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November 6, 2017

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Members of the Public Utilities, Energy, and Technology Interim Committee

Re: Report from Public Service Commission of Utah ("PSC") under Utah Code Ann. § 54-7-13.5(6)

Senators and Representatives,

Under Utah Code Ann. § 54-7-13.5(6), the PSC is required to report before December 1 in 2017 and 2018 "regarding whether allowing an electrical corporation to continue to recover costs under Subsection [54-7-13.5](2)(d) is reasonable and in the public interest." For simplicity, this report will refer to Under Utah Code Ann. § 54-7-13.5(2)(b) as "Subsection (2)(b)."

Energy Balancing Account ("EBA") Background

In 2009, the Utah Legislature enacted S.B. 75, creating the EBA statute codified at Utah Code Ann. § 54-7-13.5. The statute authorizes the PSC to establish the EBA, an account to track expenses by an electrical corporation that fall into the category of net power costs. Net power costs generally include fuel costs necessary to generate electricity, costs and revenues associated with an electrical corporation's purchase and sale of electricity, and certain transmission costs.

An electrical corporation like Rocky Mountain Power must forecast its net power costs in each general rate case. Prior to the EBA statute, for a year in which Rocky Mountain Power did not file a general rate case, the utility would be able to recover costs from ratepayers only for the previously forecasted net power costs. If actual net power costs were higher than the forecasted costs, utility shareholders were responsible for the difference. If actual net power costs were lower than the forecasted costs, utility shareholders would benefit from the difference.

In March 2011, the PSC issued an order implementing an EBA for Rocky Mountain Power. That order included a risk-sharing mechanism for the difference between actual net power costs and the forecast from the most recent general rate case. Under that risk-sharing mechanism, Rocky Mountain Power was allowed to recover from ratepayers 70% of net power costs that exceeded the forecasted costs, and was required to refund ratepayers for 70% of the net power costs that are lower than the forecasted costs. In the order the PSC concluded that the risk-sharing mechanism "preserves [Rocky Mountain Power's] financial incentive to minimize net power cost both in the short-run and the long-run."

During the 2016 General Session of the Utah Legislature, S.B. 115, Sustainable Transportation and Energy Plan Act, in addition to authorizing several policy-based utility programs, enacted Subsection (2)(b) which states: "Beginning June 1, 2016, for an electrical corporation with an [EBA] established before January 1, 2016, the [PSC] shall allow an electrical corporation to recover 100% of the electrical corporation's prudently incurred costs as determined and approved by the [PSC] under this section." As required by Subsection (2)(b), the PSC discontinued operation of Rocky Mountain Power's EBA risk-sharing mechanism on June 1, 2016.

S.B. 115 requires this report from the PSC and a parallel report in 2018. The bill also provides a sunset date for Subection (2)(b). Under that sunset date, absent future legislative action, Subsection (2)(b), which prohibits the use of the risk-sharing mechanism, is repealed on December 31, 2019.

EBA Dockets

Since the approval of Rocky Mountain Power's EBA, the utility has filed six separate dockets with the PSC, seeking to adjust its net power costs. The chart below summarizes those dockets.

PSC Docket – Date Filed	Rate Increase/(Refund) Requested	Rate Increase/(Refund) Approved by PSC	Application of Risk-Sharing Mechanism
12-035-67 – 3/15/12	$29,286,005	$27,800,000	Yes
13-035-32 – 3/15/13	$17,394,963	$15,000,000	Yes
14-035-31 – 3/17/14	$28,339,553	$25,300,000	Yes
15-035-03 – 3/16/15	($14,432,000)	($15,539,000)	Yes
16-035-01 – 3/15/16	($13,088,000)	($15,569,000)	Yes for costs incurred before June 1, 2016, no for later costs.
17-035-01 – 3/15/17	($6,542,837)	Currently being litigated	No

Stakeholder Feedback

In March 2017, the PSC solicited feedback from stakeholders on the PSC's report, which is required by statute to address whether Subsection (2)(b) "is reasonable and in the public interest." The PSC received comments from the following stakeholders: Rocky Mountain Power, the Utah Division of Public Utilities ("Division"), the Utah Office of Consumer Services ("Office"), the Utah Association of Energy users ("UAE"), and the Utah Industrial Energy Consumers ("UIEC"). Those comments are summarized below:

<u>Rocky Mountain Power</u>

Rocky Mountain Power supports the elimination of the risk-sharing mechanism allowing a full recovery of its net power cost through the EBA. Rocky Mountain Power states this outcome:

- benefits customers and is in the public interest because it ensures customers only pay the actual costs for the energy they consume;
- is standard throughout the utility industry;
- helps mitigate the need for frequent rate case proceedings; and
- ensures customers are served by a financially healthy utility.

Rocky Mountain Power contends that risk-sharing mechanisms are ineffective in reducing costs and managing risk, and highlights the following issues:

1. Permanent elimination of the risk-sharing mechanism keeps utility rates just, reasonable, and in the public interest because customers pay the actual costs of the energy they consume and receive accurate price signals upon which those customers can base their consumption decisions. Changes in net power costs are uncontrollable variables, so there is no justification for cost sharing. Full costs are passed through to customers in general rate cases, more accurately reflecting the utility's revenue requirement; while a risk-sharing mechanism incentivizes artificial manipulation of net power cost forecasts.

2. Only seven states with non-restructured power markets incorporate similar risk-sharing mechanisms. Of those, only three have mechanisms with sharing of less than 90 percent of the differences between forecasted and actual power costs. In Utah, Dominion Energy has a similar balancing account that does not include a risk-sharing mechanism.

3. Risk-sharing mechanisms are an ineffective incentive to reduce costs and manage risk. Rocky Mountain Power must provide safe and reliable energy in a least-cost manner, and risks passing to its shareholders 100 percent of any cost deemed imprudent. Prudent actions, not a percentage of the difference between actual and forecasted costs, are the proper economic incentives. Perfect cost forecasting is impossible, but the utility still has an obligation to serve its customer load in a cost effective way.

Rocky Mountain Power contends other stakeholders:

- narrowly focus on cost recovery and fail to address how "customers paying the actual costs of the energy they consume is not just and reasonable and in the public interest;" and
- provide no evidence for the conclusion that an EBA without a risk-sharing mechanism results in a misalignment of the utility's incentives in forecasting, managing, and accounting for costs, and in maintaining operational efficiency.

Rocky Mountain Power argues that the risk-sharing mechanism has no impact on its operations, citing a Division audit from 2016 and stating that forcasted costs are a rate-setting baseline rather than a standard for operations. The utility asserts that the appropriate operational standard is serving load in the least cost manner, not the unattainable standard of acquiring energy at the base forecast; and that increased scrutiny and a more thorough prudence review ensures it serves load in a least cost manner.

Rocky Mountain Power states the risk-sharing mechanism has served its purpose of providing a gradual change in ratemaking practices and is no longer necessary. The utility argues it has an economic self-interest in minimizing costs and is highly motivated to earn a fair return for its shareholders in the face of increasing competition from self-generation and direct access, forces that were not present when the EBA was approved. Rocky Mountain Power disputes the recommendation that its authorized rate of return should be adjusted to compensate for the elimination of the risk-sharing mechanism, drawing a comparison to Dominion Energy.

Utah Division of Public Utilities

The Division states the risk-sharing mechanism is in the public interest and contends its elimination represents a significant shift of risk to ratepayers. The risk-sharing mechanism provided incentives for the utility to better manage its costs, share business risk with ratepayers, and reduce the fluctuations in customers' bills from year to year. According to the Division, elimination of the risk-sharing mechanism "misaligns the Company's incentives in forecasting, managing net power costs, accounting for net power costs, and overall operational efficiency." The Division asserts the volatility of customers' bills has increased significantly since the creation of the EBA. It claims this volatility has been magnified by the removal of the risk-sharing mechanism and notes that there has been no adjustment to Rocky Mountain Power's approved return on equity "to compensate for the reduction in risk PacifiCorp previously assumed" under the EBA with the risk-sharing mechanism.

The Division recommends that the EBA should be eliminated, or that if it is retained, the risk-sharing mechanism should be reinstated to "maintain a reasonable level of incentives to [Rocky Mountain Power] to manage the risks it faces, and not simply pass those risks to ratepayers."

Utah Office of Consumer Services

The Office concludes it is premature to determine whether allowing Rocky Mountain Power to recover 100 percent of its net power costs through the EBA is reasonable and in the public interest. The Office states it cannot determine whether a risk-sharing mechanism is reasonable considering:

- the PSC's recent approval of other changes to the EBA in addition to the removal of the risk-sharing mechanism;
- impacts from implementation of other S.B. 115 provisions.

The Office claims that until a currently in-process audit report from the Division and subsequent PSC processes are complete, stakeholders will lack sufficient evidence to provide significant input regarding the elimination of the risk-sharing mechanism. The Office states that because of the timing of this report, “there is little information on which to draw conclusions about the reasonableness of the [elimination of the risk-sharing mechanism].”

The Office disputes Rocky Mountain Power’s assertion that the EBA has provided greater rate stability or has benefitted customers due to a lower incidence of rate case proceedings, arguing that the utility lacks an incentive to file a general rate case to adjust its forecast since it recovers all forecast variances in the EBA. The Office also disputes Rocky Mountain Power’s claim that the risk-sharing mechanism adversely affected customers by denying them full refunds, providing data to argue the risk-sharing mechanism provided over $40 million in relief to customer bills before its elimination in S.B. 115.

Utah Association of Energy Users

UAE contends the risk-sharing mechanism “struck a reasonable balance between customers and shareholders” and served as a “meaningful incentive” for Rocky Mountain Power in managing its net power costs. UAE claims the risk-sharing mechanism provides Rocky Mountain Power “a material stake in each of the actions and decisions related to power costs,” bringing its interests into alignment with those of its customers. UAE argues that when Rocky Mountain Power shares in the benefits and risks of its decisions, it has a strong incentive to perform well in managing costs. UAE asserts the risk-sharing mechanism is especially critical given Rocky Mountain Power’s extensive around-the-clock dispatch and balancing requirements and fuel procurement activities.

UAE asserts it is 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,” and argues that without a risk-sharing mechanism, Rocky Mountain Power would be “economically indifferent” with respect to management of certain aspects of its operations. UAE also notes that the other states that regulate Rocky Mountain Power’s parent company, except California – which represents the lowest share of the company’s load – utilize some form of a risk-sharing mechanism. UAE recommends that if any extension of the EBA is permitted beyond December 31, 2019, the risk-sharing mechanism should be reinstated.

UAE disputes Rocky Mountain Power’s comparison of the EBA with a cost recovery account used by Dominion Energy, contending there are structural differences between the two utilities in that “a significant portion of the Dominion Energy customer load has the freedom to purchase its gas supplies in the competitive market, whereas Rocky Mountain Power customers in Utah are 100% captive to Rocky Mountain Power (except for self-generation).” UAE contends that when customers have no alternative suppliers to a utility, it is more important that the right economic incentives are set in place to manage costs that are passed on to customers.

Utah Industrial Energy Consumers

UIEC argues that with the removal of the risk-sharing mechanism from the EBA, customers assume all risk, leaving Rocky Mountain Power with no incentive to manage that risk. UIEC contends that even with the risk-sharing mechanism, the EBA was not in the public interest because regulators could never be confident that only actual, prudently incurred costs were passed through the EBA. UIEC states the EBA should be eliminated. UIEC expresses support for many of the arguments made by the Division and UAE but expresses doubt about the Office's assertion that more clarity may develop as the current EBA proceeding at the PSC is concluded.

Public Service Commission Perspective and Conclusion

As noted previously in this report, in 2011 the PSC concluded that the risk-sharing mechanism "preserves [Rocky Mountain Power's] financial incentive to minimize net power cost both in the short-run and the long-run." Subsection (2)(b) eliminated the risk-sharing mechanism, but the PSC has not modified that conclusion. The comments filed with the PSC by stakeholders with respect to this report were consistent with the positions of those stakeholders for several years: Rocky Mountain Power supports elimination of the risk-sharing mechanism; all other stakeholders dispute the utility's position for various reasons.

The Utah Legislature must decide before the 2019 General Session whether to:

- extend the sunset date for Subsection (2)(b) which would continue to prohibit the PSC from implementing a risk-sharing mechanism; or
- allow Subsection (2)(b) to sunset, which would authorize the PSC to reinstate a risk-sharing mechanism.

The PSC was neutral during the 2016 General Session on the reversal by S.B. 115 of the PSC's decision to implement a risk-sharing mechanism for Rocky Mountain Power's EBA, and remains neutral on what action the Legislature should take with respect to Subsection (2)(b).
The dominant reason for PSC neutrality at this point is that we have already been asked by multiple stakeholders to conclude whether the EBA, without a risk-sharing mechanism, remains in the public interest. We have issued an order delaying that evaluation until after the Legislature decides whether or not to allow Subsection (2)(b) to sunset, but still may have to adjudicate that issue in the future. Additionally, at some point we may be required to adjudicate whether Subsection (2)(b) warrants a change to Rocky Mountain Power's allowed rate of return.

We must examine future EBA proposals on their merits as demonstrated by the record evidence in the appropriate PSC docket. We see no way to take an affirmative position with respect to whether or not Subsection (2)(b) should be allowed to sunset without compromising or abandoning our ability to adjudicate future EBA issues in an unbiased way. Therefore, we have focused this report on providing background on the EBA and Subsection (2)(b), and on summarizing the positions of various stakeholders. We hope we have summarized those positions accurately. The full text of their comments can be found on the PSC website: https://psc.utah.gov/2017/01/09/docket-no-17-035-01/.

We hope this information is helpful. Please reach out to us with any questions or concerns about our administration of the EBA, the previous risk-sharing mechanism, or Subsection (2)(b).

Respectfully submitted,

/s/ Thad LeVar, Chair
/s/ David R. Clark, Commissioner
/s/ Jordan A. White, Commissioner
Public Service Commission of Utah