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June 23, 2005

***Via Electronic and US Mail***

Public Utility Commission  
Attn: Filing Center  
550 Capitol St. NE #215  
P.O. Box 2148  
Salem OR 97308-2148

Re: In the Matter of PACIFIC POWER & LIGHT Request for a  
General Rate Increase in the Company's Oregon Annual Revenues  
**Docket No. UE 170**

Dear Filing Center:

Enclosed for filing in the above-referenced proceeding please find the original and two (2) copies of the Response to PacifiCorp's Application for Waiver of OAR 860-038-0080(1)(b) on behalf of the Industrial Customers of Northwest Utilities.

Please return one file-stamped copy in the enclosed stamped envelope.

Thank you for your assistance.

Sincerely,

/s/ Sheila Ho  
Sheila R. Ho

Enclosures

cc: Service List

## CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I have this day served the foregoing Response to PacifiCorp's Application for Waiver of OAR 860-038-0080(1)(b) on behalf of the Industrial Customers of Northwest Utilities upon the parties on the service list by causing the same to be mailed, postage-prepaid, through the U.S. Mail.

Dated at Portland, Oregon, this 23rd day of June, 2005.

/s/ Sheila R. Ho  
Sheila R. Ho

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**BEFORE THE PUBLIC UTILITY COMMISSION  
OF OREGON**

**UE 170**

In the Matter of	)	
	)	
PACIFIC POWER & LIGHT	)	RESPONSE OF THE INDUSTRIAL
(dba PACIFICORP)	)	CUSTOMERS OF NORTHWEST
	)	UTILITIES TO PACIFICORP'S
Request for a General Rate Increase in the	)	APPLICATION FOR WAIVER OF OAR
Company's Oregon Annual Revenues.	)	860-038-0080(1)(b)
_____	)	

On June 6, 2005, PacifiCorp submitted an Application for Waiver ("Application") of OAR 860-038-0080(1)(b) (the "Market Price Rule") in the above-referenced docket. PacifiCorp requests that the Public Utility Commission of Oregon ("OPUC" or the "Commission") waive the market pricing requirements adopted pursuant to Senate Bill ("SB") 1149 for three generating resources: West Valley, Gadsby, and Currant Creek. The Industrial Customers of Northwest Utilities ("ICNU") requests that the Application be denied for the following reasons:

- The Application was filed too late in this proceeding to allow the parties sufficient time to address PacifiCorp's request.
- The Commission has never determined that the costs of West Valley, Gadsby, and Currant Creek were prudent, or that they should be included in rates at cost.
- Granting the Application would violate SB 1149 because:  
1) direct access customers would be subject to the costs of new resource decisions; and 2) it could result in new stranded costs, which could harm development of a retail market.

- Granting the Application would violate ORS § 757.646 by increasing PacifiCorp's vertical and horizontal market power.
- Granting the Application would harm customers.
- PacifiCorp has made no effort to craft an opt-out option as required by Order No. 05-133.
- PacifiCorp has not proposed other measures to mitigate the anticompetitive impacts of cost-based treatment of new resources.

## **BACKGROUND**

PacifiCorp initiated this Docket by filing a general rate case on November 12, 2004. The filing sought to include the costs of West Valley, Gadsby, and Currant Creek in rates as cost-based resources. Current Oregon law requires that new generating resources owned by an electric utility be reflected in rates at market prices, rather than at cost. OAR 860-038-0080(1)(b). ICNU filed direct testimony in this Docket on May 9, 2005, pointing out that the proposed rate treatment violated the Market Price Rule and requesting that these resources be reflected in rates at market prices. Re PacifiCorp, OPUC Docket No. UE 170, ICNU/100, Falkenberg/2–3 (May 9, 2005).

The Commission adopted the Market Price Rule as part of the implementation of direct access under SB 1149. In implementing SB 1149, the Commission elected to replace the traditional rate base standard for valuing new utility-owned generation with a market standard. ORS §§ 757.600-.687. The Market Price Rule was critical to implementing two key goals of SB 1149: 1) creating a competitive generating market; and 2) insuring fair and reasonable transition charges and credits. An essential purpose of the rule is to protect direct access customers from the effects of new resource decisions by utilities.

As PacifiCorp points out in its Application, the Commission has considered modifying the Market Price Rule, but it has decided to retain it for the time being. Application at 4. In October 2002, the Commission initiated an investigation in Docket No. UM 1066 to consider the regulatory policies affecting new resources. In particular, the Commission investigated whether to continue the Market Price Rule. After conducting numerous rounds of comments, workshops, and argument, the Commission issued Order No. 05-133, which kept the Market Price Rule in effect and held Docket No. UM 1066 in abeyance. Re Investigation into Regulatory Policies Affecting New Resource Development, OPUC Docket No. UM 1066, Order No. 05-133 at 2-3 (Mar. 17, 2005). Accordingly, a utility may not obtain cost-based rate treatment of a new resource unless the Commission grants a waiver of the Market Price Rule.

### **ARGUMENT**

Under OAR 860-038-0001(4), PacifiCorp must demonstrate good cause to obtain a waiver of the Market Price Rule. To demonstrate good cause, PacifiCorp offers the following arguments:

- Granting the waiver will benefit customers;
- West Valley, Gadsby, and Currant Creek previously have been included in rates at cost;
- West Valley, Gadsby, and Currant Creek are priced comparably with market resources; and
- Granting the waiver is consistent with Oregon law.

PacifiCorp filed its case in this proceeding in a manner that violates the Market Price Rule, and the Company did not file its Application until nearly six months later. The hearing on all issues in the general rate case is now less than five weeks away. The Commission

should summarily deny the Application, because the Parties have not had the opportunity to conduct discovery or offer testimony on whether PacifiCorp has met the requirements for waiver of the Market Price Rule. However, if the Commission decides to consider the merits of the Application in this Docket, the parties should be provided an opportunity to address these issues in testimony and briefs and at oral argument.

PacifiCorp's Application also should be denied because, as described below, each of the factual and legal reasons supporting the application is false. Further, PacifiCorp has not adequately mitigated the adverse effects of waiving the Market Price Rule.

### **1. Granting the Waiver Will Not Benefit Customers**

As an initial matter, the Commission should note that it has never found West Valley, Gadsby, or Currant Creek to be prudent. OPUC Docket No. UE 170, ICNU/100, Falkenberg/9. West Valley is a high cost resource that was acquired from a PacifiCorp affiliate through a questionable competitive bidding procedure. Id. at Falkenberg/10–12. Mr. Falkenberg conducted an extensive analysis of the prudence of West Valley in his direct testimony and concluded that the costs of the project far outweigh its benefits. Id. at Falkenberg/15–18. Thus, allowing the Company to receive cost-based treatment of West Valley will harm rather than benefit customers.

Similarly, Mr. Falkenberg analyzed the costs of Gadsby and determined that they were exceptionally high. Id. at Falkenberg/30. He recommended a \$7.5 million prudence disallowance related to Gadsby plant investment. Id. at Falkenberg/31. Finally, Mr. Falkenberg concluded that the costs of Currant Creek were higher than the net market value of the power produced by the project as derived from the thermal revenue output of PacifiCorp's power cost



model (“GRID”). Id. at Falkenberg/32. Mr. Falkenberg’s analysis demonstrates that waiver of the Market Price Rule will result in higher rates and will not benefit customers.

## **2. West Valley, Gadsby, and Currant Creek Are Not Comparable with Market Resources**

Mr. Falkenberg analyzed the costs of West Valley, Gadsby, and Currant Creek compared to market prices, based on the output of GRID. Under this analysis, replacing the costs of these resources with market prices, as determined by GRID, would result in the following revenue requirement reductions:

	<b>Adjustment</b>	<b>Company</b>	<b>Oregon</b>
<b>1</b>	<b>Currant Creek</b>	<b>-\$6,038,839</b>	<b>-\$1,263,331</b>
<b>2</b>	<b>West Valley</b>	<b>-\$4,242,698</b>	<b>-\$885,900</b>
<b>3</b>	<b>Gadsby</b>	<b>-\$5,426,599</b>	<b>-\$1,361,548</b>

Id. at Falkenberg/4, Table 1. As Mr. Falkenberg’s analysis demonstrates, PacifiCorp’s claim that the costs of these resources are comparable with market values is not supported by its own power cost model.

## **3. West Valley, Gadsby, and Currant Creek Have Not Been Included in Rates at Cost**

Currant Creek is a new resource that has never been included in Oregon rates.

See id. at Falkenberg/33. PacifiCorp claims that Gadsby and Currant Creek “are already reflected in [its] revenue requirement at cost.” Application at 2. This is untrue. The costs of Gadsby and West Valley were included in rates pursuant to “black box” stipulations in Docket Nos. UE 134 and UE 147. The stipulations explicitly provide that they set no precedent. For example, the UE 147 Stipulation provides:

By entering into this Stipulation, no party shall be deemed to have approved, admitted or consented to the facts, principles, methods or theories employed by

any other party in arriving at the terms of this Stipulation except as specifically noted in this Stipulation.

Re PacifiCorp, OPUC Docket No. UE 147, Stipulation at 6 (Sept. 1, 2003). The Stipulation also provides:

The Parties agree that, as a result of the withdrawal of these cases, no Party is collaterally estopped in the future from challenging the prudence of the West Valley plant, arguing that it should be included in the Company's revenue requirement at market prices rather than at cost or raising any other issues related to the West Valley Plant, other than those related to the affiliated interests issues resolved in UI 196.

Id. at 3.

Furthermore, Order No. 02-657, issued in the proceeding in which the Commission approved PacifiCorp's affiliated interest filing regarding the West Valley lease, indicated that the Commission did not make a prudence finding regarding the West Valley lease in that proceeding. Re PacifiCorp, OPUC Docket No. UI 196, Order No. 02-657 at 1 (Sept. 18, 2002). Consequently, the prudence of West Valley has never been established because the Commission never decided the issue in UE 134, UE 147, or UI 196. In the end, there is no Commission precedent concerning prudence or the market value rule for Gadsby and West Valley. Therefore, West Valley, Gadsby, and Currant Creek have not been previously included in rates at cost.

#### **4. Granting the Waiver Is Inconsistent with Oregon Law**

SB 1149 directs the Commission to develop "policies to eliminate barriers to the development of a competitive retail market structure." ORS § 757.646(1). These policies must be designed to mitigate the market power of electric utilities. Id. The requirement that new resources be included in utility rates at market prices rather than at cost is a policy designed to promote competitive markets and limit utility market power, thus ensuring that incumbent

utilities would not be guaranteed cost recovery and that all electricity suppliers would be on “equal footing.” Contrary to PacifiCorp’s assertions in its Application, the passage of ORS § 757.603, requiring each electric utility to offer a cost-of-service rate for all customers, did not amend the statutory directives to promote competition in generation markets and remove unfair advantages for incumbent utilities.

To eliminate barriers to the development of a competitive retail market, direct access customers should not be required to pay for future utility resource decisions. Forcing direct access customers to pay the costs of new utility resources could subject those customers to new stranded costs, even if they purchase all their power from the market. In addition, requiring direct access customers to pay the costs of new utility resources will enhance the market power of incumbent utilities, because customers will have a disincentive to purchase from competitive suppliers.

In previous comments to the Commission, ICNU has recognized that there may be reasons for a utility to include some new resources in rate base to serve their cost-of-service customers. Re Investigation into Regulatory Policies Affecting New Resource Development, OPUC Docket No. UM 1066, ICNU Opening Comments at 2 (Jan. 30, 2004). However, ICNU maintained that any change in the rules must be consistent with a direct access environment and statutes promoting competition in generation markets. Id. at 5-8; Re Investigation into Regulatory Policies Affecting New Resource Development, OPUC Docket No. UM 1066, ICNU Reply Comments at 2, 4-5 (Feb. 20, 2004). ICNU proposed the use of opt-outs and enhanced competitive bidding requirements to satisfy these concerns. OPUC Docket No. UM 1066, ICNU Reply Comments at 2. The same standard should apply to a request for a waiver. Thus, it is

inappropriate to allow PacifiCorp to enhance its current market position without incorporating mitigation measures, including, but not limited to, stronger competitive bidding requirements and workable opt-out mechanisms.

The Commission is moving forward with improvements to the competitive bidding requirements in Docket No. UM 1182; however, little progress has been made on developing an opt-out proposal. In addition, while Docket No. UM 1182 may yield better competitive bidding measures, those measures are not in place yet. The process by which West Valley, Gadsby, and Currant Creek were developed may be inconsistent with the requirements for a fair competitive bidding process. Thus, the conditions to granting a waiver of the Market Price Rule have not been met.

To date, the Commission has granted a waiver of the Market Price Rule in only one instance. In Docket No. LC 33, the Commission granted waiver of the rule with respect to PGE's Port Westward plant; however, the Commission made no determination as to whether to include the costs of Port Westward in rates. Re PGE, OPUC Docket No. LC 33, Order No. 04-376 at 4 (July 20, 2004). Significantly, in granting the waiver, the Commission noted:

On June 22, 2004, PGE sent a letter to the LC 33 participants stating that PGE would hold workshops to develop mechanisms "for qualifying large customers to exempt themselves from costs and benefits of the Port Westward plant . . . ." We welcome such discussion and ask that PGE report the status and content of those discussions within 90 days of the issuance of this order.

Id. at 4-5 n.2. Unfortunately, few discussions with PGE have occurred, and no opt-out proposal has been adopted.

In Docket No. UM 1066, the Commission conducted a thorough review of whether to change the Market Price Rule. In addition, the parties in that Docket devoted

considerable resources to developing an opt-out proposal. The Commission ultimately decided to defer a decision on the Market Price Rule, pending the completion of proceedings related to least-cost planning, competitive bidding, and performance-based ratemaking. OPUC Docket No. UM 1066, Order No. 05-133 at 2. On the issue of opt-outs, the Commission stated:

We also expect parties to continue their efforts to craft an option for large customers to opt out of PGE's and PacifiCorp's new generating resources. By September 30, 2005, each company should file either an opt-out tariff for our review or a consensus report explaining that an opt-out is not workable.

Id.

Since Order No. 05-133 was issued on March 17, 2005, PacifiCorp has made no effort to develop an opt-out tariff or to develop a consensus that an opt-out is not workable. PacifiCorp's failure to pursue an opt-out is all the more puzzling given the fact that the Revised Protocol contains specific allocation provisions to address a new resource opt-out. Re PacifiCorp, OPUC Docket No. UM 1050, Order No. 05-021, Attachment A at 10:4–11:18 (Jan. 12, 2005).

PacifiCorp has not recognized the anti-competitive effects of cost-based treatment of new resources. PacifiCorp's Application is premised on the grounds that competitive markets are not functioning and that the Commission is no longer bound by the legislative directive to remove barriers to competition and reduce the market power of utilities. Because PacifiCorp is unwilling to recognize the anti-competitive problems related to its Application or implement appropriate mitigation measures, the Commission should reject the Application, until a reasonable opt-out option for direct access customers has been developed and approved.

Dated this 23rd day of June, 2005.

Respectfully submitted,

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/s/ Matthew Perkins

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