Decision No. C04-476

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF COLORADO

DOCKET NO. 03A-436E

IN THE MATTER OF THE APPLICATION OF PUBLIC SERVICE COMPANY OF COLORADO FOR AN ORDER AUTHORIZING IT TO IMPLEMENT A PURCHASED CAPACITY COST ADJUSTMENT RIDER IN ITS PUC NO. 7 - ELECTRIC TARIFF.

ORDER GRANTING APPLICATION, IN PART

Mailed Date: May 10, 2004
Adopted Date: May 4, 2004

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I. BY THE COMMISSION

A. Introduction

1. On October 3, 2003, Public Service Company of Colorado (Public Service or the Company) filed an application for an order authorizing it to implement a Purchased Capacity

Cost Adjustment Rider (PCCA) to recover the incremental purchased capacity costs actually paid to third-party power producers that are not currently being recovered in its base rates. Public Service also proposes to modify the operation of the Earnings Test for 2004 through 2006 to provide for return of 100 percent of any earnings in excess of its authorized rate of return on equity to customers. It proposed this modification in order to alleviate any concerns that it might realize any windfall as a result of the implementation of the PCCA.

2. Public Service also provided a brief history of how it came to file the PCCA application. Public Service explains that the Commission approved its plan to enter into power purchase contracts for over 1,900 megawatts (MW) of new capacity, as part of the 1999 Integrated Resource Planning docket (IRP), Docket No. 99A-549E. The new capacity was scheduled to come on line over several years to be available to Public Service's customers. Public Service states that, since 2002, large amounts of capacity have or will come on line[1] and that the capacity costs associated with the new resources are substantial.

3. Public Service further represents that it was not able to include those capacity costs as part of the recently concluded Phase I rate case due to the timing of when the capacity was scheduled to come on line.[2] Therefore, it did not have the flexibility to time the Phase I rate proceeding to coincide with the anticipated additional

[1] Public Service lists 876 MW from Calpine (Blue Spruce and Rocky Mountain Energy Center) and 246 MW from Front Range Power (Colorado Springs Utilities and El Paso Energy) as having come on line or will come on line.

[2] Public Service points out that it filed its Phase I rate case, Docket No. 02S-315EG, on May 31, 2002 based on a test year ending December 31, 2001. According to Public Service, the timing of this filing had been agreed to as part of the settlement of the merger proceeding involving New Century Energies, Inc. and Northern States Power Company to create Xcel Energy, Inc.

purchased capacity costs it would incur beginning in 2003. Public Service asserts that, without the PCCA adjustment mechanism, it will incur substantial known and measurable increases in the level of purchased capacity payments paid to third-party power suppliers beginning in 2003 to meet its customers' electric needs without having the means to recover those costs.[3]

4. The PCCA mechanism, according to Public Service, is patterned after the Qualifying Facilities Capacity Cost Adjustment (QFCCA) that was in effect from 1993 until April 30, 2003. Public Service represents that the principal difference between the QFCCA and the proposed PCCA is its proposal to calculate the PCCA percentage rider based on the projected purchase capacity costs and the forecasted level of base rate revenues for the years during which the rider will be in effect. Public Service claims that using projected costs and revenues to calculate the rider will provide for a more accurate matching of costs and revenues since the PCCA will be based on the level of costs Public Service expects to incur during the time it is in effect, and will keep the level of deferred purchased capacity costs to a minimum.

5. In addition to approval of the PCCA, Public Service also seeks to alter the Earnings Test sharing mechanism for 2004 through 2006 to return 100 percent of any earnings above 10.75 percent[4] to its customers. Since the PCCA would provide for dollar-for-dollar recovery of incremental purchased power capacity costs, while other costs included in its approved base rates might be declining, Public Service argues that the alteration to the Earnings Test sharing mechanism it proposes should alleviate concerns that the PCCA would allow it to

[3] Forecasted total PUC jurisdictional capacity costs will grow to $333,242,432 during 2004 and $353,882,568 in 2005. According to Public Service, this represents a 16.5 percent increase ($47,316,502) in costs for 2004 and 23.8 percent ($67,956,638) increase in costs for 2005 over the level of purchased capacity costs in the base rates approved in Phase I.

[4] 10.75% is the rate of return on equity authorized for Public Service's Electric Department by the Commission in Docket No. 02S-315EG.

over-recover its electric utility cost of service. By including all revenues and expenses associated with purchased capacity in the Earnings Test, and by agreeing to return 100 percent of any excess earnings over 10.75 percent to customers, Public Service assures the Commission and interested parties that it will not realize any windfall as a result of decreases in costs.[5]

II. PROCEDURAL HISTORY

6. On October 3, 2003, Public Service filed its PCCA application with attached tariffs incorporating the proposed PCCA to be effective by March 1, 2004, and no later than April 1, 2004. Along with the application, Public Service also filed the direct testimony and exhibits of Fredric C. Stoffel, Vice President, Policy Development; Ronald N. Darnell, Director, Pricing and Planning; and Deborah A. Blair, Director, Revenue Analysis. Staff of the Commission (Staff); the Colorado Office of Consumer Counsel (OCC); the Colorado Energy Consumers (CEC),[6] Climax Molybdenum Company (Climax); and CF&I Steel, L.P. doing business as Rocky Mountain Steel Mills (CF&I) intervened in this matter. In Decision No. C03-1422, mailed December 18, 2003, we granted the petitions to intervene of CEC, CF&I and Climax and set the matter for hearing before the Commission *en banc*. We also set a pre-hearing conference for January 6, 2004, to deal with any pending motions, the timing of discovery, and the establishment of a procedural schedule.

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[5] For example, decreases in depreciation.

[6] Members of the CEC include, but are not limited to: Air Liquide America, Anheuser-Busch, Ball Corporation, Coors Brewing Company, Lockheed Martin, the University of Denver, Johnson & Wales University, Adams Twelve Five Star School District, and Denver Public Schools.

7. At the pre-hearing conference, we set a procedural schedule that required Answer Testimony to be filed by March 1, 2004, and Rebuttal and Cross-Answer Testimony to be filed by March 26, 2004. Hearings on the application were scheduled for April 14 through 16, 2004. Statements of Position were to be filed by April 23, 2004. We also ordered response time to direct testimony to be ten calendar days and objections to be filed within seven calendar days. Response time to Answer Testimony was limited to seven calendar days and five days for Rebuttal and Cross-Answer Testimony.

8. On February 17, 2004, Public Service filed the Supplemental Direct Testimony of Mr. Stoffel and Mr. Darnell and Supplemental Exhibit Numbers FCS-3 and RND-8 through RND-13. These filings changed Public Service's estimated customer impact of the PCCA for 2004, and included the Air Quality Improvement Rider (AQIR) credit. According to the supplemental testimony, assuming the PCCA takes effect on June 1, 2004 (given the procedural schedule we established in Decision No. C04-0053), the PCCA will increase from 2.53 percent (calculated for a March 1, 2004 implementation date) to 2.97 percent. Further, Public Service estimated that the impact to customers in 2004 with a June 1, 2004 implementation date would be less than that proposed in Public Service's direct testimony, because even though the rider is increased from 2.53 percent to 2.97 percent, the period the new rate is in effect for 2004 will be reduced from ten months to seven months.[7]

[7] Public Service represents in Direct Testimony Exhibit No. FCS-2 that the average residential customer would have paid $1.13 per month (or $11.30 over ten months) in 2004. The same average customer will pay $1.33 a month or $9.31 over seven months.

9. On February 27, 2004, we granted the request of the intervenors to extend the date for filing Answer Testimony to March 15, 2004 to allow the intervenors time to respond to Public Service's Direct Testimony and Supplemental Direct Testimony with one filing.

10. On March 3, 2004, we issued Decision No. C04-0221, which found that the procedural schedule adopted for this docket would not result in a Commission Decision on Public Service's application within 120 days of the application being deemed complete as required by § 40-6-109.5(1), C.R.S. Consequently, we extended to time to issue a decision an additional 90 days pursuant to § 40-6-109.5(1).

11. On March 11, 2004, we extended the deadline for Public Service to file its Rebuttal Testimony from March 26, 2004, to April 5, 2004. Additionally, on our own motion, we extended the date for filing Cross-answer Testimony to April 5, 2004, and enlarged the discovery cut-off dates as well.

12. On March 15, 2004, the intervenors filed Answer Testimony and exhibits objecting to various aspects of Public Service's proposed PCCA rider. Staff, while generally supporting a PCCA rider, nonetheless objected to specific portions of Public Service's proposal. Among other things (discussed in more detail *infra*), Staff recommends that we limit the inclusion of specific purchased power contracts only to those authorized by the Commission in conjunction with Public Service's 1999 Integrated Resource Plan (IRP) in Docket No. 99A-549E to be recovered in the proposed PCCA, and require that the PCCA expire on December 31, 2006.

13. The OCC generally agrees with Staff's recommendations. It indicates that it supports the PCCA so long as Public Service is limited to recover those capacity costs that were

included in the 1999 IRP. The OCC further recommends that Public Service be prevented from recovering those costs if it is over-earning (discussed in more detail *infra*), and that the PCCA automatically expire in 2006, unless there is a general rate proceeding before that time.

14. CEC, CF&I and Climax opposed the PCCA proposal. Those intervenors generally contended that Public Service's proposal contained a number of fundamental problems and shortcomings concerning single-issue ratemaking (described in more detail *infra*). Therefore, CEC, CF&I and Climax recommended that the Commission should not approve Public Service's PCCA proposal.

15. In Rebuttal Testimony filed by Mr. Stoffel, Mr. Darnell and Ms. Karen Hyde, Public Service generally refutes the claims and counterproposals offered by the intervenors. However, in his Rebuttal Testimony, Mr. Stoffel agreed that the PCCA rider should only remain in effect through calendar year 2006. In addressing OCC's concerns, Mr. Stoffel also testified that if the Commission is concerned that capping earnings will undermine Public Service's incentives, it would not object to OCC's proposal that all earnings above 10.75 percent return on equity (ROE) be used to offset the PCCA. If there are additional earnings above 10.75 percent ROE - beyond the amount needed to offset the PCCA - those earnings should be shared between ratepayers and shareholders according to Public Service's current tariff.

16. Consistent with the directives in Decision No. C04-0053, we conducted hearings on the PCCA on April 14-16, 2004. Witnesses for Public Service, Staff, OCC, CF&I and Climax, and CEC testified regarding Public Service's application. Now, being duly advised in the matter, we grant the application in part, consistent with the discussion below.

III. FINDINGS OF FACT AND DISCUSSION

A. PCCA Justification

17. Public Service asserts that it will incur substantial known and measurable increases in the level of purchased capacity payments paid to third-party suppliers beginning in 2003. Those costs are not being recovered in base rates. Company witness Mr. Stoffel requested (in the interest of administrative efficiency) that the Commission approve the PCCA as a cost recovery mechanism to recover these purchased capacity payments without an additional rate case. Mr. Stoffel claimed that the Company will forgo $31.5 million during 2004 if the PCCA is not approved.

18. Testimony provided by Staff and OCC reveals that a Stipulation with Respect to Purchased Capacity Cost Adjustment (Stipulation) was entered into by Public Service, Staff and OCC at the same time as the Settlement Agreement that resolved all issues in Public Service's Phase 1 rate case was entered into by Public Service, Staff and OCC, along with other parties. This Stipulation was not filed or provided to the Commission during the Phase 1 rate case. Staff explained that several parties to the Phase 1 rate case other than the signatories to the Stipulation preferred that it not be filed as part of the rate case. In the Stipulation, Staff and OCC agreed to support Commission approval of a PCCA mechanism for the years 2004 through 2006.

19. Staff generally agreedt with Public Service that a PCCA mechanism was appropriate. Staff witness Dr. Schmitz concurred with Public Service's assertion that it will incur substantial new capacity costs outside the test period of the just completed Phase 1 rate case, and, as such, a means was needed in this particular circumstance to allow Public Service to recover those costs.

20. OCC witness Mr. Reif testified that unique circumstances justify the use of a limited cost adjustment for a limited period of time. Mr. Reif noted that consumer demand for electricity has been growing dramatically and new power sources are necessary. He also noted that purchased capacity costs during 2004 to 2006 were not considered when base rates were established in the last rate case, and that requiring a new rate case to enable Public Service to recover these costs seemed inefficient.

21. CF&I and Climax witness Mr. Baron opposed the PCCA, testifying that it was inappropriate to implement a PCCA to allow recovery of the Company's incremental purchased power costs. According to Mr. Baron, the PCCA, as proposed by Public Service, does not adequately include the impact of all cost and investment changes that comprise the overall base rate revenue requirement.

22. CEC witness Mr. Binz argued that regulators should avoid using "automatic" cost adjustments. Rather, cost adjustment mechanisms should only be used when special conditions apply. For example, recovered costs should represent a significant portion of a utility's costs, should fluctuate significantly, and should be outside the utility's control. Mr. Binz argued that the purchased capacity costs at issue here will not fluctuate significantly and are not outside the utility's control.

23. In rebuttal testimony, Public Service witness Mr. Stoffel defends the Company's proposal by pointing out that large amounts of the obligation to pay for electric power are not included in the costs the parties settled upon in the last rate case. Further, the increases in purchased capacity costs not included in the rate case settlement are very large and significant. Mr. Stoffel also points out that, although there is a single jump from one level of costs to a higher

level of costs and then purchased capacity costs appear to stabilize, nevertheless these costs will be significantly higher in the next few years. Mr. Stoffel agrees with Staff and OCC that the PCCA should operate only through 2006. Mr. Stoffel maintains that Public Service cannot avail itself of the types of choices or actions suggested by CEC witness Mr. Binz (including making different choices in its resource plan, determining the term of wholesale contracts, or making demand side choices) during the short duration the PCCA will be in effect.

24. In its Statement of Position, Staff maintains that, although the Commission should generally avoid establishing automatic adjustment mechanisms, the circumstances associated with the capacity costs of the contracts approved in the 1999 IRP are extraordinary and warrant the creation of an automatic adjustment mechanism for a number of reasons. For instance, the 1999 IRP resources were reviewed and approved by the Commission in the 1999 IRP process. Further, there is a large increase in purchased capacity costs associated with the 1800 megawatts included in the 1999 IRP that, due to timing issues, could not be included in the 2001 test year of the last rate case. Staff also points out that Public Service would be forced to file a rate case in the current time frame if a mechanism is not developed to allow recovery of these capacity costs approved in the 1999 IRP proceedings. Consequently, Staff maintains that the PCCA is a limited solution to a unique and limited problem.

25. We agree that the capacity costs of the contracts ordered by the Commission during the 1999 IRP proceedings constitute an extraordinary and unique set of costs for Public Service. The costs of the contracts ordered by the Commission as a part of the 1999 IRP proceeding are substantial. Further, these costs comprise a sudden increase in capacity costs that Public Service could not have recovered in the last rate case. We consequently find that this

unique set of circumstances warrants implementation of the PCCA as a cost recovery mechanism.

B. Single-issue Ratemaking

26. Public Service, in Mr. Stoffel's Direct Testimony, admitted that its application for a PCCA may be viewed as single-issue ratemaking. However, Mr. Stoffel states that, because the Company was not able to time when the general capacity associated with the purchased capacity obligation in the 1999 IRP came on line, or the filing of its Phase 1 rate case, a PCCA is the most administratively efficient mechanism under the circumstances.

27. Staff witness Dr. Schmitz characterized piecemeal (single-issue) ratemaking as allowing a utility to increase rates to cover demonstrated increased costs associated with one cost category while failing to examine the utility's overall financial situation to determine whether other costs have decreased or revenues have increased. Dr. Schmitz asserted that proposals to implement automatic recovery mechanisms properly raise concern about single-issue ratemaking. However, it is Staff's opinion that the inclusion of the earnings test mechanism adequately addresses the concern about piecemeal ratemaking in this proceeding. As a result, Staff supports Public Service's proposal that 100 percent of any earnings be returned to ratepayers as a part of the earnings test mechanism.

28. CF&I and Climax witness Mr. Baron argued that Public Service's PCCA proposal should be rejected as single-issue ratemaking. Mr. Baron goes on to say that the problem with a proposal such as the PCCA is that it does not adequately address the impact of other cost and investment changes that comprise the overall base revenue requirement. In particular, base rate

expenses (other than the expenditures for capacity at issue here) may be declining, and these reduced expenses are not considered in this limited single issue docket.

29. CEC witness Mr. Binz points out that the proposed PCCA modifies the existing regulatory structure by isolating purchased capacity cost and recovering these costs separately through a tracking mechanism. Mr. Binz finds this modification to the existing regulatory structure unpalatable because of its implications for both the fairness of regulation and for the incentives faced by Public Service.

30. In Rebuttal Testimony, Public Service witness Mr. Stoffel agreed with CEC witness Mr. Binz and with CF&I and Climax witness Mr. Baron that the PCCA focuses on a specific set of known and measurable costs outside a general rate case. However, Public Service disagreed that the regulatory problem referred to as single-issue ratemaking is presented by the Company’s proposal. The usual regulatory concern about single-issue ratemaking—the concern that a utility would be given opportunity to earn more than its authorized rate of return—is mitigated by its proposal to return 100 percent of its earnings over authorized levels to ratepayers.

31. In its Statement of Position, Public Service characterized the regulatory concern about single-issue ratemaking as the concern that rates may be increased to recover an increasing cost category while there may be other cost categories where the costs are decreasing, which may result in excess earnings. Public Service asserts that, under its proposal, all earnings over the authorized level are returned to customers through the earnings test mechanism.

32. We agree that single-issue ratemaking should be approached with hesitancy. However, we agree that, in this particular case, administrative efficiency favors a cost recovery mechanism. We find that it would be impractical to conduct another rate case in the near future to allow Public Service to recover capacity costs that the Commission has ordered it to incur. Instead, we find that a PCCA mechanism provides a more reasonable means for Public Service to recover capacity costs of contracts ordered by the Commission. Further, based on representations made by the Company, we expect that it is highly likely that Public Service will file a rate case in 2006.

C. PCCA Mechanism

33. Public Service witness Mr. Darnell proposes a PCCA mechanism that will be used to calculate the percentage rider to be applied to all customer bills to recover the purchased capacity costs not being recovered through base rates. According to Mr. Darnell's proposal, the amount recovered in the PCCA will be decreased by the amount of purchased capacity cost collected through the AQIR, calculated by Public Service to be $1,800,000. As proposed, the PCCA rider will be calculated using the projected purchased capacity costs, projected retail jurisdictional percentage, projected retail revenues, test year purchased capacity costs, and the test year retail revenues. Specifically, a "base percentage" is determined by calculating the amount of 2001 pro forma retail purchased capacity cost as a percentage of 2001 pro forma retail revenues. This base percentage is 20.04 percent. Next, a "projected percentage" is determined by calculating the amount of projected retail purchased capacity cost as a percentage of projected retail revenues. The PCCA rider is the difference between the projected percentage and the base percentage.

34. Under Public Service's proposal, amounts that are over- or under-collected will be tracked in a deferred balance account. Public Service represents that it is not seeking to collect interest on any under-collections.

35. Public Service proposes that the PCCA become effective on June 1, 2004,[8] to remain in effect until rates go into effect upon completion of its next Phase 1 electric rate case. After the PCCA is initially implemented, the Company proposes to file its PCCA rider application annually on December 1, for a January 1 effective date. The deferred PCCA balance as of October 31 would be used to calculate the PCCA rider for the following year.

36. According to the unfiled Stipulation (discussed *supra*), the PCCA mechanism was to be designed to recover the Colorado jurisdictional portion of the Company's increasing incremental purchased capacity expense. The Stipulation states that the increases in purchased capacity expense would result *primarily* from known and measurable changes associated with power purchase agreements with winning bidders in the Company's 1999 IRP. As part of the terms of the Stipulation, Staff and OCC reserved the right to take issue with the mechanics and methods proposed by Public Service for the PCCA.

37. Staff generally supports the concept of a PCCA. However, Staff did object to the creation of an open-ended rider as proposed by Public Service. Staff argues that the cost recovery through the PCCA should be limited only to costs associated with specific contracts that were authorized by the Commission in the 1999 IRP. For instance, Staff witness Ms. Podein indicated that cost recovery should be limited to the resources that are part of Public Service's

[8] Public Service initially proposed that the PCCA become effective on March 1, 2004 and changed this proposed effective date due to the procedural schedule ordered by the Commission in this Docket.

base rates[9] plus the several specific IRP-approved resources that were not reflected in base rates. Those include: 1) Tri-State Brighton/Knutson; 2) SkyGen/Blue Spruce; 3) Front Range Power; and 4) Calpine Hudson/Rocky Mountain Energy Center. Staff contends that limiting the costs eligible for recovery through the PCCA in this manner is a more balanced approach to cost recovery.

38. Staff also argues that asymmetrical interest should be applied to the deferred balance so that the PCCA mechanism is consistent with the previous QFCCA mechanism. Like the QFCCA, Staff contends that the interest rate applied to over-collected amounts should be based on Public Service's most recent weighted cost of capital, while the interest rate applied to under-collected amounts should be based on Public Service's most recent customer deposit rate. Staff maintains that applying interest to the deferred balance amount provides the Company with an incentive to accurately project revenue, capacity expense, and the jurisdictional allocator, and to minimize over-collection.

39. Additionally, Staff contends that the rider should be expressed as a percentage with four decimal places. According to Staff, this improves the accuracy of the PCCA base and makes a significant difference in the amount to be recovered through the PCCA.

40. Staff prefers that the PCCA terminate on December 31, 2006, in conjunction with the termination of the Earnings Test. Staff points out that the Company's proposed dates for filing the PCCA rider does not leave sufficient time for Staff to review the filing. Therefore, Staff recommends that the PCCA rider be filed on or before November 1 for a January 1 effective

[9] *See E*xhibit No. RND-3, page 2.

date. Staff indicates that this recommendation may require use of a deferred balance as of September 30. Staff also recommends that the Commission require the Company to provide, as part of its annual filing, supporting work papers that detail monthly projected revenue, monthly projections of purchased capacity expense, and the projected jurisdictional allocator. Staff contends that receiving this information as part of the filing will speed the review process.

41. In Staff's view, the PCCA is not an appropriate mechanism for establishing the prudence of new capacity acquisitions. Rather, Staff suggests that the issue of prudence could be addressed in a manner similar to that in the Incentive Cost Adjustment mechanism, where the rider is allowed to go into effect and the Commission subsequently orders the Company to make an additional filing, if necessary, where the determination on the issue of prudence is made.

42. The OCC also supports the concept of a limited PCCA for a limited period of time. Like Staff, OCC contends that cost recovery through the PCCA should be limited to 1999 IRP resources.

43. The OCC also agrees that the PCCA should expire in 2006 unless there is a general rate case before that time. In support of a 2006 PCCA expiration date, OCC points out that the stipulation clearly states that the PCCA should be in effect for three years, 2004 through 2006. Additionally, OCC contends that it is not appropriate to have a PCCA in effect after the earnings test expires at the end of 2006, nor is it good public policy to have an open-ended PCCA.

44. On the other hand, CEC witness Iverson argues that, because the projected incremental revenues exceed the incremental costs of purchased capacity, there is no need for a

PCCA mechanism. CEC contends that Public Service's assumption that only 20 cents (base percentage of 20.04 percent) of every incremental dollar offsets purchased capacity costs, is not reasonable.

45. In Rebuttal Testimony, Public Service agreed that the PCCA rider should terminate on December 31, 2006. The Company does not object to Staff's proposal to express the PCCA percentages to four decimal places. Public Service also agrees to file the PCCA rider on November 1 for a January 1 effective date and use a September 30 deferred balance. The Company also agreed to submit purchase power costs associated with new contracts to a prudence review as part of the annual earnings test proceeding.

46. Public Service witness Ms. Hyde argued that limiting the PCCA to only recover costs associated with 1999 IRP resources would amount to a $34.7 million[10] penalty against the Company for the period the PCCA would be in effect. According to Ms. Hyde, Staff's proposal would prevent recovery of costs associated with capacity purchases allowed for by IRP and Least Cost Resource Plan (LCP) rule exemptions.

47. Public Service argued that interest should not be applied to the deferred balance because of the short life of the PCCA. Public Service contends that it cannot control activities that would result in under- or over-collection (*i.e.*, weather impacts on sales volumes). If the Commission decides interest should be applied to the deferred balance, the Company asserts that the same rate should apply to both over- and under-collections.

[10] Ms. Hyde's rebuttal testimony lists this amount as $44.6 million. Ms. Hyde orally testified that the $44.6 million amount accounts for both wholesale and retail purchased capacity costs before the jurisdictional split. The $34.7 million amount accounts for only retail purchased capacity costs.

48. While we concur that a PCCA mechanism is appropriate in this matter, we nonetheless find it reasonable to limit the costs to be recovered through the PCCA rider. We agree with Staff that purchased capacity costs for specific contracts listed in Hearing Exhibit 17 should not be eligible for recovery through the PCCA. Specifically, the contracts not eligible for PCCA cost recovery include: 1) CLF&P - Wygen[11]; 2) Celerity[12]; and 3) PRPA+PRPA Extension.[13] Further, the contracts identified in Hearing Exhibit 17 as "estimated replacement contracts" which are not eligible for PCCA cost recovery include: 1) Ptarmigan; 2) Redlands; 3) STS Energenics; and 4) Brush 1 & 3.[14]

49. In its Statement of Position, Public Service argues that excluding the CLF&P – Wygen contract would result in inequitable treatment without justification because the CLF&P – Gillette contract is included in base rates and both power purchase contracts are part of the Cheyenne transaction. We are disallowing PCCA cost recovery for CLF&P – Wygen because it is distinct, in our view, from the CLF&P – Gillette contract. The difference is that the CLF&P – Gillette contract was identified during the Phase 1 rate case as part of the 2001 pro forma purchased capacity expense. As such, it gave the parties to the Phase 1 case the opportunity to review and determine whether it was an appropriate expense that should be reflected in base rates. We are further persuaded that the capacity cost for this contract should not be recovered

[11] Public Service refers to this contract in Ms. Hyde's rebuttal testimony as Black Hills Generation – Wygen and in its Statement of Position as Black Hills - Wygen This record is complicated by occurrences of different names being used to refer to the same resource.

[12] Public Service refers to this resource in Ms. Hyde's rebuttal testimony and in its Statement of Position as Celerity Energy of Colorado.

[13] Public Service refers to this resource in Ms. Hyde's rebuttal testimony as Platte River Power Authority renewal and in its Statement of Position as Platte River Power Authority.

[14] Public Service refers to these resources in Ms. Hyde's rebuttal testimony and in its Statement of Position as Ptarmigan/Vallecito renewal; Redlands Water and Power renewal; the STS Energenics renewal; and the Brush 1 and 3 renewals.

through the PCCA by Public Service's representation that the cost of this contract is below its embedded cost for purchased capacity. Finally, our decision to disallow PCCA cost recovery of this contract takes into consideration the uncertainty over Public Service's future obligations to serve Cheyenne Light Fuel & Power as a customer.

50. We will not allow PCCA cost recovery for purchased capacity from Celerity and PRPA+PRPA Extension (Platte River Power Authority renewal) contracts notwithstanding the argument that these contracts were entered into under the IRP/Lease Cost Plan (LCP) exemption. Public Service witness Ms. Hyde testified that the IRP/LCP exemption was only exercised by Public Service when small amounts of capacity were required to meet the Company's obligation to serve its customers, or when the contract pricing was such that this capacity was cost effective. Unlike the other purchased capacity costs we found to be extraordinary and therefore recoverable through the PCCA, we find these contracts and any other contracts that might be entered into under the LCP rule exemption to be in the "normal course of business" for Public Service in meeting its obligation to serve and in managing its costs. It is not reasonable to expect that the costs associated with this type of capacity purchases would be eligible for dollar-for-dollar cost recovery. Rather, the earnings calculation performed for the Earnings Test should account for these costs.

51. We further find that purchased capacity costs associated with replacement contracts including Ptarmigan, Redlands, STS Energenics and Brush 1 and 3 (as identified in paragraph 48 above) should not be recovered through the PCCA. These costs are not known and measurable. There is a general assumption that when a contract for purchased capacity expires, the capacity will be replaced by either more purchased capacity or by self-generation to meet the

obligation to serve, and the costs that are included in base rates for the expired contract will cover the costs for the replacement capacity. The earnings calculation for the Earnings Test should capture any differences in these costs.

52. We cap PCCA cost recovery to the per contract amounts listed in Hearing Exhibit 17 as modified to exclude the per contract amounts associated with the seven contracts identified above.[15] Public Service represented that these are the known and measurable costs for each of the capacity purchases. The individual amounts Hearing Exhibit 17 (as modified) are the "allowed" purchased capacity cost that shall be used by Public Service in calculating the PCCA rider.

53. We also find that the allowed purchased capacity cost amount for each contract shall be reduced by any reduction in payment made to the purchased capacity supplier. For example, Public Service has testified that capacity payments may be reduced for failure to perform under the terms of a contract. As a trade-off for receiving quicker cost recovery through

[15] Those contract amounts are as follows:

Company	**2004**	**2005**	**2006**
Celerity	$99,750	$171,000	$171,000
CLF&P –Wygen	$5,052,000	$8,877,600	$9,093,600
PRPA + PRPA Extension	$2,152,500	$3,690,000	$3,690,000
Ptarmigan	$75,000	$150,000 (estimated replacement contract starting 7/1/04)	$150,000 (estimated replacement contract starting 7/1/04)
Redlands		$60,000 (estimated replacement contract starting 1/1/05)	$60,000 (estimated replacement contract starting 1/1/05)
Brush 1 & 3		$60,000 (estimated replacement contract starting 11/1/05)	$60,000 (estimated replacement contract starting 11/1/05)
STS Energenics			$125,000 (estimated replacement contract starting 12/8/05)

implementation of a PCCA, ratepayers should only pay for actual capacity payments if the payments are lower than those identified on Hearing Exhibit 17, as modified.

54. We generally approve the PCCA formula proposed by Public Service except that allowed purchased capacity costs shall be used instead of “projected” purchased capacity costs. As proposed, we agree the $1,800,000 recovered through the AQIR shall be subtracted from the allowed retail purchased capacity cost.

55. Our decision limiting PCCA recovery to specific contracts not listed in paragraph 48 above, and capping the total amount to be recovered through the PCCA, results in a maximum amount of $73.7 million to be recovered via the PCCA mechanism for the period June 1, 2004 through December 31, 2004.

56. The deferred balance will now represent the difference between allowed and recovered purchased capacity costs and shall be tracked monthly. We will not require interest to be applied to the deferred balance. By limiting and capping the amounts allowed to be recovered through the PCCA, we limit the incentive or any opportunity for Public Service to over-collect beyond any natural over-collection resulting from differences in projected revenues and actual revenues due to variation in customer monthly usage.

57. We are in accord with Public Service’s agreement with Staff to express PCCA percentages to four decimal places. We also find it reasonable to require that the PCCA rider application be filed on or before November 1 for a January 1 effective date, utilizing a deferred balance as of September 30. Public Service stated that it has no objection to these timeframes. Public Service also stated that it has no objection to providing supporting work papers to Staff at

the time of the filing. We agree with Staff that detailed information is necessary to timely review the filing. However, deem it necessary to also include the following work papers to be provided by Public Service: 1) monthly projected retail revenues; 2) monthly allowed purchased capacity cost itemized by contract; 3) monthly reductions in amounts of purchased capacity cost itemized by contract and listing the reason for each reduction; 4) projected retail jurisdictional allocator; 5) actual retail jurisdictional allocator for the previous period; and 6) monthly deferred balance amounts.

58. We agree with Public Service that existing contracts should not be subject to a prudence review. However, if there is a material change to an existing contract, then that contract shall be subject to a prudence review. Because we are limiting and capping PCCA cost recovery to the contracts identified in Hearing Exhibit 17 (as modified) we find it appropriate to conduct a prudence review of any new contract or changed contract during the Earnings Test proceeding.

D. Incentives

59. Staff Witness Schmitz contends that, if the Commission determines that allowing 100 percent of over earnings to flow to ratepayers creates serious incentive problems for Public Service, then the PCCA costs would be simply included in the earnings test and the sharing percentages would not change. This inclusion would provide the same incentives for efficiency measures as are present in the current earnings test mechanism. According to Staff, limiting the PCCA to include only costs associated with the 1999 IRP mitigates the risk of reduced incentive for the company to bargain aggressively. Limiting the PCCA in this way further mitigates the concern that utility management would alter Public Service’s resource mix.

60. CEC witness Binz agreed that the PCCA mechanism fundamentally alters the risk that Public Service executives still consider when making buy versus build decisions. In the normal regulatory process, a utility has a sharp incentive to institute efficiency measures and costs attainment so that it can benefit financially under the rates approved by a regulatory body. By accelerating rate changes, the PCCA changes the incentive associated with the normal regulatory process.

61. In Rebuttal Testimony, Public Service countered that, although the Company's proposal to return 100 percent of its over earnings to its customers can theoretically undermine incentives to increase productivity, the limited term of the PCCA and the related earnings cap address any concerns.

62. In its Statement of Position, Public Service maintained that the PCCA will not create an incentive for the Company to buy more expensive capacity that the Company alternatively could build. The Company noted that there is not enough time to construct new generation during the short duration of the PCCA. The Company also pointed out that, because contracts are already signed or already exist, executing these contracts cannot create an incentive to purchase power rather than build generation resources.

63. Staff, in its Statement of Position, argued that limiting the PCCA to inclusion of resources already approved in the 1999 IRP does minimal damage to incentives for efficiency. Conversely, Staff finds that allowing the inclusion of non-1999 IRP resources interferes with incentives for efficient procurement of resources because allowing non-1999 IRP resources may dull Public Service's incentive to bargain aggressively in contract negotiations, and may bias its decision-making in favor of purchasing power, rather than constructing its own resources.

Further, Staff asserts that returning 100 percent of over earnings to ratepayers raises the concern that earnings test incentives for efficiency might be dulled. According to Staff, the fact that Public Service is uncertain of its final earnings level for any particular year and as a result may implement efficiency improvements mitigates this concern. If the Commission believes that returning 100 percent of over earnings creates serious incentive problems as the earnings test is applied, Staff recommends that the PCCA costs simply be included in the earnings test and that the mechanism then operate as it currently does.

64. CF&I and Climax, in its Statement of Position, observed that in the decision approving the QFCCA the Commission addressed the "perverse management incentives" that might be created if a particular earnings test were adopted. At that time the Commission did not know that approval of an earnings test and the development of the QFCCA would delay the filing of a Phase 1 rate case for almost 9 years. CF&I and Climax contend that implementing a PCCA may similarly delay Public Service's filing of its next rate case.

65. The Commission has a responsibility to maintain incentives for Public Service to improve efficiencies, reduce costs, and otherwise act prudently. We note our concern that jurisdictional revenues from automatic adjustment mechanisms are now approaching 40 percent. While these mechanisms may be appropriate to account for non-base rate expenses that are increasing and are outside the Company's control, as more and more expenses are added to the list, there may be less incentive for the Company to maintain pressure on other expenses that are within its control. When negotiating purchase contracts, analyzing costs, or even designing rates, the Company should always have structural incentives to act in the best interest of ratepayers.

66. We find that incentives can be provided to Public Service to perform efficiently and mitigate incentives to perform inefficiently. By limiting the PCCA to the recovery of costs of contracts approved during the 1999 IRP; capping the PCCA at a certain dollar figure; limiting Public Services to recovery through the PCCA to recovery of cost of contracts that perform in accordance with the terms of the contracts; including costs recovered through the PCCA in the Earnings Test; and, not changing the sharing portion of the Earnings Test mechanism that returns a portion of earnings to customers, Public Service will be provided with the necessary tools to perform prudently and efficiently.

67. As an aside, we note that we are not bound by the terms of the PCCA Stipulation entered into as part of the settlement agreement in the Phase 1 rate case. The parties to that agreement assumed the risk that we would not approve a PCCA. We further find that there was no meeting of the minds of the parties to that Stipulation beyond the amounts we approve here, which equate to 69 percent of the costs Public Service sought to recover through the PCCA. However, we believe that our decision strikes a reasonable and prudent balance based on the persuasive arguments provided by all parties to this matter. We find that our decision balances the increased capacity costs incurred or to be incurred by Public Service, which are not recoverable in its rate base, with the extraordinary circumstances Public Service finds itself in. We further find that our holding today contains sufficient incentives for Public Service to maintain productivity and negotiate effectively when increasing capacity.

E. Earnings Test

68. In the direct testimony of Public Service witness Mr. Stoffel, Public Service proposes to incorporate costs and revenues associated with power purchase agreements in its

annual earnings test and to return to customers 100 percent of any earnings above the Company's current 10.75 percent allowed return. According to Public Service, this earnings test modification is intended to address any concern that implementation of a PCCA might result in overearnings by the Company.

69. Staff supports the modification as a reasonable balance to allowing quicker recovery of limited purchased capacity costs. According to Staff, this would ensure that ratepayers are not required to pay 100 percent of incremental purchase capacity costs, while at the same time allowing Public Service to enjoy retention of earning above its current authorized level.

70. The OCC does not however, support the proposal to return 100 percent of any earnings above 10.75 percent to ratepayers. Dr. Schechter argues that it will remove any incentive to increase the efficiency of its operations. The OCC instead proposes that the earnings sharing mechanism remain unchanged, with the exception that 100 percent of potential over-earnings first be used to buy down the PCCA.

71. Public Service witness Ms. Blair took issue with OCC's proposal, explaining that there would be practical timing problems associated with the OCC proposal to offset the PCCA with overearnings before the earnings sharing mechanism would apply. Mr. Stoffel offered that, if the Commission is concerned that capping the Company's earnings will in fact undermine the Company's incentives, the Company would not object to adoption of the OCC proposal.

72. We will require Public Service to account for all purchased capacity expense and all PCCA revenues in its earnings calculation. We find that the earnings sharing mechanism (the

thresholds and percentages used to determine sharing of over earnings) should not be changed because of our decision to limit and cap the amounts allowed to be recovered through the PCCA. We reject the OCC proposal to offset the PCCA with over earnings before earnings sharing is applied because, as Public Service indicated, the timing of the Earnings Test filings would have to change. We also take into consideration in our decision to reject OCC's proposal that both the Earnings Test and PCCA will terminate on December 31, 2006.

F. Jurisdictional Allocation Methodology

73. In answer testimony, OCC witness Dr. Schechter asserted that he disagreed with allocating sales of purchased capacity using the 12 coincident peak (12CP) method to determine the Federal Energy Regulatory Commission/Colorado Public Utilities Commission (FERC/PUC) jurisdictional allocation factors because it does not guarantee that a 100 MW sale of capacity would reduce the PCCA by the price that the purchaser of the capacity pays to Public Service. Dr. Schechter explained that according to the 12CP method, if the purchaser of the capacity happens to be using zero percent of the capacity at the time of the coincident peaks, then there would be no change to the jurisdictional allocation factor. Instead, the OCC proposed use of a revenue credit methodology requiring that sales of capacity be used to offset the PCCA on a dollar for dollar basis. During cross-examination, Dr. Schechter stated that it would also be acceptable to the OCC if the costs associated with a sale of purchase capacity were assigned away from the PUC jurisdiction.

74. In rebuttal testimony and in its Statement of Position, Public Service points to previous Commission Decision No. C00-1319, which rejected the revenue credit methodology for earnings calculation purposes and set specific requirements to be met when proposing this

type of change in allocation methodology. Public Service argued that OCC has not met those requirements.

75. We are not persuaded by the allocation methodologies proposed by OCC for sales of purchased capacity. Rather, we agree with the previous Commission decision requiring adequate explanation of the effects of the proposed change on retail and wholesale customers and a demonstration that the proposal is beneficial to retail customers.

76. Therefore, we grant Public Service's application for a PCCA rider in part, consistent with the discussion above.

IV. ORDER

A. The Commission Orders That:

1. The Application Of Public Service Company of Colorado to Implement a Purchased Capacity Cost Adjustment rider is granted in part consistent with the discussion above.

2. The capacity costs recoverable by Public Service under the Purchased Capacity Cost Adjustment rider we grant here shall be limited as specifically indicated in this Order.

3. The Purchased Capacity Cost Adjustment rider approved in this Order shall expire on December 31, 2006, or upon approval of rates derived from a Phase 1 rate case, whichever occurs sooner.

4. The maximum amount to be recovered by Public Service through the Purchased Capacity Cost Adjustment rider shall not exceed $73,690,287.

5. The deferred balance shall represent the difference between allowed and recovered purchased capacity costs as detailed in this Order. Public Service shall track the deferred balance amount monthly.

6. The Purchased Capacity Cost Adjustment percentages shall be expressed to four decimal places.

7. Public Service shall file its annual Purchased Capacity Cost Adjustment rider application on or before November 1 of each year, for a January 1 effective date, utilizing a deferred balance as of September 30.

8. Public Service shall provide Commission Staff with supporting detailed work papers as part of its annual filing as detailed in this Order.

9. Public Service shall account for all purchased capacity expense and all Purchased Capacity Cost Adjustment revenues in its annual Earnings Test calculations.

10. The Purchased Capacity Cost Adjustment rider shall be limited to recovery of capacity costs involving contracts approved as part of the 1999 IRP, except for those contracts specifically excluded and detailed in this Order.

11. The 20-day time period provided by § 40-6-114(1), C.R.S., to file an application for rehearing, reargument, or reconsideration shall begin on the first day after the Effective Date of this Order.

12. This Order is effective on its Mailed Date.

B. ADOPTED IN COMMISSIONERS' DELIBERATION MEETING May 4, 2004.

THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

Commissioners

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