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BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application of Rocky Mountain Power to Decrease the Deferred EBA Rate through the Energy Balancing Account Mechanism	RESPONSIVE COMMENTS OF UIEC Docket No. 17-035-01

Pursuant to the Courtesy Notice issued by the Utah Public Service Commission ("Commission" or "PSC") on March 23, 2017 in Docket No. 17-035-01, the Utah Industrial Energy Consumers intervention group ("UIEC")[1] hereby submits these Comments in Response to the Initial Comments filed by the Division of Public Utilities ("Division" or "DPU"), the Office of Consumer Services ("Office") and Rocky Mountain Power ("RMP" or "Company") on September 15, 2017.

[1] The UIEC was granted intervention in this docket on October 13, 2017. The intervening parties are identified as Tesoro Refining & Marketing Company, LLC, Lafarge Holcim Ltd., and Post Consumer Brands, LLC d/b/a Malt-O-Meal Brands.

The Commission requested comments and responsive comments from the parties on "whether allowing an electrical corporation to continue to recover [100% of the electrical corporation's prudently incurred] costs under subsection (2)(d) [of the EBA statute] is reasonable and in the public interest."

A. Response to the Division's Initial Comments.

The Division's Comments in this docket recommend that the EBA should be eliminated.[2] The Division concludes, as did its report on the EBA Pilot Program,[3] that the EBA benefits only the Company, with little or no net benefit to ratepayers."[4] It states that the "elimination of the sharing band further benefits the company and magnifies the problem of shifting risks onto ratepayers."[5]

The UIEC agree with the Division's conclusions. The EBA, Section 54-7-13.5, requires that for an EBA to be effective, it must be found to be in the public interest.[6] The Commission has identified three essential criteria for the EBA to be in the public interest: [7]

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[2] Division Comments at 4.

[3] Final Evaluation Report of PacifiCorp's EBA Pilot Program, Docket 09-035-15 (filed May 20, 2016) ("Pilot Rep.").

[4] *Id.* at 3.

[5] *Id.*

[6] The EBA statute provides that "[a]n energy balancing account shall become effective upon a commission finding that the energy balancing account is: (i) in the public interest; (ii) for prudently-incurred costs; and (iii) implemented at the conclusion of a general rate case." Utah Code Ann. § 54-7-13.5(2) (2010). Once approved, the EBA must be "maintained" in accordance with the requirements of Section 54-13.5 (which includes the "public interest" requirement) to avoid constituting impermissible retroactive ratemaking (*id.* at § 54-7-13.5(4)(c).)

[7] The meaning of the "public interest" must be derived "from the purposes of the regulatory legislation in question." *Ellis-Hall Consultants, LLC v. Pub. Serv. Comm'n*, 342 P.2d 256, 261 (Utah 2014) (*quoting NAACP v. Fed. Power Comm'n*, 425 U.S. 662, 669, 96 S. Ct. 1806, 48 L.Ed.2d 284 (1976)). The Commission has generally required that for the public interest standard to be met, there must be some net benefit to ratepayers. *See, e.g., In the Matter of the Merger of the Parent Corps. of Qwest Communications Corp., LCI Int'l Telecomm. Corp. and US West Communications, Inc.* ("*Qwest Merger*"), Report and Order at 14, Docket No. 99-049-41, 2000 WL 873341 (Utah PSC, June 9, 2000) (applicants must show that the merger "provides a *net positive benefit* to the public") (emphasis

> To serve the public interest and to ensure just and reasonable rates, most importantly this new mechanism must [1] fairly allocate risk between customers and shareholders, [2] maintain incentives to operate efficiently, both in the long-run and short-run, and [3] satisfy the requirements of the Energy Balancing Account statute.[8]

In its order approving the pilot EBA, the Commission found that the energy cost adjustment mechanism as originally filed by RMP did not fairly allocate risks and did not provide adequate incentive to the Company to minimize net power costs by operating efficiently.[9] Therefore, the energy cost adjustment mechanism proposed by the Company could not be found to be in the public interest without including some way to fairly allocate risk between customers and shareholders.[10] The Commission ultimately approved the "EBA pilot program" but declined to rely on prudence reviews alone to ensure that the Company was incentivized to minimize its power costs. Instead, it conditioned approval upon a mechanism by which the risk of deviating from forecasted power costs was shared between the Company and ratepayers.[11]

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added); *see also In the Matter of the Application of PacifiCorp and Scottish Power plc for an Order Approving the Issuance of PacifiCorp Common Stock*, Report and Order at 26-27, Docket No. 98-2035-04 (Utah PSC, Nov. 23, 1999) (The Commission "is to consider [all positive benefits and negative impacts], giving each its proper weight, and determine whether on balance the [proposal] is beneficial or detrimental to the public.").

[8] Corr. Rep. and Order, Docket 09-035-15 at 67-68 (Mar. 3, 2011).

[9] *Id.* at 66-67; *see also id.* at 69-70 ("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.") (emphasis added).

[10] *Id.* at 66-67, 69.

[11] *See* Division Comments at 2. The Division quoted the following section of the Commission's Order, which stated the Commission's rationale for approving an EBA with 70-30 sharing bands:

> 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*

In its Comments, the Division notes (as reported in its Pilot Report) that there was a general consensus[12] among most parties 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 risk onto ratepayers and minimized the incentive for good decision making."[13] The UIEC believe that the 70-30 sharing band provided some incentive to the Company, but that the EBA is generally not in the public interest, with or without sharing bands, because no sharing mechanism can sufficiently incentivize prudent action.[14] Nevertheless, the UIEC agree with the Division that, by eliminating the 70-30 sharing mechanism, SB 115 has removed all remaining risk from the Company, degrading the EBA into the same mechanism that the Commission previously determined is not in the public interest without a risk sharing mechanism.

The Division's Comments also recommend that the EBA should be discontinued because, among other things, the EBA does not compensate ratepayers for the additional risk they take at 100-0 by adjusting the Company's return on equity.[15] The EBA allows the Company to adjust

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the best method, at this point, to ensure customer and shareholder interests are aligned and the public interest is maintained.

Corr. Rep and Order at 69-70 (emphasis added). (The Division's Comments cite to the same language, but from the Commission's uncorrected Report and Order, Docket 09-035-15 at 69-70) (March 2, 2011)

[12] The UIEC took the position that the EBA statute would permit a sharing mechanism, but neither opposed nor supported the sharing mechanism. *See* Post-Hearing Brief of UIEC, Docket No. 09-035-15 at 37-38 (Dec. 13, 2010).

[13] Division Comments at 3 (citing Pilot Rep. at 60, 65); *see also id.* at 2-3 (Division commenting that Commission has already concluded that "the sharing band was necessary to keep both the Company and ratepayers at risk.") (*quoting* Report and Order, Docket No. 09-035-15 at 69 (March 2, 2011)).

[14] Rocky Mountain Power confirms: "the reality is that sharing bands have no effect on the operations of the Company." RMP Comments at 6.

[15] Division Comments at 3-4.

its power costs from year to year, even in periods of over earning,[16] without the need to file a general rate case where the Company's rate of return could be examined and adjusted to account for the additional ratepayer risk.

The UIEC agree with the Division that RMP's rate of return should be reviewed and adjusted to reflect its risk. At the same time, the method of setting of base power costs should also be examined separately to ensure that the Company is not incentivized merely to perform to its forecasted energy case, but to actually minimize net power costs. Truing up the deviation from forecasted costs protects the utility's rate of return but it does not ensure that ratepayers are receiving energy at the lowest reasonable cost.

The UIEC support the Division's conclusion that the EBA benefits only RMP; it provides little or no benefit to ratepayers; it does not share the risk between RMP and ratepayers; it fails to incentivize RMP to efficiency in forecasting or managing its net power costs; it is therefore not in the public interest and it should be eliminated.[17]

B. Response to UAE Comments.

The EBA allows the Company to use an abbreviated proceeding to recover its "prudently incurred," "actual power costs."[18] The assumption underlying the EBA is that actual, prudently incurred costs can be determined through an audit of the Company's transactions. That assumption has turned out to be false. The Division's experience, after more than five years of reviewing EBA filings, is that prudence reviews of the Company's power costs, especially its

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[16] *See* Division's Pilot Report at 29-31 (Company earning its authorized rate of return even with the 70/30 bands in place, yet the EBA had not resulted in any reduction in energy rates, rate volatility, or the need for annual rate increases). The Division states, "If the Company can earn its allowed rate of return with the 70-30 sharing band, then it will over-earn without the sharing bands with everything else held constant." *Id.* at 31.

[17] *See* Division Comments at 4.

[18] Utah Code Ann. § 54-7-13.5(2)(a), (1)(b).

daily power transactions, are insufficient to meaningfully assess the prudence of those power costs.[19]

The UAE's Comments in this docket illustrate the problem with relying on prudence reviews. The Company must manage the dispatch of its system every hour of every day, and it engages in a very large number of power purchase and sales transactions every year.[20] The Division can review only a small percentage, despite its diligent effort and despite expending substantial time and resources in performing audits.[21] Given the complexity of the system and the volume of power transactions, even with unlimited time and resources, the Division's auditors will never know whether the Company efficiently managed its dispatch or whether a front office transaction was prudent because the Division cannot know the market price or the available options at the moment a transaction or dispatch decision was made.

The UAE concludes that "it is far preferable to harness the natural economic self-interest of the Company than to rely on after-the-fact prudence audits to review the reasonableness of past actions."[22] The UIEC agree. Rather than asking in an audit whether the Company prudently

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[19] *See* Pilot Rep. at 17. The difficulty in determining prudence has not been resolved. In its Pilot Report, the Division stated it had no confidence that it is "virtually impossible" to meaningfully assess the prudence of the Company's daily transactions, nor would it be able to do so even with improved documentation. Pilot Rep. at 43. At hearing on the Pilot Program, held on January 17, 2017, the Division testified that it could not attest to the audit results as being "a statistically accurate representation of the universe of [net power costs]." *See* Report and Order, 09-035-15 at 4 (Feb. 16. 2017) (quoting Hr'g Transcript (384480A) at 13:9-11). The Division stated it has no evidence to reasonably believe that reported net power costs are materially inaccurate (*id.*), but neither could it confirm accuracy.

[20] *See* UAE Comments at 4 (during 2016, the Company engaged in more than 11.8 million MWh of long-term, intermediate-term and short-term firm purchase transactions, and more than 12.4 million MWh sales transactions).

[21] Pilot Rep. at 5, 22, 41-45; *see also* Hr'g Transcript, Docket No. 09-035-15 at 44:2-14 (Jan. 17-2017) (out of "tens of thousands" daily transactions involved in an EBA review, the Division's audit typically includes a review of "about 60.")

[22] UAE Comments at 4-5.

dispatched its system or whether tens of thousands of front office transactions were prudent, the Company should simply be put at risk for managing its power costs.

The UIEC do not believe that sharing bands are an adequate solution to ensure the accuracy and prudence of power costs. Cost recovery should depend, instead, on whether customers are receiving power at the lower of the Company's cost of generating power or the market price for power at the time the power is consumed. The Company's cost of purchased power can and should be measured against the market, and the Company should bear the risk of deviating from market pricing. If the ratepayers are to share any of that risk, they should be provided with real-time, accurate information about their consumption and pricing, so that they have some means to manage the risk.

C. Response to RMP's Comments.

RMP's Comments conclude that elimination of the sharing band positively impacts customers because, among other things, it ensures that customers pay the actual costs for the energy they consume.[23] The Company claims that sharing bands have "no effect on the operations of the Company," and that it is required to provide power in "a least-cost manner" in any event.[24] It states that "the Company always faces the possibility that an action or decision could be deemed imprudent resulting in 100 percent of the cost being absorbed by shareholders." *Id.*

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[23] RMP Comments at 8. Presumably, RMP would have customers pay the "actual cost of power" even if the actual cost is unreasonably high as a result of the Company's inefficiencies. RMP also claims the elimination of the sharing band "keeps the NPC component of rates just, reasonable and in the public interest; helps maintain overall customer rate stability by mitigating the need for more frequent general rate cases; and helps ensure customers are served by a financially healthy utility." *Id.*

[24] RMP Comments at 5-6.

The UIEC agree that RMP is always subject to disallowance for imprudence. But, it is preferable to prevent imprudence by placing the Company at risk for its decisions than to rely on after-the-fact prudence reviews. Disallowance can only occur when imprudence is discovered, which, for the reasons discussed above, is extremely difficult. The 70-30 split was adopted to address that difficulty – to incentivize prudence to some degree in an attempt to balance the risk between shareholders and ratepayers.[25]

At the same time RMP recognizes its obligation to provide power in a "least-cost manner," it acknowledges that its "true" incentive is to earn its authorized rate of return by avoiding a disallowance for imprudent actions.[26] The Company is thus conflicted between its obligation to minimize power costs and its incentive to earn its rate of return. Because the EBA cannot be readily audited, it does not provide a meaningful incentive to the Company, and regulators cannot be sure that RMP is providing energy at the lowest reasonable cost. In enacting SB 115, the Legislature has thus created for the Commission an intractable dilemma in having to protect the Company's earnings by allowing full recovery of net power costs, while also attempting to ensure that energy is delivered to consumers at the lowest reasonable cost by a utility that has no incentive to act prudently. The conflict is inherent in the EBA and made worse by elimination of the sharing bands.

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[25] The Commission has recognized that the risk of actual costs differing "detrimentally and substantially from forecasted costs" is a "zero sum game, where all benefits flow to one group (customers or shareholders) at the expense of the other." Corr. Rep. and Order at 70.

[26] RMP Comments at 6-7.

RMP's Comments also assert that, while a sharing band sometimes may be justified, it is not justified when "the risk being shared is a forecast risk."[27] It claims that a sharing band is ineffective to manage that risk and that, because "the current regulatory structure in which rates are set provides sufficient protection to customers," customers should bear the risk of net power cost forecasts as well as the variations between actual and forecasted net power costs.[28]

The UIEC disagree. The current EBA provides virtually no protection for ratepayers. EBA audits are of limited efficacy in policing accuracy or prudence; the Company has no other incentive to act prudently; and the regulatory structure allows RMP to avoid an adjustment to its rate of return by not filing a rate case. In the meantime, RMP is recovering 100% of the difference between actual net power costs and out-of-date forecasts (which RMP said it would be willing to abandon if the EBA were approved),[29] while placing the risk of inaccurate forecasts on the ratepayers.[30] What began as an EBA regulatory structure with a risk sharing mechanism and an offer from the Company to abandon forecasted power costs, has become a mechanism with a dollar-for-dollar true-up based on a stale forecast, which allows the utility to protect its earnings by indefinitely avoiding an adjustment to its rate of return. Even with sharing bands, the Division concluded that the regulatory structure of the EBA benefits only the Company.[31] The removal of the sharing bands is just the final nail in the coffin of ratepayer protection.

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[27] RMP Comments at 7.

[28] *Id.*

[29] *See* Rebuttal Testimony of Greg Duvall, Docket No. 09-035-15 at 3:57-59 (Dec. 10, 2009) ("RMP has an interest in recovering its prudently incurred net power costs and is willing to abandon forecasts of net power costs in favor of allowing the Commission to determine if net power costs incurred by RMP are prudent.")

[30] RMP Comments at 7.

[31] Division Comments at 3.

D. Response to Comments of the Office of Consumer Services.

The Office of Consumer Services takes a wait-and-see approach, suggesting that it is premature to draw conclusions about the elimination of the 70-30 sharing band until the end of the current EBA reconciliation proceeding, which will conclude in March of 2018.[32] The UIEC doubt that waiting until the current proceeding is concluded will clarify the question of whether the EBA without a sharing mechanism is in the public interest. Although the 2017 EBA process includes additional time for the Division to complete its audit,[33] relying solely on prudence audits will not adequately ensure the public interest is served, for all of the reasons discussed above. The EBA cannot be in the public interest regardless of how the 2017 process turns out.

CONCLUSION

Even with the 70-30 sharing bands, the EBA was not in the public interest. While the sharing bands placed a portion of the risk on the Company, regulators could never be confident that only actual, prudently incurred costs were passed through the EBA. With the enactment of SB 115, all risk is now placed on ratepayers, and all incentives for the Company to manage that risk have been removed. The EBA is not in the public interest and it should be eliminated.

Dated this 16th day of October, 2017.

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[32] OCS Comments at 2.

[33] *See* Order, Docket No. 09-035-15 at 17, 27-28 (Feb. 16, 2017) (approving schedule allowing the Division until November 17 to file audit report and ordering an interim rate to go into effect on May 1 to be amortized through April 30 of the following year.) The portion of the Order ordering an interim rate is currently on appeal to the Utah Court of Appeals. *Utah Office of Consumer Serv. v. Utah Pub. Serv. Comm'n*, Case No. 20170364-CA (filed May 5, 2017).

CERTIFICATE OF SERVICE
(Docket No. 17-035-01)

I hereby certify that on this 16th day of October, 2017, I caused to be e-mailed, a true and correct copy of the foregoing RESPONSIVE COMMENTS OF UTAH INDUSTRIAL ENERGY CONSUMERS to:

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