP's allowed return on equity.⁵ In my opinion, if the
206 Commission is otherwise inclined to proceed to Phase II, a necessary precondition
207 should be RMP's acknowledgment that an ECAM reduces the Company's risk
208 and that it is appropriate to reflect such risk reduction in its allowed return on
209 equity. This acknowledgement has not been forthcoming in the Company's
210 rebuttal testimony.

211

212 **Response to Charles E. Peterson**

213 **Q. What is your response to Mr. Peterson's rebuttal testimony?**

214 A. Mr. Peterson appears to categorize most of the concerns raised by
215 witnesses for non-RMP parties as "design" issues to be addressed in a Phase II
216 proceeding. While it may be true that many issues raised in Phase I have
217 implications for design of an ECAM, I disagree with the thrust of Mr. Peterson's
218 testimony which suggests that issues such as risk transfer, single-issue
219 ratemaking, incentives for efficient operation, etc., should not be considered in

⁵ See, for example, rebuttal testimony of Karl A. McDermott, lines 460-489, and rebuttal testimony of Frank C. Graves, lines 561-590.

220 Phase I. These issues all represent drawbacks to an ECAM. If the Commission
221 is considering the threshold question of whether to proceed to a Phase II, then it is
222 essential that the downside of adopting an ECAM be part of that consideration.

223 In my direct testimony, I do not take the position that any one of these
224 drawbacks is sufficient by itself to preclude the adoption of an ECAM. Rather,
225 these disadvantages of an ECAM are indicative of the hurdles that must be
226 overcome by a compelling demonstration that adoption of an ECAM is in the
227 public interest. Giving proper weight to these disadvantages is an essential part of
228 determining whether it is in the public interest to adopt an ECAM of any design in
229 Utah at this time. It is my opinion that the Company has not made a sufficiently
230 compelling demonstration of its need for an ECAM at this time to overcome these
231 many disadvantages to warrant further consideration in a Phase II.

232 **Q. Does this conclude your surrebuttal testimony?**

233 **A.** Yes, it does.