ITEM NO. 2

PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: July 3, 2018

REGULAR _X_ **CONSENT** ____ **EFFECTIVE DATE** ______ **N/A** ______

DATE: June 25, 2018

TO: Public Utility Commission

JE for LK

FROM: Lance Kaufman

JE JE for JC

THROUGH: Jason Eisdorfer and John Crider

SUBJECT: PACIFIC POWER: (Docket No. UM 1824) Status report on Staff investigation into Oregon Specific Cost Allocation Issues.

STAFF RECOMMENDATION:

None.

DISCUSSION:

Issues

This report provides an update on Staff's investigation into PacifiCorp's Oregon specific cost allocation issues. The report includes background on PacifiCorp's cost allocations, describes the allocation issues currently under investigation, identifies potential evaluation criteria for cost allocation methods, and identifies the next steps in the investigation.

Discussion and Analysis

Background
PacifiCorp provides electric distribution service to customers in six states: California, Oregon, Washington, Idaho, Utah, and Wyoming. PacifiCorp formed in 1910 as Pacific Power and Light (PP&L), serving electric customers in Oregon and Washington. In 1987, PacifiCorp acquired Utah Power and Light (UP&L). At the time, PacifiCorp provided service as PP&L in California, Idaho, Montana, Oregon, Washington, and Wyoming. Utah Power and Light provided service in Idaho, Utah, and Wyoming.

The Public Utility Commission of Oregon (OPUC) approved the merger between PP&L and UP&L in Order No. 88-767. In this order, the Commission approved a stipulation regarding cost allocation guidelines. These guidelines directed parties to develop an agreement on how to allocate the joint costs and benefits of the merger, and provided that if agreement on an allocation issue cannot be reached, the method of allocation will be determined by the Commission based on the guidelines in the stipulation. The stipulation also states "Pacific agrees, however, that its shareholders will assume all risks that may result from less than full system cost recovery if interdivisional allocation methods differ among the merged company's jurisdictions."[1]

Since then, PacifiCorp's rates in Oregon have utilized the following allocation methodologies:

- Accord Method Pre-1998
- Modified Accord 1998 to 2005
- Revised Protocol 2005 to 2011 adopted in Order 05-021
- 2010 Protocol 2011 to 2016 adopted in Order No. 11-244
- 2017 Protocol 2016 to present adopted in Order No. 16-319

When the 2017 Protocol was adopted in Order 16-319, the Commission also resolved to open an investigation into Oregon specific allocation issues. This Oregon-specific investigation is running concurrently with PacifiCorp's multi-state process which continues to look at cost allocation now and into the future. Order No. 16-319 notes that the Oregon specific investigation is intended to:

1. Conduct detailed analysis on a reasonable allocation method for the company and its Oregon Customers;
2. Progress simultaneously with the multi-state process (MSP) workgroup;
3. Address allocation issues due to the passage of Senate Bill 1547 (SB 1547);
4. Explore allocation approaches consistent with cost-causation principles; and
5. Explore allocation approaches that make sense for Oregon customers.

The Commission opened its investigation, docketed as UM 1824, via Order No. 17-124. In its order, the Commission directed Staff to begin the investigation as a non-contested case and anticipated that parties would identify key Oregon-specific issues. The Commission also underscored a difference of opinion between Oregon and PacifiCorp's other state jurisdictions regarding the use of a rolled-in[2] method of allocation and considerations arising from SB 1547. The Commission also conveyed its expectation that the Company would cooperate in answering all relevant requests for information

[1] OPUC Order No 88-767 at Page 6.
[2] "Rolled-in" refers to a cost allocation method where a plant's all-in costs – capital and O&M – are shared based on a proportion of energy and capacity demand. This method is the basis of current and previous MSP protocols.

from all participants. Finally, the Commission intended for the Oregon-specific investigation to culminate in a long-term Oregon resolution of underlying issues.

Staff filed a status report in this docket on September 22, 2017, describing the content of the first three workshops and the analysis performed in the first six months of the investigation. Following the publication of Staff's status report, in a letter filed September 25, 2017, PacifiCorp requested guidance from the Commission regarding various issues involved in this investigation.

On October 11, 2017, Administrative Law Judge (ALJ) Rowe issued a Scheduling Memorandum that directed the parties to discuss PacifiCorp's request for clarification. Parties met to discuss the matters raised by PacifiCorp on October 27, 2017. Staff filed a memo in this docket on November 2, 2017, requesting that the Commission defer until 2018 its consideration of the issues raised by PacifiCorp. Staff stated that the review would benefit from occurring within the context of a concrete proposed cost allocation methodology. The Commission adopted Staff's proposal in Order No. 17-456.

Staff provided a status update on UM 1824 at the February 27, 2018. That update summarized four workshops and preliminary allocation issues under consideration by Staff.

Staff has continued to investigate the Oregon specific issues identified in the February 27, 2018, update. This update summarizes the progress that Staff has made in this docket in the following areas:

1. Develop additional context for PacifiCorp cost allocations.
2. Clarify the relationship between Docket No. UM 1824 and Docket No UM 1050.
3. Update on progress in MSP dockets.
4. Update on next steps in MSP dockets.

The purpose of this investigation is to explore allocation options that are consistent with cost causation principles, equitable for Oregon customers, and accommodate divergent state energy policies. The progression of this investigation in parallel with PacifiCorp's MSP Workgroup, which is generally proceeding under Docket UM 1050, will allow the investigation to inform Oregon parties during MSP discussions.

Additional Context for PacifiCorp Cost Allocations
Some costs of providing utility service are directly attributable to a customer or a customer group. For example, when a customer requests a new service connection the cost of that new service connection can be tracked and directly charged to the

customer. Other costs are not directly attributable to a customer, or even a group of customers. For example, the salaries of a utility's officers are not directly associated with any individual customer or customer group. Costs that are not directly attributable to a customer group are allocated among customers in some particular manner. Costs are allocated using allocation factors. Allocation factors identify the percent of a cost that is allocated to each specific group.

A general principle of cost allocation is that costs are allocated in proportion to cost drivers. For example, net power costs, which are the net costs of generating and delivering power (primarily fuel and purchased power). These costs are not directly assigned to any particular customers or customer groups because it is not possible to identify the specific customer or groups of customers that are receiving the benefit of specific portions of fuel or purchased power. However, these costs do have a very reasonable and direct cost driver: energy use. For this reason, the allocation factor for net power costs are often calculated using the percent of annual energy use. On the other hand, the salaries of utility officers do not have direct cost drivers. Because there is no direct cost driver for officers, there is a greater diversity of approaches to allocating these costs. A cost allocation methodology is a methodology that identifies how all costs are assigned or allocated to groups of customers.

Every utility that has operations in multiple states must develop a method of allocating costs among its service territory states. In addition, state regulating bodies have authority to influence how system costs are allocated to their own state for ratemaking purposes. For this reason, it is possible to over- or under- allocate the utility's total costs among the states. For example, Washington uses an allocation methodology for PacifiCorp's costs that is not consistent with the general multi-state agreements adopted by most of PacifiCorp's other states. In years where Washington's method allocates less costs to Washington than the general multi-state agreement method, PacifiCorp's costs are under-allocated in total. In years where Washington's method allocates more costs to Washington than the general method, PacifiCorp's costs are over-allocated in total.

PacifiCorp has sought to avoid over- and under- allocation of costs by engaging its separate state regulators and stakeholders in a multi-state process (MSP). This process involves bringing the states together on a regular basis to discuss cost allocation issues, and to be party to allocation agreements. As stated above, the order approving the PPL and UPL merger notes that "Pacific agrees, however, that its shareholders will assume all risks that may result from less than full system cost recovery if interdivisional allocation methods differ among the merged company's jurisdictions." This statement refers to the risk that PacifiCorp's costs may be over or under allocated among the states as described in the Washington situation above.

Despite PacifiCorp's agreement that shareholders bear the risk of under-allocation, the OPUC has worked proactively to minimize this risk for PacifiCorp by agreeing to rolled in based protocols rather than cost causation based models. Staff is continuing to work within the MSP process to reach an agreement with PacifiCorp and its participating jurisdictions.

During the MSP meetings that formed the basis of the current allocation agreement, the 2017 Protocol, and more increasingly since the subsequent passage of SB 1547, parties became aware of a growing policy variance between the PacifiCorp states. States are taking very different approaches to carbon policy and have different expectations related to continued use of coal-fired generation. As a result, PacifiCorp now faces inconsistent planning requirements across its six jurisdictions. The problem with this inconsistency is highlighted by PacifiCorp's current long term fuel plan for Jim Bridger coal plant. Oregon Statute requires that investments for Jim Bridger be based on an end of coal fired operations no later than December 31, 2029. Other states require that PacifiCorp bases investments for Jim Bridger on an assumption that coal fired operations continue into 2030 and beyond. Therefore, PacifiCorp is required to make investment decisions based on two different economic lives.

PacifiCorp cannot make two sets of investments at the same plant, one for its western states and another for its eastern jurisdictions. This results in another form of revenue shortfall related to the merger. PacifiCorp must invest in a manner that has a high probability of cost recovery in one state, but a low probability of recover in another state.

MSP participants agreed to develop the 2017 Protocol as a short term agreement to allow more time to explore long term resolution to cost allocation issues. When adopting the 2017 Protocol, the Commission recognized that there was need for a venue for Oregon participants to explore issues independently from the broader multi-state docket UM 1050. This docket, UM 1824, was established to provide such a venue.

Relationship between Docket No. UM 1824 and Docket No. UM 1050
Docket No. UM 1050 is a venue for the Commission to evaluate and consider multi-state agreements. This docket has historically focused on evaluating and responding to proposals developed through the broader MSP workgroup. As a result, certain Oregon related allocation issues have not received sufficient analysis and attention from Staff, PacifiCorp, and the Commission. In UM 1050, Staff provided testimony in support of the 2017 Protocol by comparing it to the alternative if the Commission rejected the 2017 Protocol, which was to revert to the Revised Protocol. In Staff's view, PacifiCorp made certain short term concessions to Oregon in the 2017 Protocol which made the 2017 protocol preferable to the Revised Protocol.

However, Staff did not present an alternative to the 2017 Protocol. When adopting the Revised Protocol, the Commission indicated interest in a cost-causation based allocation method rather than a rolled-in method. Both the Revised Protocol and the 2017 Protocol are forms of rolled-in, which Staff finds have subsidized fast growing states such as Utah at the expense of slow growing states such as Oregon.

Such an alternative cannot be reasonably developed within the context of UM 1050 because the development of the alternative requires the cooperation of PacifiCorp for developing and providing information. Because the MSP process involves all of PacifiCorp's other jurisdictions and seeks to find an agreement among all, analysis of alternative proposals that are inconsistent with the policy-views of some states may be contrary to PacifiCorp's interest of obtaining agreement by all states.

Staff's goal for UM 1824 is to analyze a set of allocation alternatives, and to ask the Commission to identify which of the allocation alternatives could be acceptable allocation methods in the event that MSP does not result in an acceptable allocation agreement. Developing such a baseline methodology will bring value to both Oregon parties during the MSP negations and the Commission during any decision on MSP agreements.

Staff has a secondary goal for UM 1824: to investigate miscellaneous allocation issues that may not be relevant to other parties in the broader MSP discussion. Attachment A to Staff's previous memo in this docket describes some of these issues.

Progress in MSP Dockets
Progress in Docket No. UM 1824 has been limited due to recent changes in US tax law. Staff issued information requests on February 7, 2018, March 6, 2018 and June 26, 2018. These information requests explore the revenue requirement impacts of incremental differences modifications of the Revised Protocol and the Hybrid Method. The intent behind these information requests is to develop a quantitative analysis of the alternatives under consideration by Staff. These alternatives are described in Staff's previous memo in this docket.

PacifiCorp has not been able to provide responses to these Information Requests to date because they require evaluating the tax impact of the Tax Cuts and Jobs Act. PacifiCorp has indicated that it anticipates providing responses to these Information Requests soon.

PacifiCorp is continuing to develop a complete allocation Strawman Proposal in Docket No. UM 1050. PacifiCorp has solicited feedback from Staff on a framework proposal. While the individual components of PacifiCorp's framework have merit, there is not sufficient specific information to draw any conclusions regarding the proposal as a whole. Staff is also conscious of the fact that Utah has not moved from insistence that an MSP agreement be consistent with rolled-in. Given the historic pattern of Utah's negotiation strategy, it is important that Commission provide feedback on an allocation alternative prior to Staff making concessions to Utah in the broader MSP context.

Staff also has concerns about proceeding in Docket No. UM 1050 before PacifiCorp has filled in the framework proposal with detail, including revenue requirement impacts.

Next Steps in MSP Dockets
For the reasons described above Staff recommends that appropriate next steps are to have PacifiCorp provide responses to Staff's outstanding information requests in UM 1824, to fill in the framework proposal with a Strawman Proposal, and to calculate the revenue requirement impacts of the Strawman Proposal.

Revenue requirement analysis of both the UM 1824 alternatives and the PacifiCorp strawman are necessary to appropriately evaluate an allocation methodology. A complete strawman proposal is necessary for parties to think through the broader risks and implications of the proposal.

The next MSP meeting is scheduled for August 22, 2018. This may be sufficient time for PacifiCorp to respond to the outstanding information requests and for Staff to perform preliminary analysis of the alternatives. Staff also asks that PacifiCorp distribute a more thorough Strawman Proposal as well as the requirement impacts of the proposal prior to the August 22, 2018 meeting.

Conclusion

This investigation has progressed successfully as an informal investigation. If PacifiCorp can provide responses to Staff's outstanding data requests by July 10, 2018 this docket can continue as an informal investigation. If PacifiCorp is unable to meet this time frame, Staff will consider requesting that the Commission transition UM 1824 into a contested case.

PROPOSED COMMISSION MOTION:

None.