

Steve Michel
Western Resource Advocates
409 E. Palace Ave. #2
Santa Fe NM 87501
505-820-1590

Sophie Hayes (12546)
Utah Clean Energy
1014 2nd Ave.
Salt Lake City, UT 84103
801-363-4046

**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 NANCY L KELLY

Phase II, Part 1

ON BEHALF OF

WESTERN RESOURCE ADVOCATES

AND

UTAH CLEAN ENERGY

August 10, 2010

1 **I. INTRODUCTION**

2 **Q: Please state your name, employer and present position.**

3 A: My name is Nancy L. Kelly. I am employed by Western Resource Advocates (WRA) in
4 its Energy Program as a Senior Policy Advisor.

5 **Q: Have you previously filed testimony in this docket?**

6 A: Yes. On behalf of WRA, I filed Direct and Surrebuttal Testimony on November 16, 2009
7 and January 5, 2010 in Phase I of this docket. On behalf of WRA and Utah Clean Energy
8 (UCE) I filed Direct Testimony on June 16, 2010 in Phase II, Part 1, and Direct
9 Testimony on August 4, 2010 in Phase II, Part 2.

10 **Q: On whose behalf are you submitting testimony today?**

11 A: WRA and UCE.

12 **Q: What is the purpose of your testimony?**

13 A: To respond to the rebuttal testimony of Company witness Mr. N. Gregory Duvall in
14 Phase II, Part 1 filed July 20, 2010.

15 **Q: Please summarize the issues you will cover.**

16 A: First, I will address whether the issues addressed by my June 16 testimony comply with
17 the Commission's Report and Order in Phase I of this docket issued February 8, 2010.
18 Within this context, I will provide additional information from the academic literature
19 regarding the possible effects of an ECAM. Second, I will respond to Mr. Duvall's
20 discussion of my testimony and recommendation. Third, I will respond to Mr. Duvall's

21 contention that optimal resource planning and acquisition are not threshold issues to an
22 ECAM. Finally, I will provide background regarding the significance of optimal resource
23 planning and acquisition to past regulatory decisions.

24 **II. WHETHER THE TESTIMONY SUBMITTED JUNE 16, 2010 COMPLIES WITH**
25 **THE COMMISSION’S FEBRUARY 8, 2010 ORDER**

26 **Q: Mr. Duvall dismisses your direct testimony and much of the direct testimony of the**
27 **Office of Consumer Services (OCS) and some of the testimony of the Division of**
28 **Public Utilities (DPU) as not complying with the direction established by the**
29 **Commission in its February 8, 2010 Order on Phase I issues and, therefore, is**
30 **irrelevant to this docket. How do you respond?**¹

31 A: My reading of the intention of the February 8, 2010 order differs from Mr. Duvall’s. I
32 read the order as inviting further exploration of methods to address the Company’s claim
33 of difficulty in collecting its net power cost while assuring that the public interest is
34 served. I gleaned this meaning from the third paragraph not quoted by Mr. Duvall in
35 conjunction with statements made in the two full paragraphs he did quote.²

36 In addition to the two paragraphs quoted by Mr. Duvall is a third paragraph that
37 intervenes between the two. In that paragraph, the Commission states: “In light of the
38 testimony presented in Phase I, it is clear to us that *a final conclusion on the public*
39 *interest is dependent upon a number of matters and evidence which were not sufficiently*
40 *developed at the conclusion of Phase I.*”³ It also states, “this does not preclude the

¹ Highly Confidential Rebuttal Testimony of Gregory N. Duvall at 212-275.

² Ibid at 166-197.

³ Utah Public Service Commission Report and Order in the Matter of the Application of Rocky Mountain Power for Approval of its Energy Cost Adjustment Mechanism, Docket No. 09-035-15 (Phase I), February 8, 2010 at page 2.

41 examination of an alternative ECAM *or any other measure or means* which would
42 address the difficulties PacifiCorp claims to be associated with its recovery of power
43 costs *consistent with a reasonable balance of public policies*. In addition, we would like
44 to see the two issues raised by the Office of Consumer Services addressed: namely, is the
45 company's use of natural gas hedging and level of and reliance on market energy affected
46 by the use of an ECAM? We will continue this docket into Phase II to make this
47 exploration together with *all other relevant areas of inquiry*." [Emphasis added.]⁴

48 **Q: Do you consider your June 16 testimony to be responsive to the Commission order?**

49 A: Yes. The Commission has stated, "a final conclusion on the public interest is dependent
50 upon a number of matters and evidence which were not sufficiently developed at the
51 conclusion of Phase I." My June 16 testimony attempts to bolster the record, as
52 requested by the Commission, regarding the need for an IRP compliance mechanism to
53 be in place before shifting the full risk of PacifiCorp's past and future resource
54 acquisition to customers.

55 In addition my June 16 testimony proposes other "measures or means" that the
56 Commission can use to mitigate WRA and UCE's primary concerns with an ECAM such
57 that the adoption of an ECAM might "be consistent with a reasonable balance of public
58 policies." The two significant issues that the proposed mechanism mitigates are (1) the
59 shifting of risk of poor past planning to customers and (2) the incentive an ECAM
60 provides to Company management to continue to acquire a riskier resource portfolio than

⁴ Utah Public Service Commission Report and Order In the Matter of the Application of Rocky Mountain Power for Approval of its Energy Cost Adjustment Mechanism, Docket No. 09-035-15 (Phase I), February 8, 2010 at page 2; see also Highly Confidential Rebuttal Testimony of Gregory N. Duvall at lines 190-197.

61 the portfolio shown to best manage the cost-risk tradeoff by the Company's planning
62 studies. I clarified the need for and further developed this mitigation mechanism in my
63 August 4, 2010 testimony.⁵

64 **Q: Do you have additional information regarding the effect of an ECAM that can**
65 **further develop the record?**

66 A: Yes. Several scholars, in weighing the pros and cons of a fuel adjustment mechanism (a
67 component of an ECAM as proposed by PacifiCorp) and in evaluating the actual
68 performance of fuel adjustment mechanisms, have written about the effect of an ECAM
69 on resource procurement. As noted previously, this effect is termed "input bias" in the
70 academic literature. In addition to evaluating the input biasing effects of these types of
71 mechanisms, these authors note other issues.

72 In *Fuel Adjustment Mechanisms and Economic Efficiency*,⁶ Baron and De Bont review
73 arguments for and against fuel adjustment mechanisms, as well as analyze their input-
74 biasing effects. Baron and De Bont explain that proponents of automatic adjustment
75 clauses (AACs) argue they are necessary to maintain financial viability and to raise
76 capital. The ostensible goal of an AAC is to protect the utility from rising fuel costs
77 while at the same time protecting customers. However, "Utilities appear to interpret this

⁵ The Commission order did not anticipate the bifurcating of Phase II in its February 8 order. The August 4, 2010 testimony in which I further developed the mitigation mechanism I first proposed in my June 16, 2010 testimony is also responsive to the Commission order.

⁶ David P. Baron and Raymond R. De Bont, *Fuel Adjustment Mechanisms and Economic Efficiency*, 27 *The Journal of Industrial Economics* 243-261 (1979) (hereinafter *Baron and De Bont*).

78 objective as meaning that fuel adjustment clauses should operate to enhance rates of
79 return rather than simply to match revenues with increases in fuel costs.”⁷

80 The authors also explore a litany of objections to automatic adjustment mechanisms,
81 including the following: other mechanisms can protect utilities from the uncertainties of
82 regulatory lag by granting interim rate relief or by using future test periods; AACs can be
83 manipulated by utilities to the detriment of customers; AACs result in increased output
84 prices due to higher fuel costs even though average costs decrease due to productivity
85 gains; AACs not only pass fuel costs on to customers but they are also used to pass
86 through endogenous operating costs in addition to exogenous factor price changes; and
87 finally, AACs weaken incentives for efficiency, “since if utilities can pass on all fuel cost
88 increases, they may have no incentive to choose the least-cost fuel supply.”⁸

89 Baron and De Bont explain,

90 [The] characterization of the bias in the choice of technology caused by the fuel
91 adjustment clause is not complete, but several interesting conclusions can be
92 drawn. First, if a fuel such as natural gas or oil is anticipated to rise in price in the
93 future, then the fuel adjustment clause would encourage the overconsumption of
94 that fuel through a technology biased in favor of the employment of that fuel. *At*
95 *a time when the conservation of these fuels is being encouraged, a fuel adjustment*
96 *clause would hinder achievement of that goal.* This also suggests that an electric
97 utility would have less incentive to convert to alternate fuel sources when that
98 conversion is costly Second, if the real price of a fuel is ‘expected’ to be
99 stable . . . then the fuel-adjustment clause may lead to the use of a fuel-capital
100 ratio that is less than the technically efficient ratio. This reflects the effect of
101 factor price uncertainty, the covariance term, on the marginal profit of the firm
102 which results from the adjustment.⁹ (Emphasis added)

103 Baron and De Bont conclude:

⁷ *Baron and De Bont* at 245.

⁸ *Ibid.* at 245-47.

⁹ *Ibid.* at 253-54.

104 Fuel adjustment mechanisms can lead to inefficiency both with respect to a
105 utility's choice of a technology and its selection of fuel supply sources. . . . Fuel
106 adjustment clauses thus pose a complex efficiency problem, which can be
107 compensated for but not eliminated by the design of the adjustment formula.¹⁰

108 In *Fuel-Adjustment Clauses and Profit Risk*,¹¹ Frank A. Scott, Jr. shows that fuel
109 adjustment clauses (FACs) reduce a utilities' profit variance and argues that this
110 reduction in variance also reduces profit risk. "[A] fuel-adjustment clause reduces the
111 variance of profit and hence profit risk."¹²

112 He also analyzes the impact of a FAC on input mix selection. He explains that a
113 regulated utility, in an effort to maximize profits, can influence output price only
114 indirectly: "If the regulator uses a method related to inputs, such as rate-of-return
115 regulation or a fuel-adjustment clause, to set price, then the firm can affect the output
116 price by varying the relative levels of input used in production."¹³

117 Scott explains:

118 Ignoring the effects of inputs on profit level and concentrating on profit risk, we
119 find that lagged regulation with no fuel-adjustment clause creates no systematic
120 bias in the firm's selection of inputs. . . . *The addition of a fuel-adjustment clause*
121 *changes things considerably*. A fuel clause alters the effect of inputs on the
122 variance of profit [because capital and labor contribute a relatively greater amount
123 to profit variance than fuel].¹⁴ (Emphasis added.)

124 Additionally,

125 Fuel contributes less to profit risk when a fuel clause is in effect. As a result, the
126 firm can increase its market value by using relatively less capital and labor and
127 more fuel than when no fuel clause is used. *The addition of a fuel clause does*

¹⁰ *Ibid.* at 259.

¹¹ Frank A. Scott, Jr., *Fuel-Adjustment Clauses and Profit Risk*, in *Issues in Public-Utility Pricing and Regulation*, edited by Michael A. Crew. 1980. 77-92 (hereinafter *Scott*).

¹² *Scott* at 83.

¹³ *Ibid.* at 84.

¹⁴ *Ibid.* at 85.

128 *introduce a systematic bias into the firm's selection of inputs.*¹⁵ (Emphasis
129 added.)

130 In *Economic Efficiency and Automatic Fuel-Cost Adjustment mechanisms: Theory and*
131 *Empirical Evidence*,¹⁶ John F. Stewart gives a thorough review of past scholarship on the
132 impacts and effects of fuel-cost adjustment mechanisms and contributes his own findings
133 on its validity. He explains the common-sense proposition common among previous
134 scholarship:

135 A firm operating with a fuel-adjustment clause will find its revenue adjusted more
136 rapidly for input-price increases related to fuel than for input-price increases
137 related to other factors. Thus the greater portion of the firm's costs that are
138 related to fuel, the better the firm is insulated against profit deterioration caused
139 by the interaction of input-price inflation and regulatory lag. It would thus be
140 reasonable to conclude that regulated firms with fuel-adjustment clauses may try
141 to insulate themselves against inflation by adopting more fuel-intensive
142 technologies than they would otherwise.¹⁷

143 With regard to the empirical validity of the common-sense proposition that FACs
144 facilitate an input bias, Stewart says,

145 It is interesting to note that not only do [the results of Stewart's analysis] tend to
146 support our general common-sense proposition (that when the opportunity arises,
147 firms operating under a fuel-adjustment clause will attempt to insulate themselves
148 against inflation by choosing more fuel-intensive fuel production models than
149 they otherwise would choose), they also provide some support for more specific
150 theoretical propositions. For example, Baron and DeBont (1979) show that with
151 their model the longer the lag between the time of the price increase and the time
152 when the adjustment takes effect, the smaller the input bias will be. . . . *The*
153 *results also suggest that the fuel-adjustment clause may have a quantitatively*
154 *significant effect on factor choice in new plants.*¹⁸ (Emphasis added.)

155 Stewart concludes with the following analysis:

156 [W]hen one looks for empirical evidence of a pro-fuel bias, one must realize that
157 real utilities are not free to adapt their production technologies completely to the

¹⁵ *Ibid.*

¹⁶ John F. Stewart, *Economic Efficiency and Automatic Fuel-Cost Adjustment Mechanisms: Theory and Empirical Evidence*, in *Regulatory Reform and Public Utilities* 167-181 (Michael A. Crew, ed. 1982) (hereinafter *Stewart*).

¹⁷ *Stewart* at 169.

¹⁸ *Ibid.* at 177-78.

158 present situation; rather they must adapt to a new situation through time as
159 opportunities present themselves. . . . [W]e have looked at the fuel-intensity
160 choices made by firms for new plants that were designed after the rapid inflation
161 became evident, and have found that firms operating under fuel-adjustment
162 clauses appear to choose more fuel-intensive technology than do firms without
163 fuel-adjustment clauses. *This empirical evidence provides relatively strong*
164 *support that firms do respond to the incentives suggested by our common-sense*
165 *proposition concerning the fuel adjustment clause.*¹⁹ (Emphasis added.)

166 **Q: What else does the literature say about other problematic effects of ECAMs?**

167 A: Many scholars have explored the fact that ECAMs are associated with creating incentives
168 for general economic inefficiency by encouraging utility acquisition of relatively fuel-
169 intensive resources and weakening the utilities' incentive to pursue lower fuel prices.

170 In *The Impact of the Automatic Adjustment Clause on Fuel Purchase and Utilization*
171 *Practices in the U.S. Electric Utility Industry*,²⁰ David L. Kaserman and Richard C. Tepel
172 explain, "Use of the automatic adjustment clause has come under increasing criticism in
173 recent years at least in part as a result of the potential incentive-distorting effects of this
174 regulatory mechanism."²¹

175 The authors cite two main reasons for such criticism. First, AACs encourage input bias:
176 "With output price directly related to the quantity of fuel used, the regulated firm subject
177 to an adjustment clause will have a profit incentive to over-utilize the aggregate fuel input
178 relative to other inputs . . . *through the choice of relatively fuel intensive technologies in*
179 *the construction of new generating plants.*"²² (Emphasis added.) Second, AACs

¹⁹ *Ibid.* at 178.

²⁰ David L. Kaserman and Richard C. Tepel, *The Impact of the Automatic Adjustment Clause on Fuel Purchase and Utilization Practices in the U.S. Electric Utility Industry*, 48 *The Southern Economic Journal* 678-700 (1982) (hereinafter *Kaserman and Tepel*).

²¹ *Kaserman and Tepel* at 687.

²² *Ibid.* at 687-88.

180 encourages firms “to pay a higher price for the aggregate fuel input than would be paid in
181 the absence of the adjustment clause.”²³

182 Indeed, their findings “indicate that the presence of an automatic fuel adjustment clause
183 leads the regulated firm to pay a higher price for the aggregate fuel input than would be
184 paid in the absence of the clause.”²⁴ Additionally, they find “that the distorting effect
185 that the automatic fuel adjustment clause has on a utility company fuel purchasing
186 practices is of substantial proportions.”²⁵

187 In conclusion, Kaserman and Tepel write,

188 What we have examined in this paper is a formalized version of a somewhat
189 popular notion that those utilities that are allowed to pass fuel price increases on
190 to their customers without holding formal rate hearings will tend to pay a higher
191 average price for the fuel input than those utilities that are not. In short, we have
192 found this notion to be intuitively appealing, theoretically ambiguous and
193 empirically accurate. . . . Our findings indicate that the automatic fuel adjustment
194 clause will lead to unnecessarily high utility company costs not only because of
195 the previously recognized fuel-intensive input bias fostered by this form of
196 regulation, but also because of an adverse aggregate input price effect. Indeed,
197 given the limited opportunities for substituting fuel for capital in the *ex post*
198 production function, this aggregate price effect may well be the more important
199 contributor to the observed cost increases.²⁶

200 Thus, in insulating a utility from fuel price increases, a fuel adjustment clause weakens
201 the utility’s incentive to pursue least cost fuel options, and Kaserman and Tepel conclude
202 that the resulting higher fuel costs may contribute the most to overall cost increases.

203 **Q: What can we take from this literature review that is germane to this docket?**

²³ *Ibid.* at 688.

²⁴ *Ibid.* at 688.

²⁵ *Ibid.* at 696.

²⁶ *Ibid.* at 699.

204 A: Two significant points. First, the input-bias created by an ECAM undermines least-cost,
205 least-risk planning to the detriment of customers. For example, the input bias with regard
206 to this ECAM would advantage short-term wholesale market purchases and fossil-fuel
207 resources while disadvantaging energy efficiency programs and renewable resources.
208 Energy efficiency and renewable energy are well suited to addressing the major risks
209 facing customers in the current planning environment—such as volatile wholesale market
210 electricity and natural gas prices and uncertain costs of complying with carbon
211 legislation—because they carry little or no fuel risk. By creating a bias favorable to
212 market purchases and fossil-fueled resources—which have lower capital costs but higher
213 and more volatile fuel costs—over resources that best manage the various risks facing the
214 industry today, customers would be subject to the risk that long-run power costs would
215 significantly exceed the costs of resource portfolios that include higher levels of energy
216 efficiency and renewables.

217 Therefore, if the Commission finds that some ECAM design is in the public interest,
218 including resource acquisition targets as proposed in both my June 16, 2010 and August
219 4, 2010 testimony to correct the input biasing effect is essential.

220 Second, as discussed in my August 4, 2010 testimony, since an ECAM reduces
221 management incentives to operate efficiently, any ECAM design must include
222 components, such as significant sharing bands, to mitigate this disincentive.²⁷

223 **III. RESPONSE TO MR. DUVALLE'S CRITIQUE OF TESTIOMNY**

²⁷ The disincentive to operate efficiently is well addressed by Paul Chernick's Direct Testimony in Phase I of this docket as well as by the academic literature. I also explained this effect in my August 4, 2010 testimony at 122-126 and 212-219.

224 **Q: Please summarize your June 16 testimony.**

225 A: I identified market reliance and natural gas resource acquisition issues as fundamentally
226 integrated resource planning issues, noted that the Company's resource selections
227 through time had not resulted in the resource selections that best balanced cost and risk,
228 explained that an ECAM shifts the risk that actual costs will exceed expectations when
229 planning to customers, described the input biasing effect of an ECAM, and concluded
230 that without some type of mechanism in place to assure customers the benefits of
231 integrated resource planning, long-run resource acquisition would likely result in riskier,
232 environmentally inferior, resources.

233 I therefore recommended that in conjunction with adoption of an ECAM, the
234 Commission implement an IRP compliance mechanism.

235 **Q: Please describe the IRP compliance mechanism you propose to mitigate issues of**
236 **planning bias and assure that customers receive the benefits of resource planning**
237 **through appropriate resource acquisition.**

238 A: In my June 16, 2010 testimony I suggested a combination of targets and limits. In
239 particular, I suggested demand-side management and renewable resource targets and
240 limits on market resources consistent with the portfolio that best mitigates risk and
241 uncertainty as determined through the IRP process using the Commission's suggested
242 three-step approach for evaluating risk and uncertainty.²⁸

²⁸ The approach contains the following three steps: "1) Identify the optimal portfolios for a relatively broad, and consistently applied, set of fixed input assumptions; 2) subject the unique sets of these portfolios to stochastic risk analysis and identify superior portfolios with respect to the tradeoff between expected cost and risk exposure; 3) examine the cost consequences of the superior portfolios with respect to uncertainty by subjecting the portfolio to

243 In my testimony filed August 4, 2010 in Part 2 of Phase II, I further developed my
244 proposal. As I explained in that testimony, a simpler approach would be to require the
245 Company to meet resource acquisition targets without limiting market activity.

246 **Q: How does Mr. Duvall describe your testimony?**

247 A: He states that I “focus in greater depth on the IRP process, concluding that the IRP
248 process has not resulted in an ‘optimal’ mix of resources and that it lacks teeth.”²⁹

249 **Q: Does he disagree with your characterization that the IRP process lacks teeth?**

250 A: No.

251 **Q: How does he address the main point of your testimony?**

252 A: He develops a strawman by saying that my testimony “may be regarded as a proposal for
253 the IRP process to be changed in the future.”³⁰ He then counters my supposed contention
254 that the IRP process requires reform. He says:

255 First, the IRP process has been a valuable process to enable the Company
256 to provide analysis of its resource planning to the Commission and
257 interested parties and to get the input of the Commission and those parties
258 as it finalizes its plans. The fact that the Company, and perhaps the
259 Commission, have not agreed with all of Ms. Kelly’s position over the
260 years, is not an indication the process has resulted in a “suboptimal” mix
261 of resources.

262 Second, this is not the appropriate docket in which to reform the IRP
263 process. To the extent that Ms. Kelly believes the process needs changes,

evaluation under the initial set of relatively broad fixed input assumptions.” Public Service Commission of Utah, *Report and Order, In the Matter of the Acknowledgement of PacifiCorp’s Integrated Resource Plan*, Docket No. 09-2035-01, April 1, 2010, p. 19. (The same information is found on page 40 of the order issued February 6, 2008 in Docket No. 07-2035-01.)

²⁹ Duvall at 639-641.

³⁰ Highly Confidential Rebuttal Testimony of Gregory N. Duvall at 644-653.

264 those changes should be suggested in the IRP process. Changes to the IRP
265 process should in no way be a precondition to adoption of an ECAM.

266 **Q: Do you agree with Mr. Duvall's characterization of your testimony as "a proposal**
267 **for the IRP process to be changed in the future?"**

268 A: No. My concern and that of other intervenors as expressed in comments is not with the
269 integrated resource planning process itself. I agree with Mr. Duvall that the process is
270 valuable. My concern has been in the final selection of the portfolio that becomes the
271 basis for resource acquisition.

272 **Q: Does Mr. Duvall refute your contention that the IRP process has not resulted in**
273 **optimal mix of resources using evidence from IRP planning studies?**

274 A: No. The extent of his refutation is the statement included in the quote above that just
275 because the Company has not agreed with all of my positions over the years does not
276 mean that the IRP process is suboptimal.

277 **Q: How did you reach the conclusion that the process has resulted in a suboptimal mix**
278 **of resources?**

279 A: I conducted both independent analysis and review of past Commission orders.
280 My January 5, 2010 surrebuttal testimony in Phase I of this docket included my analysis
281 from IRP 2008.³¹ Exhibit NLK-1 attached to that testimony compared the portfolio the
282 Company would have chosen as preferred before removing the Lakeside resource
283 (Portfolio 5) with the portfolio that multiple stakeholders identified as preferred
284 (Portfolio 8). Out of 28 performance metrics, Portfolio 5 outscored Portfolio 8 on only

³¹ Surrebuttal Testimony of Nancy L Kelly on Behalf of Western Resource Advocates, January 5, 2010 at 168-191.

285 eight, leaving 20 performance metrics in which it underscored Portfolio 8. Significantly,
286 Portfolio 8 is the portfolio that performed best in Step 3 of the Commission’s three-step
287 approach to evaluating risk and uncertainty. So, Portfolio 8 is the “Step-Three Portfolio.”

288 With regard to past Commission orders, as I noted in my January 5, 2010 surrebuttal
289 testimony, “the Company has submitted nine integrated resource plans excluding updates.
290 Only three of those were fully acknowledged.”³² The Commission has since issued an
291 IRP order acknowledging IRP 2008. In its April 1, 2010 Report and Order in the Matter
292 of the Acknowledgement of PacifiCorp’s Integrated Resource Plan, the Commission
293 concluded that IRP 2008 generally adheres to the Standards and Guidelines. However,
294 the Commission did not conclude that the chosen resource portfolio was optimal. To the
295 contrary it stated, “Indeed, we are not convinced the Preferred Portfolio is the optimal
296 portfolio.”³³

297 **Q: How do you respond to Mr. Duvall’s concern that this is not the appropriate docket**
298 **to reform the IRP process?**

299 A: I agree. My testimony did not propose reforming the IRP process; it proposed an IRP
300 compliance mechanism to be implemented *if the Commission adopts an ECAM*. Utah
301 customers should not bear the past or future net power cost or net power cost risk of
302 resources that are not supported by IRP planning studies.

303 **Q: How did Mr. Duvall respond to your recommendation to require DSM and**
304 **renewable resource targets?**

³² Surrebuttal Testimony of Nancy L Kelly on Behalf of Western Resource Advocates, January 5, 2010 at 216-217.

³³ Page 58.

305 A: With regard to renewable resources he explained “by the end of 2010, the development of
306 wind is nearly 350 MW and five years ahead of the acquisition commitment of adding an
307 additional 1400 MW of renewable resources by 2015.” With regard to DSM, Mr. Duvall
308 said, “the Company is fully committed to energy efficiency even though it has not
309 mandated energy efficiency targets.” He said “the recommendations appear to be
310 unrelated to issues being addressed at this stage of the ECAM proceeding and should not
311 be adopted.”³⁴

312 **Q: What is your reaction to his response?**

313 A: His response underscores the need for an IRP compliance mechanism. While IRP studies
314 have demonstrated that renewable resources and aggressive DSM significantly reduce
315 upper tail risk and in many scenarios lower expected cost, the Company’s reason for
316 acquiring these resources appear to be more closely tied to meeting merger commitments
317 than to benefitting customers. WRA and UCE wonder what level of renewables the
318 Company would have invested in absent the merger commitment. As noted in WRA’s
319 comments on the 2008 IRP Update attached to my August 4 testimony as Exhibit NLK-1,
320 not only has PacifiCorp delayed the timing of its wind acquisition, over the planning
321 period, but more than 450 MW of planned wind resources have been removed.

322 Similarly, while the Company professes a commitment to undertaking energy efficiency,
323 DSM has been significantly cut in the IRP Update.

324 **Q: How did Mr. Duvall respond to your initial proposal to require limits on market**
325 **transactions?**

³⁴ Duvall at 660-666.

326 A: He thought the recommendation, as proposed, would not be in the public interest, because
327 it would not allow the Company sufficient flexibility to respond to opportunities in the
328 market.

329 **Q: What is your reaction to his response?**

330 A: I agree that the Company needs flexibility to respond to opportunities in the market.
331 Requiring resource acquisition targets consistent with the portfolio identified as best
332 balancing cost and risk through the Commission's three-step process as explained in my
333 August 4, 2010 testimony is a better approach.³⁵

334 **IV. WHETHER RESOURCE PLANNING AND RESOURCE ACQUISITION ARE**
335 **RELEVANT TO THIS DOCKET**

336 **Q: Mr. Duvall claims that in determining to move to Phase II, the Commission had**
337 **concluded that market reliance and natural gas hedging were not threshold issues.**
338 **Do you agree?**³⁶

339 A: No. As I stated in my answer regarding whether my June 16 testimony complied with the
340 February 8 Order, my understanding of the order differs from Mr. Duvall's. I believe his
341 reading of the order is too narrow and misses its intention. I read the order as requesting
342 parties to further develop the record regarding these issues. As noted before, the
343 Commission states that "conclusion on the public interest is dependent up a number of
344 matters and evidence which were not sufficiently developed at the conclusion of Phase I,"

³⁵ Prefiled Direct Testimony of Nancy L. Kelly, Phase II, Part 2 at 90-201.

³⁶ Duvall at 255-256.

345 and it says “we will continue this docket in Phase II to make this exploration together
346 with all other relevant areas of inquiry.”³⁷

347 **Q: Mr. Duvall says “The IRP is the appropriate proceeding to address reliance on**
348 **wholesale market purchases to satisfy load and reserve requirements and nothing**
349 **further is required in advance of implementing an ECAM.”³⁸ How do you respond?**

350 A: This statement ignores the essential argument of most parties in this proceeding, that is,
351 because an ECAM will shift significant risks to customers—risks customers are in no
352 position to mitigate—the Commission will need to establish mitigation measures to
353 accompany the ECAM in order to make the whole ECAM package in the public interest.
354 Resource planning and acquisition is not, as Mr. Duvall seems to suggest, irrelevant to
355 the ECAM, because adoption of an ECAM would change the utility’s resource
356 acquisition incentives. Therefore, resource acquisition is a threshold issue for creating an
357 ECAM that is in the public interest.

358 **Q: Mr. Duvall argues that the testimony of other parties ignores the fact that there is**
359 **also risk to customers in committing to long-term resources. He shows that, in the**
360 **current economic environment, purchasing capacity in the market appears to be**
361 **more cost effective than a new facility. He argues that since use of the market is**
362 **projected to be lower cost, resolving the resource acquisition issue should not be a**
363 **threshold issue. How do you respond?**

³⁷ Utah Public Service Commission Report and Order In the Matter of the Application of Rocky Mountain Power for Approval of its Energy Cost Adjustment Mechanism, Docket number 09-035-15 (Phase I), February 8, 2010 at p. 2.

³⁸ Duvall at 69-71.

364 A: Resource acquisition remains a threshold issue. The purpose of integrated resource
365 planning is not to identify the least-cost portfolio, but to identify a portfolio that balances
366 cost and risk over a range of possible futures. The IRP Standards and Guidelines state
367 that planning should result in “the selection of the optimal set of resources given the
368 expected combination of costs, risk, and uncertainty.”³⁹

369 Certainly, planning should be flexible. If conditions change significantly from what was
370 anticipated when an action was first taken, then reevaluating and changing course is
371 appropriate. In such a circumstance, the Company could initiate a proceeding. The risk
372 associated with the revision and if and how that risk should be shared could be evaluated
373 and determined in that proceeding.

374 **V. SIGNIFICANCE OF EFFECTIVE RESOURCE PLANNING TO PAST**
375 **REGULATORY PROCEEDINGS AND COMMISSION ORDERS**

376 **Q: Is this the first proceeding in which PacifiCorp has requested a mechanism akin to**
377 **an ECAM since requesting the termination of the Energy Balancing Account in**
378 **1990?**

379 A: No. PacifiCorp has submitted several applications over the past nine years. PacifiCorp
380 first applied for this type of mechanism in 2001 and linked its request for a power cost
381 adjustment mechanism to a request for new IRP standards and guidelines. On November
382 5, 2001, PacifiCorp filed an application in Docket no 01-035-35 requesting (a)
383 determination of guidelines for integrated resource planning, power cost risk

³⁹ Public Service Commission, Report and Order on Standards and Guidelines, Docket No. 90-2035-01, p. 41.

384 management, and wholesale purchases and power sales, (b) approval of a power cost
385 adjustment mechanism, and (c) approval of a temporary cost adjustment mechanism.⁴⁰

386 **Q: What became of this application?**

387 A: In the Report and Order not acknowledging the PacifiCorp Resource and Market
388 Planning Program (RAMPP 6) issued February 28, 2002, the Commission opened Docket
389 No. 02-035-03 and moved the examination of the IRP Standards and Guidelines from
390 Docket No. 01-035-35 to Docket No. 02-035-03. In its IRP order, the Commission found
391 and concluded:

392 RAMPP 6 fails to meet current Guidelines, exhibits the result of a Company
393 refusal to properly address past Commission orders, and does not meet its
394 intended purpose....

395 ...So, it is not just the Company's failure to produce an integrated resource plan
396 meeting Utah regulatory requirements that compels reexamination of this
397 regulatory planning process but potential industry change as well. In this context,
398 a fundamental question of integrated resource planning as a regulatory
399 requirement is how its purposes can be accomplished in the face of what may yet
400 be a turn away from economic regulation to ward the market.

401 We believe a new docket is required to refashion integrated resource planning and
402 to assess whether it might once again be a useful vehicle of public policy. The
403 competent analyses of the parties in the present Docket, the lack of response to
404 Commission orders, and the evident failure of the current IRP bring us to this
405 conclusion.⁴¹

406 **Q: What became of the PCAM application?**

407 A: The Utah regulatory community was unwilling to consider any type of power cost
408 adjustment mechanism until the Company had implemented a resource acquisition
409 strategy that met the objectives of the Standards and Guidelines. It was perceived as

⁴⁰ Motion to Suspend Proceeding, Docket No. 02-035-03, August 27, 2002, p. 1.

⁴¹ Public Service Commission of Utah, Report and Order, In the Matter of the Acknowledgment of PacifiCorp Integrated Resource Plan (RAMPP 6), Docket No. 98-2035-05, February 28, 2002, pages 10-11.

410 unfair for Utah customers to bear the full cost and risk of what were considered to be
411 poor planning decisions.

412 **Q: What do you conclude from this?**

413 A: The public interest aspects of an ECAM are not separable from resource planning and
414 acquisition. PacifiCorp recognized the linkage when it linked its application for a PCAM
415 to a request to change the IRP standards and guidelines. The regulatory community
416 recognized this when the PCAM application was strongly opposed on the grounds that
417 PacifiCorp had not been planning effectively for its customers.⁴²

418 **Q: Are there other dockets in which assuring effective resource planning has been**
419 **important?**

420 A: Yes. The Commission identified maintaining the benefits to customers of single system
421 planning and operation as the problem it was addressing in the Multistate Process
422 proceeding. In its order issued December 14, 2004, in Docket No. 02-2035-04 the
423 Commission stated: “We conclude that the problem we are addressing and resolving in
424 this docket is the potential impact of divergent states’ policies on interjurisdictional
425 allocation and integrated system planning and operation that could result in Company
426 action that is inconsistent with long-run least cost, adequate and reliable service to
427 customers.”

428 **Q: What do you conclude from this?**

⁴² Utah Public Service Commission Report and Order In the Matter of the Application of PacifiCorp for an Investigation of Interjurisdictional Issues, Docket No. 02-2035-04 at page 36.

429 A: Assuring that customers receive the benefits of integrated resource planning is a long-
430 standing objective of this regulatory community and this Commission. Before moving
431 forward with an ECAM the Commission should carefully evaluate the linkage between
432 the two and assure the public interest is met.

433 **Q: Does this conclude your testimony?**

434 A: It does.