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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
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PREFILED DIRECT TESTIMONY OF KEVIN C. HIGGINS

[TEST PERIOD]

The UAE Intervention Group (UAE) hereby submits the Prefiled Direct Testimony of Kevin C. Higgins on test period issues.

DATED this 9th day of March, 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 9th day of March, 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

[Test Period]

March 9, 2011

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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. 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.

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

29 **Q. Have you previously testified before this Commission?**

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

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

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

41 A more detailed description of my qualifications is contained in
42 Attachment A.

43

44 **Overview and Conclusions**

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

46 A. My testimony addresses the matter of the most appropriate test period to
47 be used in this general rate proceeding.

48 **Q. What are your primary conclusions and recommendations?**

49 A. I conclude that the best test period to be used in this general rate
50 proceeding is Calendar Year 2011, consisting of the period January 1, 2011
51 through December 31, 2011. In my opinion, Calendar Year 2011 best reflects the
52 conditions Rocky Mountain Power (“RMP”) will encounter during the period the
53 rates will be in effect.

54 In the alternative, I recommend that the Commission require the use of
55 RMP’s alternative test period filed in this proceeding, the year ending June 30,
56 2011.

57

58 **Basis for Determining Test Period**

59 **Q. On what basis must test period be determined in Utah?**

60 A. The determination of a public utility’s test period is addressed in Section
61 54-4-4(3) of the Utah Code, which states:

62 (a) If in the commission’s determination of just and reasonable rates the
63 commission uses a test period, the commission shall select a test period
64 that, on the basis of the evidence, the commission finds best reflects the
65 conditions that a public utility will encounter during the period when the
66 rates determined by the commission will be in effect.

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68 (b) In establishing the test period determined in Subsection (3)(a), the
69 commission may use:

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(i) a future test period that is determined on the basis of projected data not exceeding 20 months from the date that a proposed rate increase or decrease is filed with the commission under Section 54-7-12;

(ii) a test period that is:

- (A) determined on the basis of historic data; and
- (B) adjusted for known and measurable changes; or

(iii) a test period that is determined on the basis of a combination of :

- (A) future projections; and
- (B) historic data.

(c) If pursuant to this Subsection (3), the commission establishes a test period that is not determined exclusively on the basis of future projections, in determining just and reasonable rates the commission shall consider changes outside the test period that:

- (i) occur during a time period that is close in time to the test period;
- (ii) are known in nature; and
- (iii) are measurable in amount.

Q. Did the Legislature adopt intent language associated with this statute?

A. Yes. The Legislature adopted intent language stating:

“The intent of the legislature in passing S.B. 61, Public Utility Related Amendments, is to have the Public Service Commission select a test period for setting utility rates based on the best evidence presented to the Public Service Commission without any presumption for or against either a historical or a future test period.”¹

¹ Senate Journal, Tuesday, February 19, 2003, Day 30, page 515, Intent Language to S.B. 61; House Journal, Tuesday, March 4, 2003, Day 44, page 961, Intent Language for S.B. 61.

107 **Q. Based on your experience in utility regulation, and without attempting to**
108 **render a legal opinion, how do you interpret the plain language of this statute**
109 **taken in combination with the Legislature’s intent language?**

110 A. There are three “generic” test period options available for setting rates in
111 Utah, and the Commission is free to choose the best test period based on the
112 evidence. Significantly, there is no presumption either for or against an historical,
113 a mixed, or a future test period.

114 **Q. Has the Commission provided any guidance with respect to determination of**
115 **test period?**

116 A. Yes. In its order approving the test period stipulation in a previous
117 PacifiCorp general rate case, issued October 20, 2004 in Docket No. 04-035-42,
118 the Commission identified various factors that need to be considered in selecting a
119 test period. The factors identified in the Commission’s Order include the general
120 level of inflation; changes in the utility’s investment, revenues or expenses;
121 changes in utility services; availability and accuracy of data to the parties; ability
122 to synchronize the utility’s investment, revenues and expenses; whether the utility
123 is in a cost increasing or cost declining status; incentives to efficient management
124 and operation; and length of time the new rates are expected to be in effect.

125 In that same order, the Commission also discussed some important policy
126 concerns implicated by future test periods. These concerns include diminished
127 economic examination and accountability, replacement of actual results of
128 operations data with difficult-to-analyze projections, ability of parties to

129 effectively analyze the Company's forecasts, dampening of the efficiency
130 incentive of regulatory lag, playing to the Company's strength from control of
131 critical information, and shifting of the risks of the future to ratepayers.

132 In Docket No. 07-035-93, the Commission considered the evidence
133 presented on these various factors and rejected the test period proposed by RMP
134 that had extended 18½ months beyond the filing date. Instead, the Commission
135 ordered the use of a projected test period closer in time, one which extended 12½
136 months beyond the filing date. In its Order on Test Period issued February 14,
137 2008, the Commission stated:

138 UAE and UIEC recommend the Commission balance the need for a forecasted
139 test period with the uncertainty of forecasting out to June 2009. UAE argues there
140 is an asymmetry in risk between the Company and ratepayers regarding
141 knowledge of investment requirements and control of the timing of these
142 investments. Whereas the Company can manage adverse effects of forecast error
143 by, for example, delaying or cancelling investment, the ratepayer cannot, and thus
144 assumes greater risk for forecast error. UAE also presents evidence showing how
145 forecast error of the loads in another state served by the Company can materially
146 affect Utah's allocation of system costs. Such forecast error can result in Utah
147 being allocated a greater share of interjurisdictional costs than is warranted.
148 Therefore, UAE and UIEC recommend forecasting a period nearer in time to
149 render greater confidence in the matching of costs and revenues, and the more
150 appropriate balancing of Company and ratepayer interests. [Order at 3]

151
152 The Commission went on to conclude:

153
154 We concur with UAE and conclude a projected test period ending December 31,
155 2008, will strike an appropriate balance between Company and ratepayer interests
156 and best reflects the conditions the Company will encounter during the rate
157 effective period. While the beginning date of this rate effective period is known,
158 its length is unknown. The purpose of establishing a test period is not to ensure
159 any particular period of time between rate cases, but rather to set just and
160 reasonable rates for the Company and its ratepayers. In this time of expanded
161 utility investment, potentially increasing costs, and greater uncertainty of
162 economic conditions, more frequent rate cases may be necessary to ensure just
163 and reasonable rates. [Order at 3-4]

164
165 In Docket No. 08-035-38, RMP again filed a test period that was rejected
166 by the Commission; this time the Company had proposed the unorthodox
167 combination of an end-of-period rate base with a fully projected test period. RMP
168 was ordered to re-file its case using an average rate base, but was allowed to
169 extend the test period by six months. In issuing its test period decision, the
170 Commission offered this guidance for future rate cases:

171 Participants engaged in utility regulation, especially in regards to general rate
172 cases, face a number of daunting realities. These include: the increasing
173 complexity of electricity markets; the increasing complexity of electric utility
174 operations; the increasing complexity to harmonize and the potential for conflicts
175 arising from multi-state utility operations and varying statutory provisions and
176 policy goals of the different states; the increased number of factors which are to
177 be considered and interrelated in arriving at decisions in regulating utilities, in
178 setting a revenue requirement, and in designing rates which are all required to be
179 just and reasonable; the increasing complexity and sophistication of tools and
180 analysis applied to evaluate past expenses, revenues and rate design and to arrive
181 at or project future ones; and the absolute magnitude and the relative magnitude
182 of the sums arising from differences in the evaluation of existing and future
183 electric utility operations.

184
185 The difficulty in dealing with these aspects of today's utility regulation, in the
186 context of acknowledging and accommodating the different interests of the utility,
187 customers and society, is heightened through the use of a means, itself, intended
188 to address some of these aspects – a projected test year (irrespective of whether it
189 is partially or fully forecast). Early resolution of the appropriate test year to be
190 used benefits all involved in a general rate proceeding. The utility and other
191 participants then have opportunity to focus their attention and analyses on
192 information which will be directly relevant in setting rates, rather than dealing
193 with other information which, contingent upon the test year selected, may or may
194 not be relevant or useful. We and participants have attempted to deal with this (in
195 stipulations involving the preparation and exchange of information, in case
196 scheduling, in test-year selection hearings, etc.) with conflicting views of success.
197 We conclude we will order a procedural process for all future RMP general rate
198 cases by which identification and selection of the test period to be used in the case
199 will be the first item for resolution prior to the submission of other material (e.g.,
200 revenue requirement information, rate proposals and rate schedules and tariffs)
201 and our resolution of other disputes. Once the test year is approved by the

202 Commission, the company will then file the remaining aspects of the case: the
203 change in revenue requirement the company deems appropriate, in light of the
204 designated test year; the rate design which the company proposes to use for rates,
205 charges, fees, etc.; and the proposed rate schedules and tariff provisions to
206 effectuate the company's rate design.

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208 This procedure will allow the company to explore possible, reasonable test year
209 alternatives and propose the one which it believes is most reflective of the period
210 in which future rates will be effective. Other participants will have opportunity to
211 agree or disagree with the company's selection, the Commission can resolve any
212 dispute on the selection, and all may then focus on and analyze what the selected
213 test year portends for the reasonable expenses and revenues which, combined,
214 establish the revenue requirement and direct the future rates that need to be set.
215 [Order at 6]
216

217 In 2009, the Commission adopted R746-700-10, which addresses the
218 establishment of a test period in a general rate case. In an effort to implement the
219 Commission's expectations as expressed in the preceding discussion, the rule
220 gives an applicant the choice of seeking approval for its proposed test period prior
221 to the filing of a general rate case or as part of the general rate case application.

222 In the latter case, if the applicant proposes a future test period, then:

223 ...in addition to the demonstration of adjustments to be made for the test period
224 used by the applicant in the general rate case application, the applicant will make
225 the same demonstration for the 12-month period ending on the last day of June or
226 December, whichever is closest, following the filing date of the application if this
227 alternative period does not have an end date beyond the test period used in the
228 general rate case application. [R746-700-10.A2]
229

230 **Q. What test period did RMP use in its last Utah rate case?**

231 A. In Docket No. 09-035-23, filed June 23, 2009, RMP proposed a projected
232 test period ending June 30, 2010, approximately 12¼ months after the date of
233 filing. This proposed test period was consistent with the time frame approved by
234 the Commission in Docket No. 07-035-93 and utilized an average rate base as

235 required in Docket No. 08-035-38. This test period was agreed to by stipulation
236 and was not opposed by any party.

237

238 **Test Period Proposed by RMP in the Current Proceeding**

239 **Q. What is RMP's proposal for the test period to be used in this proceeding?**

240 A. As described in the direct testimony of RMP witness Steven R.
241 McDougal, RMP is proposing to use a test period ending June 30, 2012 to support
242 its rate increase request of \$232.4 million. The Company's rate increase request
243 was filed on January 24, 2011, and the Company's proposed test period ends
244 some 17¼ months later. Similar to RMP's filing in Docket No. 07-035-93, the
245 Company's proposed test period extends nearly to the maximum point in the
246 future allowed by Utah law.

247 **Q. Did RMP seek approval for its proposed test period prior to the filing of this**
248 **general rate case as permitted pursuant to R746-700-10.B and as encouraged**
249 **in the Commission's Order issued in Docket No. 08-035-38?**

250 A. No. Even though the Company's proposed test period is very similar to
251 the one rejected by the Commission in Docket No. 07-035-93, RMP elected not to
252 seek its approval prior to the filing of this general rate case. Instead, RMP elected
253 to identify the test period for the first time as part of its general rate case filing
254 pursuant to R746-700-10.A.

255 **Q. What alternate test period did RMP file in accordance with the requirements**
256 **of R746-700-10.A2?**

257 A. The alternate test period included in RMP's filing is the year ending June
258 30, 2011.

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260 **UAE Proposed Test Period**

261 **Q. Do you support the adoption of RMP's proposed test period for setting rates**
262 **in this proceeding?**

263 A. No, I do not. I believe that a projected test period that is closer in time than
264 RMP's proposed period is a more reasonable choice. I recommend adoption of
265 the test period January 1, 2011 through December 31, 2011. This projected test
266 period extends 11¼ months beyond the date of RMP's filing and is consistent
267 with the test period adopted by the Commission in Docket No. 07-035-93 and the
268 test period filed by RMP in its general rate case filing in Docket No. 09-035-23.

269 **Q. Please explain your support for the test period January 1, 2011 through**
270 **December 31, 2011.**

271 A. The selection of Calendar Year 2011 for the test period strikes a
272 reasonable balance between customer and Company interests by setting rates
273 based on a forward-going projection of costs for the upcoming year while limiting
274 the period of projected costs to one that is relatively close in time. This approach
275 reduces the likelihood of forecast error and better protects both customers and
276 Company from the effects of difficult-to-anticipate events than a test period
277 extended further out into the future. Significantly, the Calendar Year 2011 test
278 period I am recommending is the same test period that RMP filed in Wyoming on

279 November 22, 2010. Moreover, the anticipated start of the rate effective period in
280 Utah is virtually identical to that in Wyoming (September 2011).²

281 **Q. Has anything changed since the Commission’s 2008 Order rejecting a similar**
282 **test period proposal from RMP that would warrant a different result in this**
283 **docket?**

284 A. No. To the contrary, the case for a projected test period relatively “close
285 in time” is even stronger now than when the Commission ruled in favor of this
286 approach in 2008. In the time since the Commission rejected RMP’s proposal in
287 Docket No. 07-035-93, two major regulatory changes have been enacted that
288 ameliorate any claim by the Company that a far-reaching test period is needed to
289 compensate it for projected future costs: the passage of legislation allowing for
290 cost recovery of Major Plant Additions (“MPA”) and the recent approval by the
291 Commission of a four-year Energy Balancing Account Mechanism (“EBA”) pilot.

292 The MPA statute, UCA § 54-7-13.4, allows RMP to seek single-issue rate
293 recovery for capital additions that exceed 1 percent of its rate base when filed
294 within 18 months of a general rate case order. The availability of this option –
295 which RMP has already used twice – gives the Company a singularly
296 advantageous tool to address its claims of exposure to regulatory lag without
297 subjecting the Company to an earnings test and (currently at least) without
298 recognizing incremental margins from load growth. The availability of the MPA
299 option removes any justification for relying on a more speculative test period
300 forecast as a means of mitigating the utility’s claimed exposure to regulatory lag.

² RMP Response to DPU 6.29.

301 Similarly, the Commission's recent adoption of an EBA pilot will allow
302 RMP to recover (or refund) the major portion of deviations from projected net
303 power costs going forward. The adoption of the EBA further strengthens the case
304 for setting net power costs on as solid a basis as possible by using the more
305 confident projections of costs that are closer in time.

306 Taken together, the introduction of the MPA and EBA argue for moving
307 the test period even *closer in time* than the standard of approximately 12 months
308 out than has been adopted in most recent cases. Of the two test periods presented
309 by RMP in this filing, the test period ending June 2011 best fits this bill. I
310 recommend that if the Calendar Year 2011 test period is not adopted by the
311 Commission, then the test period ending June 2011 should be selected.

312 **Q. You stated that a test period closer in time better protects both customers**
313 **and the Company from the effects of difficult-to-anticipate events. Do you**
314 **have any factual examples of this?**

315 A. Yes. For example, as noted by the Commission in its 2008 Order quoted
316 above, my previous testimony demonstrated that forecast error of the loads in
317 another state served by the Company can materially affect Utah's allocation of
318 system costs. A more recent example is REC revenue projections. The impact of
319 including (or excluding) revenue associated with renewable energy credits
320 ("RECs") from Utah rates has been discussed in considerable detail in my
321 confidential testimony filed in Docket No. 09-035-15 and Docket No. 10-035-89.

322 As discussed in those cases, the value of RECs increased in 2009 in a dramatic
323 manner.

324 The revenue requirements phase of RMP's last Utah general rate case,
325 Docket No. 09-035-23, extended from June 23, 2009 (RMP Application) to
326 February 18, 2010 (Commission Order), and utilized the test period from July 1,
327 2009 through June 30, 2010. As I discussed in Docket No. 10-035-89, the
328 evidence shows that RMP was aware of the surge in REC values prior to the
329 conclusion of that rate case. This means that this new information could have
330 been brought forward by RMP for inclusion in the test year revenue requirement
331 prior to the conclusion of the case. The fact that RMP elected not to bring this
332 information forward is not the subject of my argument here. My point here is that
333 a test period relatively close in time is better able to accommodate difficult-to-
334 anticipate events, such as a major change in REC values, because the case is being
335 conducted part-way through the test period. Had RMP elected to share its
336 knowledge of the dramatic upswing in REC revenues while the rate case was still
337 under consideration, the Commission could have set rates more representative of
338 actual conditions, given the close-in-time (July 2009 to June 2010) test period
339 used in that rate case. In contrast, had the same July 2009 to June 2010 test
340 period been the basis of a rate case litigated some six months sooner (i.e., using a
341 test period ending some 17 months beyond the filing date) then clearly the surge
342 in REC values that occurred in 2009 would not even have been discernable on the
343 horizon during the course of the proceeding.

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Moreover, my point is strengthened by RMP's own testimony in the current case. Based on RMP's proposed test period ending 17¼ months out, RMP expresses considerable uncertainty with respect to future REC values. As RMP witness Stefan Bird explains, although base period (ending June 2010) REC revenues totaled approximately \$98.5 million (total Company), RMP's filing only includes \$55.7 million of REC revenues in the test period ending June 2012. Mr. Bird attributes a large part of this differential to uncertainty in the California market associated with the pendency of a major ruling by the California Public Utilities Commission ("CPUC") affecting the eligibility of using out-of-state resources for compliance with California renewable energy requirements. With the CPUC having rendered a major decision in this regard on January 14, 2011, redefining the standards for compliance, the California market is expected to become "un-paralyzed." It is reasonable to expect that new transactions with California entities will now go forward, although, as Mr. Bird states:

...because the California market has only just now reopened due to the stay that was just lifted, the level of interest from California utilities, the volume of [tradable renewable energy credits (TRECs)] and the prices utilities are willing to pay for RECs/TRECs is unknown. Given this uncertainty in the California market, it is difficult to predict how long it will take to execute any contracts for the sale of RECs/TRECs with California utilities. In addition, another unknown is whether these utilities will issue time consuming requests for proposals ("RFP") or whether they will negotiate bilateral transactions that might include 2011 transactions. Further, the Company does not know what pricing it can expect for RECs/TRECs.³

³ Direct testimony of Stefan A. Bird, lines 151-159.

370 RMP's testimony illustrates the great difficulty of projecting REC
371 revenues a significant way into the future and helps exemplify why a projected
372 test period relatively close in time is preferred to RMP's proposal.

373 **Q. Has RMP presented other recent testimony regarding the difficulty of**
374 **preparing accurate revenue requirement forecasts?**

375 A. Yes. In seeking approval of its recent ECAM/EBA proposals in both
376 Wyoming and Utah, RMP presented extensive testimony arguing that its
377 projections of net power cost were subject to significant error. For example, in
378 Wyoming PSC Docket No. 20000-368-EA-10, RMP witness Karl A. McDermott
379 testified:

380 Unfortunately, costs that are volatile, especially those costs hard to predict with
381 accuracy, and represent a large part of the revenue requirement make it difficult
382 for regulators to set prospective rates that accurately reflect a reasonable level of
383 prudently incurred costs. Indeed, history is replete with examples of how reality
384 does not always comport with these assumptions of the test year approach.⁴

385 RMP should not be permitted to have it both ways, arguing in ECAM/EBA
386 dockets that its net power costs are "unpredictable" while arguing in rate case
387 proceedings that test periods based on cost projections extending nearly a year
388 and a half into the future provide the most reasonable basis for setting rates for
389 Utah ratepayers.
390

391

392 **Test Period Factors**

393 **Q. The Commission has indicated that one of the factors for determining test**
394 **period is the ability to synchronize the utility's investment, revenues and**

395 **expenses. Under your proposed test period, would these items be**
396 **synchronized?**

397 A. Yes. I am proposing a fully-projected test period that requires no out-of-
398 period adjustments. As such, investment, revenues and expenses would be fully
399 synchronized. Similarly, my alternative proposal, to use the test period ending
400 June 2011, would also consist of investment, revenues and expenses that are fully
401 synchronized.

402 **Q. The Commission has indicated that other factors for determining test period**
403 **include changes in the utility's investment, revenues, expenses or services.**
404 **Does your proposed test period account for such changes?**

405 A. Yes. My proposed test period would account for projected changes
406 through December 31, 2011. This would line up well with the start of the rate-
407 effective period that RMP has requested – September 21, 2011. In addition, as
408 discussed above, RMP can avail itself of the MPA statute to recover qualifying
409 investment costs beyond the test period.

410 **Q. The Commission has also indicated that the availability and accuracy of data**
411 **to the parties and the utility's superior access to data are factors in**
412 **determining test period. Does consideration of these factors support your**
413 **proposed test period?**

414 A. Yes. My proposed test period is preferred to RMP's in this regard. The
415 availability and accuracy of data are necessarily diminished as longer-term
416 forecasts are used.

⁴ Direct testimony of Karl A. McDermott, p. 6, lines 10-15.

417 **Q. Does the fact that RMP chose not to present a Calendar Year 2011 test**
418 **period as part of its filing create an un-resolvable obstacle to the use of this**
419 **test period in this case?**

420 A. No. UAE asked RMP to provide calendar year 2011 test period
421 information in its data request 1.4 submitted on January 27, 2011, a copy of which
422 is attached as UAE Exhibit TP 1.1. Therefore, RMP has been on notice for some
423 time that it will be required to provide calendar year 2011 information.
424 Moreover, the preparation of this information will not require the Company to
425 “start from scratch,” given that RMP has already filed a general rate case in
426 Wyoming using the very same Calendar Year 2011 test period I am
427 recommending in this proceeding.

428 Finally, as I will discuss in more detail in the next section of my
429 testimony, I view RMP’s decision to forego filing a test period consistent with its
430 last Utah rate case or the Commission’s decision in Docket No. 07-035-93 to be a
431 tactical maneuver on the Company’s part. I recommend against rewarding the
432 Company for this exercise in gamesmanship. “Data availability” is not a valid
433 reason for using a test period other than Calendar Year 2011.

434 **Q. The Commission has stated that the general level of inflation is a factor in**
435 **determining test period. Do you wish to comment?**

436 A. My interpretation of this statement is that, in determining whether to adopt
437 a historical test period, the Commission will consider whether a utility is
438 experiencing significant inflationary pressures that would require appropriate

439 adjustments to compensate for known increases in the price level. In adopting a
440 prospective test period, this concern is addressed by making assumptions about
441 inflation that are incorporated into the utility's forecasted costs. However,
442 general inflation has not been an economic problem in recent years and RMP
443 acknowledges that the current rate case is not motivated by the general level of
444 inflation.⁵

445 At the same time, I wish to repeat a caution I offered in a previous docket
446 regarding the practice of building future inflation into utility rates, particularly as
447 it relates to an extended future test period, such as RMP has proposed. As an
448 economist, I have concerns about pricing formulations that reinforce inflation.
449 This can occur when *projections* of inflation are built into formulas that are then
450 used to set administratively-determined prices, such as utility rates. Such pricing
451 mechanisms help to make inflation a self-fulfilling prophesy. As a matter of
452 public policy, this is a concern. It is one thing to adjust for inflation; it is another
453 to help guarantee it. This problem is less pronounced using the Calendar Year
454 2011 test period I have proposed, or the test period ending June 2011.

455 **Q. The Commission has also stated that it will consider whether the utility is in**
456 **a cost increasing or cost declining status. Please comment on the**
457 **appropriateness of your proposal with regard to this factor.**

458 A. In general, a utility that is facing increasing costs will benefit from – and
459 therefore, prefer – an extended future test period. Conversely, a utility facing a
460 declining cost situation will benefit from – and prefer – an historical test period.

⁵ Response of RMP in Opposition to UIEC's Motion and UAE's Request at 12.

461 The “near-term” projected test period I am proposing sits between these
462 two extremes. In my view, it is a reasonable mechanism for addressing both
463 increasing-cost and declining-cost situations. Moreover, the MPA and EBA are
464 alternative mechanisms for allowing the company to deal with increasing costs.

465 **Q. The Commission has indicated that another factor to be considered is**
466 **incentives to efficient management and operation. Please comment on this.**

467 A. In addressing this point, it is useful to draw a distinction between efficient
468 management and operation *per se*, and achieving *lower rates* through efficient
469 management and operation. They are not necessarily the same thing.

470 Once rates are set, either through a historical test period or a projected test
471 period, a well-run utility will seek to be as efficient as possible, because all cost
472 savings will flow to the bottom line – at least until the next general rate case. In
473 that sense, I view the choice of test period to be relatively neutral with respect to
474 achieving efficient management and operations *per se*.

475 But there can be a marked difference with respect to achieving *lower rates*
476 through efficient management and operation. With a projected test period, a utility
477 might anticipate the cost of a future activity to increase to a given level “x” some
478 12 to 20 months into the future, and build that higher projected cost into rates. If,
479 during the intervening period, the utility finds a way to perform that activity more
480 efficiently, the cost savings flow to the Company. The incentive to be efficient
481 exists with both a historical and future test period, and in both cases the benefits
482 are not experienced in rates until they are reset pursuant to a subsequent case.

483 However, net efficiency gains captured by shareholders are likely to be larger the
484 further into the future the test period is projected. In Docket No. 07-035-93, I
485 illustrated this phenomenon using the example of the savings to the Company
486 from an employee severance program.

487 **Q. The Commission has also indicated that the length of time the new rates are**
488 **expected to be in effect may be a factor in determining test period. Please**
489 **comment.**

490 A. It is difficult to predict how long new rates may stay in effect. I believe
491 the most reasonable approach is to set rates targeting the time that rates are
492 scheduled to take effect, and then allow actual conditions to determine when the
493 next rate case is necessary. This is accomplished best through the use of my
494 preferred or alternative test periods.

495 **Q. What role does the concept of “used and useful” play in the test year context?**

496 A. A fundamental principle of utility regulation is that a public utility should
497 be permitted to earn a reasonable return on its investment in facilities after they
498 have become “used and useful” for the utility’s public service within the state.
499 As explained by the Utah Supreme Court in describing some “basic principles” of
500 utility regulation: “It is only to the extent the facilities developed are used and
501 useful to the consumer that they are included in the rate base.” (Committee of
502 Consumer Services v. Public Service Commission, 595 P.2d 871, 874 (Utah
503 1979)). From a policy perspective – without attempting to address legal issues –
504 the concept of pre-paying a return on a utility’s projected investment in future

505 facilities that have not yet been completed – and indeed, might not be completed
506 according to the projected schedule – is fundamentally inconsistent with the “used
507 and useful” concept. In contrast, when rate recovery is authorized under the MPA
508 statute, as a practical matter, the subject investment must already be used and
509 useful.

510

511 **RMP Filing Strategy**

512 **Q. In its Response to UAE’s request for a test period hearing filed February 15,**
513 **2011, RMP contends that if the Company had filed the Calendar Year 2011**
514 **test period considered obvious by UAE, rather than the June 30, 2011**
515 **alternative test period, the Company would have been in violation of the**
516 **Commission’s rules. How do you respond to this argument?**

517 A. This argument is clearly a contrivance. Given the Commission’s prior
518 rulings on this issue, Calendar Year 2011 is the obvious choice for the test period
519 in this case, not as the alternative test period, but as the primary test period.

520 RMP contends that, had it filed a Calendar Year 2011 test period in
521 addition to the June 2011 alternative test period, the Company “would have lost
522 the benefit of the Commission’s resolution of the dispute regarding how many
523 alternative test periods must be filed. UIEC and UAE lost on that issue and
524 should not be allowed to avoid that loss simply by asking for the additional
525 alternative test period as soon as a case is filed compliant with the rule.”⁶

⁶ Response of RMP in Opposition to UIEC’s Motion and UAE’s Request at 7.

526 RMP's argument ignores and confounds the substance at issue here. It is
527 RMP that is attempting to frustrate a reasoned resolution of an issue on which it
528 has previously lost. Consider the Company's actions in this case: having lost on
529 the substance of an argument for a test period extending 18½ months in Docket
530 No. 07-035-93, RMP elected to bypass the opportunity offered by the
531 Commission to seek pre-approval for the Company's preferred test period, but
532 instead structured its filing in a manner that attempts to force the Commission to
533 decide between a test period very similar to the one the Commission previously
534 rejected and an "alternate" test period that is even closer in time than that which
535 the Commission required in 2008. RMP completes its "form over substance"
536 argument in its Response by contending that filing the test period previously
537 ordered by the Commission would actually be a violation of the Commission's
538 rules.

539 It appears to me that RMP has embarked on an exercise of brinksmanship
540 to try to take "off the table" the very test period that the Commission required in
541 Docket No. 07-035-93, when the test period issue was last examined without the
542 distraction of the "end-of-period" debate. The Company's tactic is all the more
543 audacious in light of the Commission's effort to ensure that an option is available
544 through R746-700-10.B to allow for test period resolution prior to the filing of a
545 general rate case. Given that RMP intended to propose a test period that is almost
546 identical to one that was expressly rejected by the Commission in Docket No. 07-
547 035-93, the most obvious and common sense course of action was for RMP to

548 seek prior approval for its preferred test period. Such a course of action also
549 would have comported with the Commission's stated commitment in Docket No.
550 08-035-38 to establish "a procedural process for all future RMP general rate cases
551 by which identification and selection of the test period to be used in the case will
552 be the first item for resolution prior to the submission of other material (e.g.,
553 revenue requirement information, rate proposals and rate schedules and tariffs)
554 and our resolution of other disputes." Instead, RMP has elected to use a test
555 period filing option better suited to a less controversial proposal (such as its
556 closer-in-time test period proposal in the last rate case, Docket No. 09-035-23).

557 The Commission should not reward RMP for this exercise of calculated
558 gamesmanship. Instead, I recommend that the Commission order that Calendar
559 Year 2011 is the appropriate test period to be used in this general rate case,
560 because this test period best reflects the conditions RMP will encounter during the
561 period the rates will be in effect. Further, I recommend that the Commission
562 order RMP to make a complete Calendar Year 2011 test period filing within two
563 weeks. If RMP is unable or unwilling to do so, or if the Commission otherwise
564 elects not to utilize a calendar year 2011 test period, the Commission should
565 require the use of RMP's alternate-filed test period ending June 2011. This
566 alternative test period is eminently reasonable in light of the availability to RMP
567 of the statutory MPA option and the recent approval of an EBA pilot. It is also
568 reasonable in light of the calculated risk that RMP elected to take in eschewing
569 the pre-approval option available in R746-700-10.B. Under these circumstances,

570 the June 2011 test period would best reflect the conditions that RMP will
571 encounter during the period that rates will be in effect.

572 **Q. Does this conclude your direct testimony?**

573 **A.** Yes, it does.