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BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application of Rocky Mountain Power for Authority to Increase its Retail Electric Utility Service Rates in Utah and for Approval of its Proposed Electric Service Schedules and Electric Service Regulations	**Docket No. 10-035-124**

PREFILED DIRECT TESTIMONY OF KEVIN C. HIGGINS

[COST OF SERVICE / RATE DESIGN]

The UAE Intervention Group (UAE) hereby submits the Prefiled Direct Testimony of Kevin C. Higgins on cost of service and rate design issues.

DATED this 2nd day of June, 2011.

/s/______________________________
Gary A. Dodge,
Attorney for UAE

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served by email this 2nd day of June, 2011, on the following:

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BEFORE

THE PUBLIC SERVICE COMMISSION OF UTAH

Direct Testimony of Kevin C. Higgins

on behalf of

UAE

Docket No. 10-035-124

[Cost of Service / Rate Design]

June 2, 2011

DIRECT TESTIMONY OF KEVIN C. HIGGINS

INTRODUCTION

Q. Please state your name and business address.

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

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

A. I am a Principal in the firm of Energy Strategies, LLC. Energy Strategies is a private consulting firm specializing in economic and policy analysis applicable to energy production, transportation, and consumption.

Q. On whose behalf are you testifying in this proceeding?

A. My testimony is being sponsored by the Utah Association of Energy Users Intervention Group ("UAE").

Q. Are you the same Kevin C. Higgins who testified on behalf of UAE in the test period and revenue requirements phases of this docket?

A. Yes, I am.

Q. Please describe your professional experience and qualifications.

A. My academic background is in economics, and I have completed all coursework and field examinations toward a Ph.D. in Economics at the University of Utah. In addition, I have served on the adjunct faculties of both the University of Utah and Westminster College, where I taught undergraduate and graduate courses in economics. I joined Energy Strategies in 1995, where I assist private and public sector clients in the areas of energy-related economic and policy analysis, including evaluation of electric and gas utility rate matters.

Prior to joining Energy Strategies, I held policy positions in state and local government. From 1983 to 1990, I was economist, then assistant director, for the Utah Energy Office, where I helped develop and implement state energy policy. From 1991 to 1994, I was chief of staff to the chairman of the Salt Lake County Commission, where I was responsible for development and implementation of a broad spectrum of public policy at the local government level.

Q. Have you previously testified before this Commission?

A. Yes. Since 1984, I have testified in twenty-six dockets before the Utah Public Service Commission on electricity and natural gas matters.

Q. Have you testified previously before any other state utility regulatory commissions?

A. Yes. I have testified in approximately 110 other proceedings on the subjects of utility rates and regulatory policy before state utility regulators in Alaska, Arkansas, Arizona, Colorado, Georgia, Idaho, Illinois, Indiana, Kansas, Kentucky, Michigan, Minnesota, Missouri, Montana, Nevada, New Mexico, New York, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, Texas, Virginia, Washington, West Virginia, and Wyoming. I have also filed affidavits in proceedings at the Federal Energy Regulatory Commission.

A more detailed description of my qualifications is contained in Attachment A, attached to my prefiled direct test period testimony, filed previously in this docket.

OVERVIEW AND CONCLUSIONS

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

A. My testimony addresses the appropriate spread of the revenue requirement increase that will be determined in this case.

Q. Please summarize your conclusions and recommendations.

A. (1) RMP's proposed rate spread does not take into account the scheduled termination of Schedule 98 at the start of the rate effective period for this case. Schedule 98 credits customers for 2011 REC revenues in the amount of approximately $3.0 million per month (Utah). Because the Schedule 98 rate is differentiated by rate schedule, when it terminates, it will impact customers differently across rate schedules. This differential impact should be taken into account when determining rate spread.

(2) According to the Calendar Year 2010 cost-of-service study ordered by the Commission, the rate schedules that RMP proposes to receive the greatest rate increases – Schedules 9 and 10 – are materially closer to parity than when using the projected test period data. The Commission has already stated in this docket that as it considers the evidence supporting forecasts in this proceeding, especially deviations from historical trends, it will give substantial weight to data reflecting

actual, verifiable experience. In my view, this means giving substantial weight to the Calendar Year 2010 cost-of-service study relative to the study for the projected test period.

(3) I recommend that the two-percentage point intervals (from midpoint) used in the rate spread proposed by RMP should be tightened into smaller intervals. For Schedules 9 and 10, it would be reasonable to use intervals of 1.25 percent and 2.50 percent from the midpoint, respectively.

(4) The target rate spread should be inclusive of the Schedule 98 impacts. For example, Schedule 10 should receive a rate increase that is 2.50 percent above the midpoint increase <u>after</u> taking account of the termination of the 2.61 percent credit applicable to Schedule 10 through Schedule 98. I also support RMP's proposal for setting Residential and Schedule 8 rate increases equal to the midpoint increase, but after taking account of Schedule 98 impacts.

(5) The incremental REC revenues that have been deferred since February 22, 2010 should be returned to customers starting on the rate effective date for this proceeding. The deferred revenues for the deferral period running from February 22, 2010 through December 31, 2010 should be credited back to customers over the one-year period September 21, 2011 through September 20, 2012. The REC revenue credit should be spread across customers using the cost-of-service equivalent of the SG allocation factor, denoted as the F10 factor in RMP's cost-of-service model, which is how REC revenues are allocated. For

ease of administration, the crediting of the REC deferral can be implemented using a kilowatt-hour credit applied to each rate schedule.

RATE SPREAD

Q. What revenue increase is RMP recommending for the Utah jurisdiction?

A. In its direct filing, RMP is proposing a revenue increase of $232,416,309, or 13.7 percent on an annual basis. Because certain special contracts apparently are not subject to the Company's proposed rate increase, the proposed base rate increase for remaining customers is 14.6 percent. However, as I noted in my revenue requirements direct testimony, RMP's proposed revenue increase does not include the effects in current rates of Schedule 97 or Schedule 98, each of which is scheduled to expire at the start of, or close to the start of, the rate effective period. As a result, the Company's proposed rate increase, as it would be *experienced* by customers subject to the increase, is even greater than 14.6 percent.

Q. Please explain.

A. Schedule 97 is a temporary percentage rider approved in Docket No. 10-035-89 that is recovering certain deferred costs associated with RMP's first Major Plant Additions case. It is scheduled to recover $15.7 million over a period of eight months, terminating on August 31, 2011, shortly before the rate effective period in this case.

Schedule 98 is also a temporary percentage rider approved in Docket No. 10-035-89 that is *crediting* customers for 2011 REC revenues in the amount of approximately $3.0 million per month (Utah). It is providing an average credit of 2.39 percent and is scheduled to terminate at the start of the rate effective period in this case.

As neither of these riders is included in RMP's presentation of its revenue increase, RMP's proposed rate increase, as experienced by customers, will include the net impact of the Schedule 97 charge and Schedule 98 credit terminating. From a customer rate impact standpoint, this impact is incremental to the overall 13.7 percent revenue requirement increase indicated by RMP – and incremental to the average 14.6 percent increase that applies when special contracts not subject to the increase are excluded.

Q. Are there conceptual differences between Schedules 97 and 98 from a ratemaking standpoint?

A. Yes. Schedule 97 recovers costs that have been deferred from a prior time period. As such, it is <u>not</u> indicative of ongoing costs: when the deferred costs are recovered, this cost item is extinguished. Consequently, it is not unreasonable to disregard the rate spread implications of the extinguishment of this charge, as RMP has done. In contrast, Schedule 98 is crediting customers for a portion of 2011 REC revenues, which is a *going-forward* component of revenue requirement. In this sense, it is analogous to Schedule 40, which is recovering going-forward costs approved in the MPA 2 docket, and which also terminates upon the start of the rate-effective period in this case, as approved MPA 2-related costs are absorbed into the test period revenue requirement.

Conceptually, the REC revenues that are being credited in Schedule 98 will be replaced by the test period REC revenues that are approved in this rate case; when that happens, the Schedule 98 credit will disappear – and that will cause a real, going-forward rate impact on customers that is not reflected in the Company's filing or its rate spread – but should be. Put another way, RMP's presentation of its proposed rate increase starts from an artificially high present revenue level because it does not include the Schedule 98 credit. This inflated starting point does not distort RMP's final proposed total revenue requirement, but it does understate the revenue change required to achieve it. As a point of reference, the MPA 2 costs currently recovered by RMP Schedule 40 properly are included in the Company's present revenues in its filing in this docket and are taken into account in RMP's proposed rate spread. Thus, the Schedule 40 and Schedule 98 dollars, despite having similar ratemaking functions, are treated inconsistently in RMP's filing.

Q. What bearing does this information have on rate spread?

A. The Schedule 98 sur-credit is differentiated by rate schedule. Consequently, when it terminates, it will impact customers differently across rate schedules. This differential impact should be taken into account when determining rate spread, as I will discuss later in this testimony. The effective credit to each major rate schedules from Schedule 98 is shown in Table KCH-1-COS below.

Table KCH-1-COS

Schedule No.	Sch 98 Effective Credit %
1, 3	2.16%
6	2.65%
8	2.71%
7,11,12	0.57%
9	3.11%
10	2.61%
15 Metered	1.08%
15 Traffic	1.66%
21	2.49%
23	2.35%
31	2.17%
Customer 1	0.00%
Customer 2	0.00%
Customer 3	3.09%
Customer 4	3.37%
Total Utah	2.39%
Total Utah (excl. Customer 1, 2, & AGA)	2.48%

Q. Have you reviewed the rate spread proposal presented by RMP witness William R. Griffith?

A. Yes, I have. Mr. Griffith's proposed rate spread is based upon the class cost-of-service analysis presented in the direct testimony of RMP witness C. Craig Paice in Exhibit RMP__ (CCP-3), which is summarized in Exhibit RMP__

(CCP-1). As described by Mr. Griffith, RMP's proposed class increases are clustered into four groups which vary by intervals of two percentage points:

Schedule 6 and Schedule 23	12.6%
Residential and Schedule 8	14.6%
Schedule 9	16.6%
Irrigation	18.6%

In order to achieve the revenue requirement target, Mr. Griffith set the proposed rate spread midpoint at 14.6 percent.

Mr. Griffith proposes that Residential and Schedule 8 customers receive the midpoint increase, because the cost-of-service results for these two classes are within two percentage points of the rate spread midpoint. All other rate schedules receive percentage increases that are grouped in two-percentage-point intervals from the midpoint. Each rate schedule that does not receive the midpoint increase receives an increase that is approximately halfway between the midpoint increase and the percentage increase indicated for the rate schedule by the RMP cost-of-service study presented by Mr. Paice, cited above.

Q. What is your assessment of Mr. Griffith's proposal?

A. If one only considers the cost-of-service information from the study presented in Exhibit RMP__ (CCP-3), then Mr. Griffith's proposal is not unreasonable – at RMP's requested revenue requirement. Under Mr. Griffith's proposal, classes earning returns below the system average receive percentage rate increases that are above the average, and vice versa, while classes earning close to the average retail return receive an increase that is approximately equal to the system average increase. At the same time, Mr. Griffith's proposal does not rigidly adhere to the class revenue deficiencies indicated by RMP's cost-of-service study, but instead moves rate schedules that are above or below parity about halfway to their respective costs-of-service relative to the midpoint increase.

Q. Is it reasonable to not adhere strictly to the class revenue deficiencies indicated by RMP's cost-of-service study?

A. Yes. As a general matter, strict adherence to cost-of-service results may be reasonably overridden by applying the principle of gradualism, which takes into consideration the impact of moving immediately to cost-based rates for customer groups that would experience significant rate increases from doing so. In this proceeding, the principle of gradualism is particularly important for customers taking service under Schedule 9, in light of the economically tenuous circumstances faced by American industry as businesses try to recover from the recession. While there are indications that the economy is recovering, it is occurring slowly, and in Utah, the unemployment rate remains high at 7.4 percent. It is even conceivable that the economy could slide back into recession. For Utah businesses, the steady stream of rate increases proposed by RMP – now well into the double-digit percentages on an annual basis – is not helping matters.

Q. Is there cost-of-service information presented in this proceeding other than Exhibit RMP__ (CCP-3) that also should be taken into account?

A. Yes. The Commission's test period order required RMP to prepare a cost-of-service study for Calendar Year 2010. A side-by-side comparison of the rate of return indices for Calendar Year 2010 and the test period ending June 2012 for major rate schedules is presented in Table KCH-2-COS, below.

TABLE KCH-2-COS

COMPARISON OF RATE OF RETURN INDICES

			Rate of Return Index	
Line No.	Schedule No.	Description	12 Months Ended Dec 2010	12 Months Ended June 2012
1	1	Residential	0.93	0.95
2	6	General Service - Large	1.16	1.23
3	8	General Service - Over 1 MW	0.97	0.97
4	7,11,12,13	Street & Area Lighting	2.54	2.61
5	9	General Service - High Voltage	0.82	0.71
6	10	Irrigation	0.87	0.72
7	15	Traffic Signals	0.86	1.02
8	15	Outdoor Lighting	2.61	3.43
9	23	General Service - Small	1.28	1.21
10	25	Mobile Home Parks	0.91	0.61
11	SpC	Customer A	0.80	0.49
12	SpC	Customer B	0.33	0.12
13	SpC	Customer C	0.59	0.52
14		Total Utah Jurisdiction	1.00	1.00

Sources: Exhibit A - Resubmitted COS by Rate Schedule for Period Ended Dec 31, 2010 and Exhibit RMP __(CCP-3), Tab 4, Page 2 in Docket 10-035-124

The table above shows that under the most recent cost-of-service results using historical data, the rate schedules that Mr. Griffith proposes to receive the greatest rate increases – Schedules 9 and 10 – are materially closer to parity than when using the projected test period data. Given that the Company's proposed test period revenue requirement substantially understates REC revenues and is being strongly challenged by parties, strong weight should be given to the actual results of the Calendar Year 2010 cost-of-service study ordered by the Commission relative to the study for the projected period. Indeed, in its test period order in this docket, the Commission placed parties on notice that as the Commission considers the evidence supporting forecasts in this proceeding, especially deviations from historical trends, it will give substantial weight to data reflecting actual, verifiable experience. In my view, this means giving substantial weight to the Calendar Year 2010 cost-of-service study relative to the study for the projected test period.

Q. How should the results of the Calendar Year 2010 cost-of-service study be incorporated into the rate spread determination in this case?

A. I recommend that this be accomplished by tightening the two-percent intervals in the rate spread proposed by Mr. Griffith into smaller intervals. For Schedules 9 and 10, it would be reasonable to use intervals of 1.25 percent and 2.50 percent, respectively.

Q. Does Mr. Griffith's rate spread take into consideration the termination of Schedule 98?

A. No, as I discussed above, it does not.

Q. How should Schedule 98 impacts be incorporated into the rate spread considerations in this case?

A. The target rate spread should be inclusive of the Schedule 98 impacts. A summary of the results of my recommended rate spread approach for major rate schedules is presented in Table KCH-3-COS, below, using a hypothetical base revenue increase equal to 50 percent of RMP's request. As shown in the table, under my proposal, Schedule 10 would receive a rate increase that is 2.50 percent above the midpoint increase <u>after</u> taking account of the termination of the 2.61 percent credit applicable to Schedule 10 through Schedule 98. Similarly, Residential and Schedule 8 customers would receive the midpoint increase after taking account of the Schedule 98 impacts on these two customer groups. Rate schedules receiving a rate increase below the average are set at .34 percent below the midpoint, inclusive of the Schedule 98 impact. Special contracts subject to the increase receive a base rate increase that maintains the same differential from Schedule 9 as occurs in Mr. Griffith's proposal.

Although this rate spread is demonstrated using a hypothetical base revenue increase equal to 50 percent of RMP's request, this approach can be readily adapted for different final revenue requirement determinations. Greater detail in support of this calculation is presented UAE Exhibit COS 1.1.

Table KCH-3-COS

UAE Rate Spread Recommendation
at Hypothetical $116.2 million Base Revenue Increase
Including Impacts from Schedule 98 Termination
for Major Utah Rate Schedules

Schedule No.	Forecast Present Rev ($000)	GRC Change ($000)	GRC Change %	Sch 98 Effective Credit %	Total %
1, 3	$622,762	$46,036	7.39%	2.16%	9.55%
6	$432,436	$27,927	6.46%	2.65%	9.11%
8	$138,877	$9,494	6.84%	2.71%	9.55%
7,11,12	$13,802	$0	0.00%	0.57%	0.57%
9	$212,323	$16,313	7.68%	3.11%	10.80%
10	$11,112	$1,049	9.44%	2.61%	12.05%
15 Metered	$1,218	$0	0.00%	1.08%	1.08%
15 Traffic	$521	$41	7.89%	1.66%	9.55%
21	$281	$23	8.31%	2.49%	10.80%
23	$121,797	$8,240	6.77%	2.35%	9.11%
31	$793	$58	7.37%	2.17%	9.55%
Customer 1	$22,943	$0	0.00%	0.00%	0.00%
Customer 2	$30,307	$0	0.00%	0.00%	0.00%
Customer 3	$46,005	$4,170	9.07%	3.09%	12.16%
Customer 4	$10,558	$661	6.26%	3.37%	9.63%
Total Utah			6.83%	2.39%	9.21%
Total Utah (excl. Customer 1, 2, & AGA)			7.06%	2.48%	9.55%

Q. In your revenue requirements testimony you recommended that incremental REC revenues that have been deferred since February 22, 2010 should be returned to customers starting on the rate effective date for this proceeding. How should these revenue credits be returned to customers?

A. For the deferral period running from February 22, 2010 through December 31, 2010, a sur-credit should be established at the start of the rate effective period in this case that will refund to customers Utah's share of the difference between actual REC revenues booked during the period and the REC revenues reflected in base rates approved by the Commission in its decision in Docket No. 09-035-23, plus interest. I am recommending that this balance be credited back to customers over the one-year period September 21, 2011 through September 20, 2012. I estimate that the REC deferral for this period, inclusive of interest, is $46,209,511.

This revenue credit should be spread across customers using the cost-of-service equivalent of the SG allocation factor, denoted as the F10 factor in RMP's cost-of-service model, which is how REC revenues are allocated. This apportionment is presented in UAE Exhibit COS 1.2. For ease of administration, the crediting of the REC deferral can be implemented using a kilowatt-hour credit applied to each rate schedule. An estimate of the credit applicable to each rate schedule is also presented in UAE Exhibit COS 1.2.

Q. Does this conclude your direct testimony?

A. Yes, it does.