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BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF ROCKY MOUNTAIN POWER FOR BINDING RATEMAKING TREATMENT FOR WIND REPOWERING	**CASE NO. PAC-E-17-06** **COMMENTS OF THE COMMISSION STAFF**

COMES NOW the Staff of the Idaho Public Utilities Commission, by and through its attorney of record, Camille Christen, Deputy Attorney General, and in response to the Notice of Proposed Settlement, Notice of Modified Procedure and Notice of Comment Deadline issued in Order No. 33939 on November 30, 2017, in Case No. PAC-E-17-06, submits the following comments.

BACKGROUND

On July 3, 2017, Rocky Mountain Power filed an Application requesting the Commission (1) determine that a decision to "repower" its existing wind fleet is prudent; (2) approve the Company's proposed ratemaking treatment for the cost recovery of new equipment required to repower the Company's wind facilities, and (3) approve the continued recovery of replaced wind equipment.

On October 19, 2017, the parties to the case—the Company, Staff, Idaho Irrigation Pumpers Association (IIPA), Monsanto, and PacifiCorp Idaho Industrial Customers (PIIC)—met to discuss potential settlement. On November 21, 2017, all parties agreed to a Settlement Stipulation (Stipulation) which is included here as Attachment A. Staff now submits these comments supporting the Stipulation. Staff's comments are organized into the following sections:

I. Staff Position Summary
II. Project Overview
III. Prudency Review
IV. Cost Recovery Evaluation
V. Asset Disposition

I. <u>Staff Position Summary</u>

Staff supports the Stipulation, in which the parties agreed that the Company's decision to repower certain wind facilities is prudent. Staff's support is based in part on the Company providing ongoing evaluation and notifying the Commission of all material changes in circumstances in order to allow for additional review. Additionally, the Company is required to mitigate ratepayer risks that are within its control. The specific terms are detailed in the Prudency Review section below.

Staff also supports the Stipulation's terms regarding cost recovery—specifically, the Resource Tracking Mechanism (RTM) as a component of the Energy Cost Adjustment Mechanism (ECAM) to enable recovery of the new wind facility investments and the undepreciated balance of the replaced assets until the revenue requirement is reflected in base rates. The cost recovery terms are described in the Cost Recovery Evaluation section.

Finally, Staff supports the Stipulation's requirements regarding replaced assets. The specific terms related to undepreciated assets are discussed in the Asset Disposition section.

II. <u>Project Overview</u>

The Company is planning to upgrade 12 of its 13 existing wind facilities totaling approximately 1000 MW of installed capacity to take advantage of a time-limited opportunity to extend Production Tax Credit (PTC) benefits for another ten years. This benefit is primarily economic, given that the first capacity deficit date doesn't occur until 2028 and because there is only a marginal increase in the amount of capacity as a result of the project.

The existing wind facilities were first installed between 2006 and 2010, all of which qualified for ten years of PTCs at that time. The original PTC benefits associated with the facilities begin expiring in August of 2017 and will be totally expired by October of 2020. These PTC benefits are currently passed through to ratepayers at 100 percent in the ECAM. By replacing the nacelle (that is, the generator at the top of the wind tower) and the rotor blades and hub with more efficient and higher capacity equipment, the Company and ratepayers will gain an additional ten years of PTC benefits and at least an additional ten years of useful life from the facilities. The Company should also see higher levels of capacity and generation as compared to the existing equipment, and reduced operation & maintenance cost (O&M) due to newer and improved equipment.

III. Prudency Review

Staff believes the project has a high likelihood of providing positive net benefits to ratepayers when coupled with the risk-mitigating provisions contained in the Stipulation. This conclusion is based on (1) Staff's thorough review of the Company's economic analysis, (2) a comprehensive evaluation of risk factors, and (3) risk-mitigation provisions that were included in the Stipulation. Staff acknowledges that some risk remains, but believes the amount of remaining risk is acceptable.

Staff believes that the Company's economic evaluation of the project is reasonable and in many ways conservative. The Company compared the relative system net present value revenue requirement difference (PVRR(d)) between operating with the project and operating without the project over the investment's 30-year useful life. The Company also calculated the PVRR(d) across 9 different alternative futures including different combinations of low, medium, and high natural gas price forecasts and zero, medium, and high carbon dioxide (CO_2) cost adders to understand their economic impact. According to the Company, with medium natural gas and CO_2 price assumptions, wind repowering results in customer benefits of $359 million. Application at 7. (The Company estimated benefits at $41 million assuming low natural gas prices and zero CO_2 costs, and at $589 million assuming high natural gas prices and high CO_2 costs. *Id.*) All scenarios assume that the repowered projects receive 100% of the available PTCs.

As part of its project evaluation, Staff identified and assessed several risks that could impact estimated net benefits and placed them into two categories based on the Company's ability to mitigate them.

Risks the Company Can Control or Can Mitigate

The first category of risks are ones the Company can control. The Stipulation includes a number of provisions to mitigate the impact of these risks on ratepayers. For example one of the most significant risks is that the repowering project might fail to qualify for PTCs under Internal Revenue Service (IRS) rules (the 80/20 test and the safe harbor requirement discussed in the Company's Application at 5-6). The Company has designed the project and taken action to mitigate this risk. *See* Application at 5-6. Further, under the Stipulation, the Company will bear the risk of loss of PTCs in the event repowering project does not qualify for PTCs under those IRS rules. Stipulation, Paragraph #10. If the Company does not meet these provisions, Staff expects that the Company will calculate PTC benefits to be passed through the ECAM to ratepayers as if full PTC benefits are being realized for the ten years the Company is eligible.

There is also a risk that project investment costs or future O&M costs may exceed estimates, thereby reducing net benefits. Under the Stipulation, the Company will cap the annual actual cost by the amount of annual benefits, thereby ensuring that the project pays for itself during the implementation phase of the project and while the cost cap in the RTM is in place. *Id.* Paragraph #9.

Another risk is that the repowering equipment may not perform as expected. Under the Stipulation, the Company will pass on all liquidated damages it receives from equipment suppliers to ratepayers in case the repowered equipment does not meeting specified availability, performance, or installation schedule requirements. *Id.* Paragraph #7.

There are also risk factors the Company cannot control but can mitigate prior to committing capital investment. For example, one significant risk is a change in the corporate income tax rate which could significantly reduce the revenue requirement benefit from PTCs. The Company will be required to monitor and evaluate all conditions and circumstances, both within and outside of the Company's control, that could change the viability of the project. *Id.* Paragraph #16. The parties have agreed that if there is a material change in circumstances, including a change to federal tax laws or changes in projected costs or benefits, the Company will make a filing with the Commission to allow for additional review and a determination of whether the Company should proceed. *Id.*

Risks the Company Cannot Control and that are Difficult to Mitigate

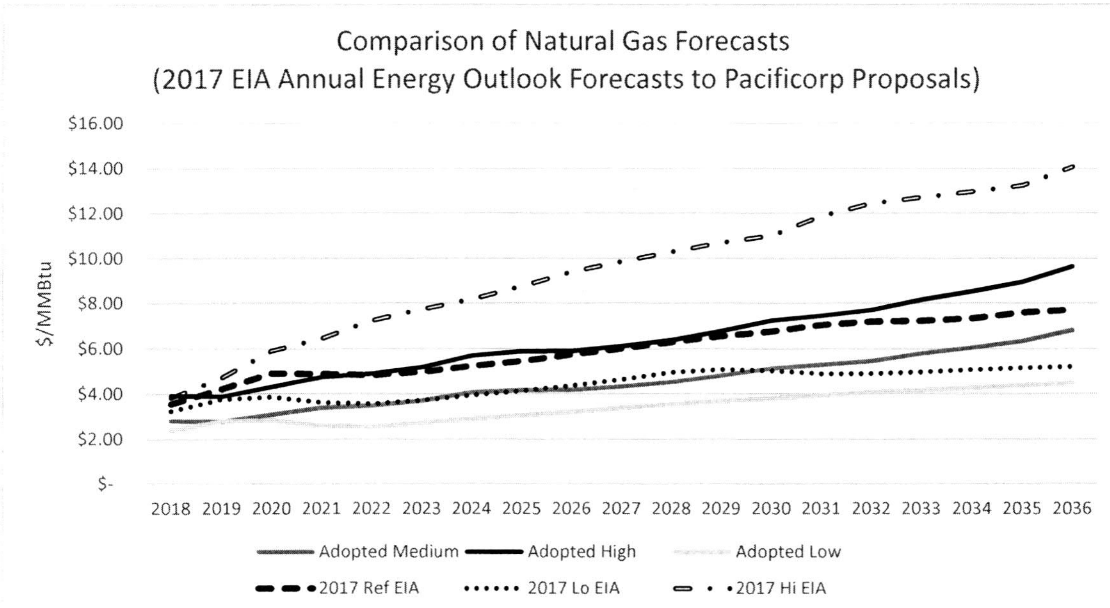
There are also remaining risks outside of the Company's control that are nearly impossible to mitigate after the project has been implemented. This includes factors such as changes to natural gas prices, CO_2 cost adders, and tax code changes after the project has been implemented.

Natural Gas Price Risk

There is a risk that the actual price of natural gas is lower than assumed by the Company, decreasing net benefits from the project. This would make the next best alternative base case, which uses increased gas-fired generation, more beneficial in comparison to the project. Staff draws two conclusions based on its evaluation. First, natural gas prices can have a large impact on the economics of the project. Second, although the Company used a reasonable range of natural gas price forecasts, Staff believes they are somewhat conservative compared to the most recent Energy Information Administration (EIA) forecasts and that the project benefits could be greater than estimated.

A higher natural gas price forecast has a significant effect on project economics making the project more beneficial to customers. The Company's high natural gas forecast increases benefits by about $360 million as compared to the Company's low natural gas forecast (both assuming zero CO_2 cost). This is because the additional amount of zero-cost fuel generation as a result of the repowering displaces natural gas generation the Company would need to meet load.

Staff also concludes that the Company's forecasts are conservative based on their being consistently lower than EIA's forecasts, as illustrated in the graph below. If actual gas prices are closer to EIA's forecasts, ratepayers will experience more upside benefits than the Company has estimated.



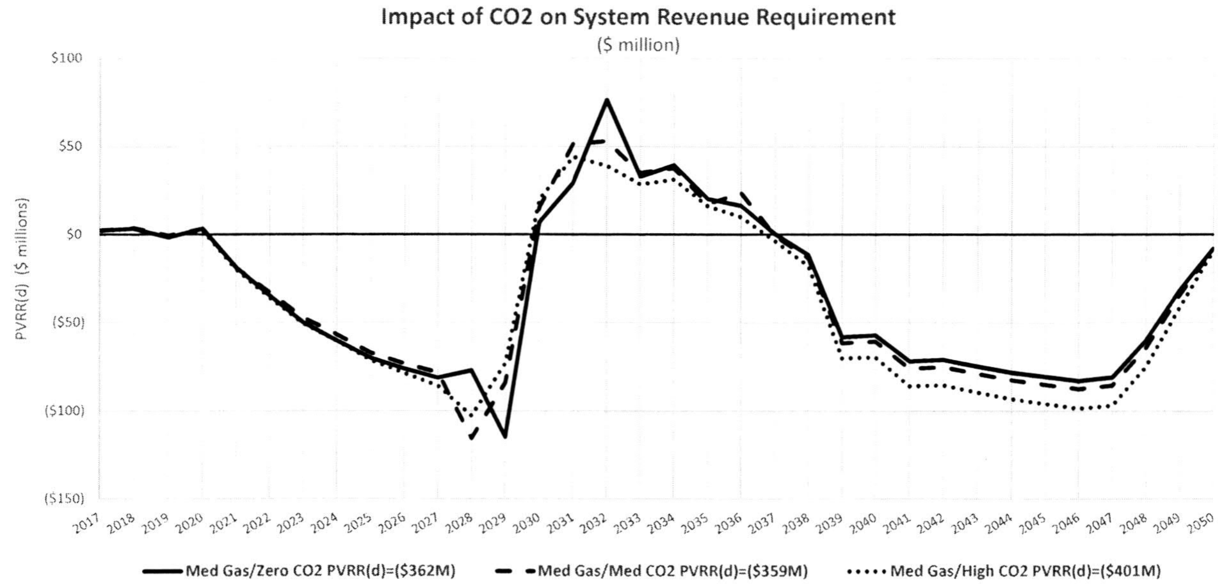
To the extent that natural gas prices are less than the Company's forecasts, the result could be reduced benefits. There are two provisions included in the Stipulation that could mitigate this risk: the RTM cost cap described in Paragraph #9, in which the parties agreed that the annual cost to customers would be capped by the amount of annual benefits, and the requirement that the Company file with the Commission in case of a material change in circumstances, as described in Paragraph #16. However, once the project is implemented, there is very little that could be done to mitigate the effects of lower than assumed natural gas prices. Regardless, Staff believes the natural gas price risk is low overall because of the Company's conservative natural gas assumptions.

CO2 Regulation Risk

Staff believes that the Company used a conservative, yet reasonable range of CO2 cost to evaluate the CO2 regulation risk and concludes that the risk to ratepayers is insignificant. The risk associated with CO2 regulation is if the actual cost of CO2 is lower than what the Company assumed in its analysis.

The Company assessed the worst case for the repowering project using a zero cost for CO2 in its economic evaluation. It resulted in favorable PVRR(d)s across all three natural gas forecasts. Any incremental CO2 cost, such as the Company's medium or high CO2 cost scenarios, only provides additional upside benefit.

Although higher levels of CO2 cost provides better project economics, the effect is relatively small. This is illustrated in the graph below by the small amount of difference in annual revenue requirement differentials between the three CO2 adders the Company evaluated.



Because the project has positive economics without federal CO2 regulations in place, Staff believes mitigation of CO2 price risk is not necessary. If federal CO2 legislation is enacted creating a price on carbon emissions, ratepayers will capture potential upside benefits from the project.

Staff also identified a potential risk that the capacity factors of the wind facilities may be lower in the future than they have been in the past, thereby jeopardizing the economics of the repowering project. Staff believes this risk is low—the Company has almost ten years of historical actual wind generation data for each site and used it to determine the amount of generation that will occur once the facilities are repowered. There is little evidence that conditions at the sites will change in the future and even if it did, this is not within the Company's ability to control. However, if wind conditions at these sites change enough to make the project uneconomic in the short term, the RTM cost cap outlined in Paragraph #9 of the Stipulation will protect ratepayers at least until the cap is removed and the RTM is no longer used for cost recovery.

Conclusion Regarding Prudency

The parties retain the ability to challenge the prudence of actual costs and benefits incurred in implementing the repowering project when the Company seeks recovery of the costs in a later proceeding. Stipulation, Paragraph #15. In addition, the Company will provide a report of net power cost (NPC) and PTC benefits associated with the project in its ECAM filing until the project is included in base rates. *Id.* Paragraph #11. This will enable parties to challenge recovery of costs and benefits associated with the project. These provisions further mitigate risk to ratepayers. Based on its review and the provisions in the Stipulation that mitigate risk, discussed above, Staff believes the Stipulation is in the public interest and should be approved.

IV. **Cost Recovery Evaluation**

Staff supports the Stipulation's provisions outlining cost recovery for the project. The provisions most important to Staff include the following:

1. The use of the RTM modified through the Stipulation providing the Company with cost recovery so that benefits are matched with costs prior to the project being included into base rates (Stipulation, Paragraph #8).
2. Flexibility to extend the use of the RTM and the cost cap for a length of time sufficient to ensure ratepayers can realize full benefits of the project (Stipulation, Paragraph #9).
3. An after-tax return on investment of 6.45% to be used in the RTM for both repowered and replaced assets until a new return is authorized in the next general rate case or federal tax rate change case (Stipulation, Paragraph #8).
4. The jurisdictional equity provided by the ability to modify the Stipulation with better terms and conditions negotiated in other jurisdictions (Stipulation, Paragraph #17).

Each of these provisions are discussed in more detail below.

Resource Tracking Mechanism (RTM)

Staff fully supports the use of an RTM so that the Company can begin recovery of project costs when benefits start accruing. *Id.* Paragraph #8. Without the RTM, ratepayers would begin to see NPC and PTC benefits that automatically flow through the ECAM while the Company incurs costs without recovery until there is a rate case. The RTM will ensure an equitable match of project costs with project benefits until the project can be included in base rates.

The RTM will work in conjunction with the ECAM. The annual balance of project cost and benefits in the RTM will be included in a separate section of the ECAM and added to the ECAM deferral balance for recovery through ECAM Schedule 94 rates.

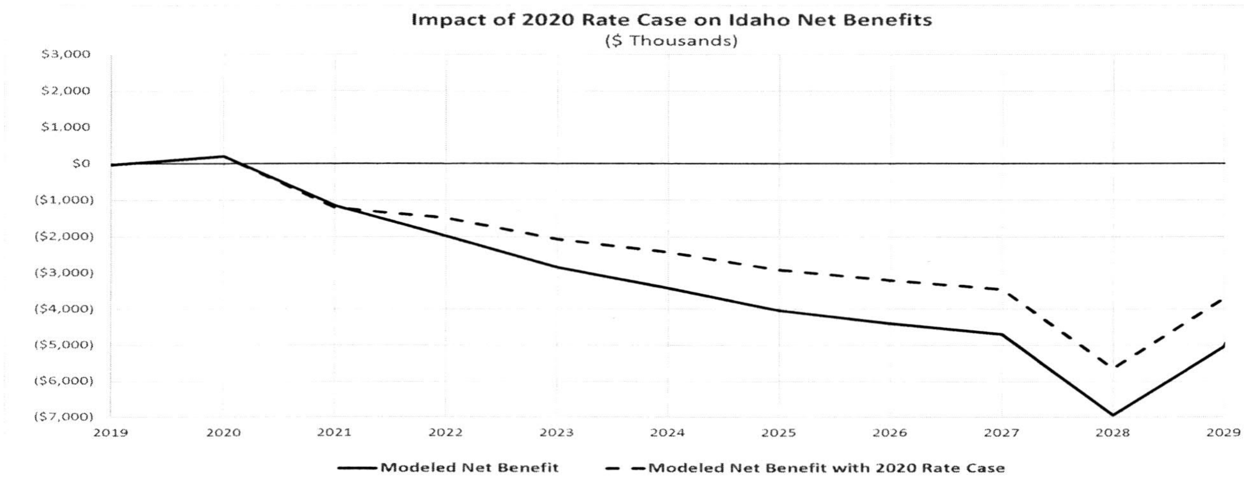
If approved, the RTM will track capital-related expense, O&M cost, depreciation, and taxes including a Wyoming wind tax. Benefits included in the RTM come primarily from PTCs provided for each megawatt-hour of wind generated from the repowered facilities and reduced NPC.

The RTM features a cap that limits the amount of annual project revenue requirement subject to recovery by the amount of annual benefits. *Id.* Paragraph #9. This provides cost mitigation as described above. The RTM also passes 100 percent of the NPC benefits to customers while the ECAM would normally only allow 90 percent pass through due to customer sharing.

<u>Extended Use of RTM</u>

The option to extend the RTM, including the cost cap, past the next general rate case and to keep the recovery of the project separate from base rates should be seriously considered during the Company's next general rate case. *See id.* Paragraph #9. This provision is beneficial to ensure ratepayers realize the full potential net benefits from the project as reflected in the Company's Application.

The amount of net benefits in the Company's PVRR(d) analysis used to justify the project captures declining capital recovery costs and reflects total estimated costs and benefits for each year of the project's life. However, if the Company files a general rate case in the 2020 timeframe, ratepayers will not see the benefit of declining capital recovery costs because they will be held constant at test year amounts between general rate cases. This effect is illustrated in the graph below.



The solid line represents the net benefit stream (negative amounts represent a positive net benefit) the Company used to justify the project over the first ten years while the dashed line represents the net benefits customers will see if there is a rate case in 2020 and cost recovery is locked into base rates for ten years. Staff's analysis shows that customers will lose approximately $10 million in net present value benefits over this time frame which is represented by the area between the two curves.

Staff also supports the option to extend the cost cap in the RTM, not to exceed the eligibility timeframe of PTCs. *See id.* Although it is unlikely to be needed during the timeframe that the project is earning PTCs, the cap provides ratepayers with stopgap risk mitigation requiring the Company to share some of the risk in case of unforeseen circumstances. Staff believes this is appropriate for a project that is almost totally based on economics and not on the need for capacity.

<u>Rate of Return</u>

Staff considered risk and rate of return in its evaluation of the reasonableness of the RTM and proposed project. It is Staff's position that the RTM reduces rate recovery risk to the Company while providing benefits to customers. While the current authorized return on equity (ROE) in Idaho for Rocky Mountain Power is 9.9 percent, Staff evaluated the impact on revenue requirements using various other ROE levels, including 9 percent and 9.5 percent, to reflect current market conditions and lower risk if the RTM is approved. Considering this evaluation, the parties did not specify particular ROE but agreed to utilize a 10.4 percent pre-tax return on investment to calculate the RTM revenue requirement. *See id.* Paragraph #8. This equates to an after-tax return on investment of 6.45 percent. *Id.* This rate applies to both repowered and replaced equipment assets.

Jurisdictional Equity

Staff supports the ability to modify the Stipulation based on more favorable terms and conditions that may be negotiated with other state jurisdictions. *Id.* Paragraph #17. Idaho is the first state jurisdiction to develop a stipulated settlement and the parties did not have the benefit of reviewing settlements in Utah and Wyoming to consider other terms. If either Utah or Wyoming obtain approval of a settlement, the parties in Idaho have agreed to reconvene and reconsider the terms and conditions contained in the other stipulation(s) and, if needed, realign the Idaho Stipulation with agreements in other jurisdictions.

V. Asset Disposition

Staff fully supports the provisions related to the disposition of replaced assets outlined in Paragraphs #12, #13, and #14 of the Stipulation.

Paragraph #12 clarifies the accounting treatment for depreciating replaced assets and the reporting of net depreciation expense included in the RTM as outlined in Jeffrey Larson's Direct Testimony. The parties also agreed upon provisions that requires the Company (1) to report on the disposition and salvage value of replaced assets (*Id.* Paragraph #13), and (2) to maximize the salvage value of the replaced equipment and to do it in a timely manner or else it "may affect cost recovery and return on remaining replaced assets." (*Id.* Paragraph #14). This provides an incentive for the Company to work toward shared goals in dispositioning these assets.

STAFF RECOMMENDATIONS

Staff recommends that the Commission approve the Settlement Stipulation as proposed.

Respectfully submitted this 13th day of December 2017.

Camille Christen

Camille Christen
Deputy Attorney General

Technical Staff: Mike Louis

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY THAT I HAVE THIS 13TH DAY OF DECEMBER 2017, SERVED THE FOREGOING **COMMENTS OF THE COMMISSION STAFF,** IN CASE NO. PAC-E-17-06, BY MAILING A COPY THEREOF, POSTAGE PREPAID, TO THE FOLLOWING:

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