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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

Charles Peterson, Technical Consultant

Jeff Einfeldt, Utility Analyst

Lane Mecham, Utility Analyst

Date: September 15, 2017

Re: **DPU Comments Relating to the Sharing Band in the Energy Balancing Account.**
Docket No. 17-035-01 (As referenced by 09-035-15)

RECOMMENDATION

The Division of Public Utilities (Division, or DPU) reiterates its position from previous Energy Balancing Account (EBA) filings and testimony in Docket No. 09-035-15 that the original 70/30 sharing band provided incentives for PacifiCorp (the Company) to manage its costs and share business risk with ratepayers and reduce the fluctuations in customers' bills from year to year. The elimination of the sharing band is a significant shift of risk to ratepayers.

ISSUE/REQUEST

The Public Service Commission (Commission) has invited comments from interested parties by September 15, 2017, regarding the Commission's report to the Public Utilities and Technology Interim Committee. DPU's comments relate to the EBA in general and the 70/30 sharing band.

DISCUSSION AND COMMENTS

In May of 2016, S.B. 115, the Sustainable Transportation and Energy Plan Act (Act) became effective. The bill "allows an electrical corporation to recover 100% of the electrical corporation's prudently incurred costs in an energy balancing account." Prior to the Act, any difference between Base net power costs (NPC) and actual NPCs were passed through the EBA, subject to a 70/30 "sharing band". The EBA was established by the Commission in Docket No. 09-35-15. The sharing band eliminated recovery or payment of 30% of the variation between Base NPC's and Actual NPC's.

In Docket 09-035-15, the Division, the Office, and some intervenors argued the sharing band was in the public interest. The parties argued that a sharing mechanism would be necessary to retain economic incentives to "promote optimal planning, expansion and efficient operation that would otherwise be lost if all excess net power cost were passed on to customers.[1]" The Commission concluded that the sharing band was necessary to keep both the Company and ratepayers at risk:

> We recognize, however, relying solely on prudence reviews will shift too much of the risk for suboptimal planning and operation currently borne by the company, who is in the best position to manage this risk, to customers, who are not. Therefore, the balancing account we adopt requires both Company, customers and shareholders to remain at risk for a portion of the actual net power cost which deviates from approved forecasts. This decision recognizes the value of Company management having meaningful financial incentives to minimize net power cost in the short-run and long-run, regardless of the extent of net power cost volatility. We find a sharing mechanism is the best method, at this point, to ensure customer and shareholder interests are aligned and the public interest is maintained.[2]

The only party opposed to the sharing mechanism in the docket was the Company, which argued that there were ample opportunities for review of the prudency and that the sharing mechanism was unnecessary.

[1] Docket No. 09-035-15, In the Matter of the Application of Rocky Mountain Power for Approval of its Proposed Energy Cost Adjustment Mechanism, March 2, 2011, Report and Order, p. 39
[2] Docket No. 09-035-15, In the Matter of the Application of Rocky Mountain Power for Approval of its Proposed Energy Cost Adjustment Mechanism, March 2, 2011, Report and Order, p. 69

SUBSEQUENT FINDINGS

In May of 2016 the DPU filed comments with the Commission on its evaluation of the PacifiCorp EBA, part of which included the evaluation of the sharing mechanism (DPU Report)[3]. The DPU asked other interested parties for comments to be addressed in the DPU Report. The Division also solicited comments from its outside consultants Daymark Energy, which were also included in the DPU Report. As set forth in the DPU Report, the Utah Association of Energy Users (UAE), the Division, and Daymark all concluded that the sharing band was in the public interest and that the changes made in SB 115 to allow 100% recovery of costs further shifted risks onto ratepayers and minimized the incentives for good decision making[4]. It was further argued by DPU that the volatility of customers' bills had increased significantly since the creation of the EBA, which is magnified by the removal of the 70/30 sharing band since it funnels more costs through the surcharge/credit on customers' bills[5].

The DPU Report also highlighted the fact that even though a shift in risk onto ratepayers had occurred, the return on equity had not been adjusted to compensate for the reduction in risk the Company previously assumed. Generally, financial and economic theory suggests that investors are rewarded with higher returns when more risk is assumed by the investors, and lower returns when fewer or no risks are assumed. Though the company now faces less risk it has maintained its allowed return.

CONCLUSION

The Division believes the EBA is beneficial to the Company with little to no net benefit to ratepayers. The elimination of the sharing band further benefits the company and magnifies the problem of shifting risks onto ratepayers. It also does not compensate ratepayers for this

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3 Docket No. 09-035-15, In the Matter of the Application of Rocky Mountain Power for Approval of its Proposed Energy Cost Adjustment Mechanism, May 20, 2016, Redacted Comments from the Division of Public Utilities
4 Docket No. 09-035-15, In the Matter of the Application of Rocky Mountain Power for Approval of its Proposed Energy Cost Adjustment Mechanism, May 20, 2016, Redacted Comments from the Division of Public Utilities, pp. 60, 65.
5 Docket No. 09-035-15, In the Matter of the Application of Rocky Mountain Power for Approval of its Proposed Energy Cost Adjustment Mechanism, May 20, 2016, Redacted Comments from the Division of Public Utilities, p. 29.

additional risk by adjusting the return on equity for the Company. By effectively guaranteeing the Company 100% recovery of its net power costs it misaligns the Company's incentives in forecasting, managing net power costs, accounting for net power costs, and overall operational efficiency. The Division recommends that the EBA be eliminated, but should it survive a sharing band should be reinstated to maintain a reasonable level of incentives to the Company to manage the risks it faces, and not simply pass those risks to ratepayers.

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