State of Utah

Department of Commerce

Division of Public Utilities

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MEMORANDUM

To: Utah Public Service Commission

From: Utah Division of Public Utilities
Chris Parker, Director
Artie Powell, Energy Section Manager
Brenda Salter, Technical Consultant
Charles E. Peterson, Technical Consultant

Date: October 27, 2015

Re: Request for Agency Action to Review the Carrying Charges Applied to Various Rocky Mountain Power Account Balances, Docket No. 15-035-69.

Recommendation (Reset Carrying Charges Annually)

The Division of Public Utilities (Division) recommends that the Public Service Commission of Utah (Commission) order that the carrying charges paid on identified accounts of Rocky Mountain Power, a division of PacifiCorp (Rocky Mountain Power or Company) be updated annually every March 1, with the first update occurring on March 1, 2016. The Division proposes to use the average of the annual Aaa and Baa Corporate interest rates for the preceding calendar year as published by the Federal Reserve Board of Governors. The Division believes that periodically revising the carrying charges will keep these charges more in-line with current market rates and reduce the possibility, or the perception of the possibility, that Rocky Mountain

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Power may take advantage of carry charges that are disparate from interest rates available in the marketplace.[1]

Issue

On August 11, 2015 the Division made a request for Agency Action to review the carrying charges applied to various Rocky Mountain Power account balances. On September 2, 2015, the Commission held a scheduling conference setting October 27, 2015 as the date for the Division's initial recommendation in this docket. The Commission also scheduled a technical conference that was held on September 29, 2015. At the technical conference the Company made a presentation discussing the history of each account's carrying charge. The Division notes that the current carrying charge for two of the eight accounts under consideration was set in the late 1990s. Their rates were fixed at 6.0 percent. For comparison, in the general rate case Docket No. 97-035-01, the Company's authorized cost of long-term debt was 7.52 percent and of its preferred stock, 5.79 percent. The Division believes that the carrying charge rate for more recent accounts, such as the EBA in 2011 and the solar incentive program in 2012, were set to be merely consistent with the rates in other accounts, including accounts associated with Questar Gas Company, and not necessarily to reflect interest rate levels at the time.

Analysis and Discussion

The Division examined eight program accounts, listed in Table 1, that it believes are the only ones that have Commission-approved carrying charges associated with them. Table 1 is a summary of information provided by the Company at the technical conference and in a follow-up informal data request at that technical conference. DPU Exhibit 1 provides additional detail and is the latest version of the information provided by the Company.

[1] The Division mentions the possibility of the Company "gaming" the interest rates only as theoretical possibility. The Division has no evidence that the Company has done this.

Table 1

Description	Current Carrying Charge	Basis for Carrying Charge
DSM	7.76%	Stipulation in Docket No. 02-035-T12, based on Company's current AFUDC calculation.
REC Balancing Accounts (RBA)	5.20%	Order in Docket No. 10-035-14, Company's most recent approved cost of debt.
Energy Balancing Accounts (EBA)	6.00%	Order in Docket No. 09-035-15
Customer Security Deposits	6.00%	Order in Docket No. 97-035-01
Home Energy Lifeline	5.20%	Order in Docket Nos. 03-035-01 & 04-035-21, Company's most recent approved cost of debt.
Solar Incentive	6.00%	Order in Docket No. 11-035-104
Blue Sky	7.57%	Order in Docket No. 07-035-T13, Company's most recent authorized return on rate base.
Customer Overpayments	6.00%	Order in Docket No. 97-035-01

As described above, the annual carrying charge in four of these accounts is currently fixed at 6.0 percent. Depending on whether the balance in a particular account is a debit balance (i.e. the Company has under-collected on the account) or a credit balance (i.e. the Company has over-collected on the account) the carrying charge interest can either accrue to the Company or to customers. The only exception is the Customer Deposits and Customer Overpayments where the carrying charge should typically accrue to the customer.

The possible incentives for the Company to "game" the carrying charge rate depends on the current interest rate, the debit or credit balance, and the anticipated duration of the account balance. The following are hypothetical scenarios.

- If the Company has the opportunity to invest at an interest rate that is higher than the carrying charge rate, then there is an incentive for the Company to try to create and maintain a credit balance (over-collection). The Company collects the money from customers and invests it at the higher rate and earns the difference between the high rate and the carrying charge the customers receive for lending their money to the Company.
- If the Company can borrow money at a rate that is lower than the carrying charge, the incentive is for the Company to create and maintain, if it can, a debit balance (under-collection). The Company earns the difference between the higher carrying charge and the lower rate that it can borrow to cover the under-collection.
- The anticipated duration of the credit or debit balance situations described above, will provide an incentive for the Company to act. If the credit or debit balance can persist for months or years, then it would only be prudent money management practice for the Company to maximize interest income or minimize interest expense. Similarly if the debit or credit balance durations were short and of highly unpredictable duration, then the Company would likely find it impractical to actively pursue a few dollars of interest income or expense.

As stated in the last bullet point a regulated utility would generally be expected to act prudently in all of its operations including its money management. In the long run prudent money management would benefit ratepayers with lower rates than otherwise. However, the situation is complicated when the utility is part of a holding company structure, which Rocky Mountain Power is. There may be situations where the parent holding company can extract the benefit of the debit or credit balances to the detriment of ratepayers. For example, if the utility has a large cash balance that might be the result of over-collection on the accounts under consideration, then the parent company might take out a loan from the subsidiary and invest the proceeds at a (expected) higher return than the carrying charges the subsidiary utility has to pay. Without strict regulatory oversight of such a transaction between the parent and the subsidiary utility, utility ratepayers would see no benefit from the interest rate arbitrage engaged in by the parent company. However, the Division is unaware of situations of loans between PacifiCorp and its parent in the manner described above.

Analysis of the Company's balances.

The Division investigated the relationship between certain interest rates, the current carrying charge, and certain major accounts of Rocky Mountain Power where carrying charges are applied. The Division notes that historically the DSM account was under collected at three periods in time. The first was during the implementation of DSM when the surcharge was set up, the second was during the run on the home insulation program, and the last was when the Company filed to cancel the DSM sur-credit Schedule 194 and to modify the Cool Keeper program from a contractor owned and managed system to a utility owned two-way communicating system.[2] Typically, the DSM sur-charge was set with the intent to zero out the DSM balance yearly.

Funds received from Customers under the Blue Sky program cover program costs and match Renewable Energy purchases to Block purchases. Funds not spent after covering program costs and matching Renewable Energy purchases may be used to fund "Qualifying Initiatives" such as solar panels installed on schools that are used for teaching renewable conservation. Qualifying initiatives are not funded until the completion of the project. Therefore, qualifying initiative program funds are normally retained for approximately one to two years after funding is awarded. Because of this, the Blue Sky Program typically carries a balance and therefore maintains a carrying charge that is included in the program funds for the year.

[2] Docket No. 13-035-136, RMP Application to Cancel Schedule 194

The Division collected information from the Company regarding the monthly balances of five of the above accounts. DPU Exhibit 3 sets forth a chart of these monthly balances between January 2002 and May 2015. DPU Exhibit 2 sets forth a chart of various interest rates obtained from the Federal Reserve Board of Governors.[3] The Division analyzed the correlations between the program balances and interest rates and did not find any strong correlations. This analysis suggests that program balances are not being influenced by the current interest rates. An opposite conclusion might have been an indication of manipulation of balances by the Company.

Analysis of Carrying Charges versus Market Interest Rates.

In its investigation of Questar Gas Company carrying charges in Docket No. 14-057-32, the Division found that in the mid-1990s when the Commission adjusted the carrying charges from typically 9.0 percent to the 6.0 percent level, about this same time the Commission also established a fixed 6.0 percent carrying charge for Rocky Mountain Power's customer security deposits and customer overpayments. DPU Exhibit 2 shows that in 1997 the 90-day commercial paper rate was about 5.5 percent and the long-term bond rates and the bank prime lending rates were about 1.5 to 2.5 percent above the 6.0 percent rate. Currently the bank prime lending rate is 3.25 percent, where it has been since 2009; in September 2015 the average Baa and Aaa bond rates is about 4.70 percent; and the 90-day commercial paper rate is around 0.14 percent. Therefore, in the 1990s when the 6.0 percent fixed charge was established, a 6.0 percent rate fit comfortably within the range of short and long-term rates. As can be seen on DPU Exhibit 2, that fit is no longer there.

[3] See http://www.federalreserve.gov/releases/h15/data.htm last accessed October 23, 2015.

The rates for the RBA and the Home Energy Lifeline are based upon the Company's embedded debt rate as established in the most recent rate case. While this rate changes from time to time as the Company has rate cases, the embedded rate does not reflect the actual borrowing rate of the Company at any point in time, but is a weighted average of rates spanning decades. To keep the carrying charges current, the Division believes it is more important that the rates reflect more closely the Company's actual current borrowing costs. This would tend to keep the Company whole if it should have to effectively loan money to a program, and at the same time would pay customers a reasonably current market-based rate for monies loaned to the Company through these programs.

Lastly, two programs, Demand-Side Management (DSM) and Blue Sky are based upon the Company's authorized weighted average cost of capital. The Division sees no reason to reward the Company's stockholder because the Company temporarily lends money to a program. The Division believes these programs' carrying charges should reflect more of the Company's current borrowing rate as well.

Conclusion and Recommendation.

In selecting a carrying charge rate, the Division is aware that there is no perfect, one-size-fits-all rate. If purely incenting the Company to keep balances at zero were the only motivation, one could richly reward ratepayers with a high interest rate paid on over-collections and "reward" the Company with little or no interest paid on under-collections. The Division also expects that there should be a rough relationship between the carrying charge level and the risk of recovery. For example, the Division believes that there is relatively low risk of recovery of DSM funds; therefore those balances do not warrant the premium carrying charge they have been receiving.

The Division believes it is unreasonable to expect the Company to be able to meaningfully control funds flowing into or out of these accounts over lengthy time periods, therefore it appears to the Division that a single interest rate balancing the interests of rate payers and the Company that has been employed to date, combined with continued regulatory monitoring of the account balances, to be the most reasonable approach. Since longer-term interest rates are typically more stable, and because the short-term rates are much more subject to manipulation by federal monetary policy, the Division believes that a readily available longer-term rate is appropriate. If the Commission believes that a move to lower, shorter-term rates is more appropriate, then it would likely be best to do that in steps in keeping with the general principle of gradualism.

The Division recommends that the Commission adopt the average of the annual Aaa and Baa Corporate interest rates for the preceding calendar year as published by the Federal Reserve Board of Governors. The Division believes that periodically revising the carrying charges will keep these charges more in-line with current market rates. The Division proposes that the annual updated rates first go into effect on March 1, 2016 and then on March 1 of succeeding years. The March to February fiscal year allows for the collection of annual data from the preceding year to be collected and evaluated.

CC Bob Lively, Rocky Mountain Power
Michele Beck, Office of Consumer Services
Service List