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August 4, 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 please find the original and six copies of the Brief of the Industrial Customers of Northwest Utilities in the above-referenced docket.

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

Thank you for your assistance.

Sincerely,

/s/ Sheila R. Ho
Sheila R. Ho

Enclosures
cc: Service List

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I have this day served the foregoing Brief 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 4th day of August, 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	)
(dba PACIFICORP)	)
	)
Request for a General Rate Increase in the	)
Company's Oregon Annual Revenues	)
	)

OPENING BRIEF OF

THE INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES

August 4, 2005

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I. INTRODUCTION

Pursuant to Administrative Law Judge Logan's June 14, 2005 Memorandum, the Industrial Customers of Northwest Utilities ("ICNU") submits this Opening Brief regarding the remaining contested issues in PacifiCorp's (or the "Company") general rate case proceeding. ICNU requests that the Oregon Public Utility Commission ("OPUC" or "Commission") reject the majority of PacifiCorp's proposed revenue requirement increase and order an increase of approximately $1 million.[1/] ICNU also recommends that the Commission deny PacifiCorp's request for an annual resource valuation mechanism ("RVM") and adopt ICNU's proposed transition adjustment mechanism for customers eligible to elect direct access.

II. BACKGROUND

On November 12, 2004, PacifiCorp filed a general rate case requesting a revenue requirement increase of approximately $102 million. In this proceeding, PacifiCorp has expanded the concept of the "moving target" general rate case by filing numerous changes or other "updates" which have increased its overall revenue requirement request. PacifiCorp has filed two RVM power cost updates that cumulatively increased its rate request by approximately $10.7 million. As originally filed, the RVM power cost increases would only occur if the Commission adopted the Company's proposed RVM and would take effect January 1, 2006. PacifiCorp also made

[1/] Unless otherwise stated, all numbers are on an Oregon jurisdictional basis.

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revisions in rebuttal testimony that increased its fuel handling costs by $2.5 million and its pension expense by $1.1 million.[2/]

PacifiCorp, Staff, the Citizens' Utility Board ("CUB"), ICNU, and Fred Meyer have entered into three partial stipulations (the first, second and fourth partial stipulations) that have resolved specific issues, including issues relating to certain power cost disputes, employee benefits, non-labor administrative and general costs, incentive program costs, cost of capital and rate of return, pensions, and rate spread/rate design. The cumulative impact of these three partial stipulations has reduced PacifiCorp's general rate case revenue requirement request to approximately $52.5 million. The $52.5 million includes the fuel handling increase, but excludes the RVM related power cost updates. This would increase general base rates by approximately 6.4% and average industrial rates by approximately 9.1%.

PacifiCorp and Staff also have entered into the third partial stipulation, which addresses fuel handling costs and RVM issues between those parties. ICNU opposes the third partial stipulation because PacifiCorp and Staff have agreed to the fuel handling adjustment, the waiver of the market price rule, an inappropriate allocation of existing Utah QFs, and certain RVM power cost increases.

In surrebuttal testimony, PacifiCorp changed its original position regarding the RVM power cost adjustments, and requested that, if the Commission rejects the annual RVM, the Commission should adopt most of its RVM adjustments as part of the general rate case. In other words, PacifiCorp has proposed that if there is not an

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[2/] The pension expense is now covered by the fourth partial stipulation.

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annual RVM, then the RVM adjustments should be made on October 4, 2005, instead of January 1, 2006. Further confusing matters, PacifiCorp is requesting that the Commission make some of the RVM power cost adjustments in the general rate case that the Company and Staff agreed should not be made if the Commission adopts the annual RVM. PacifiCorp's request to include the RVM adjustments would increase the general rate case revenue requirement request by $4.9 million. ICNU opposes both the annual RVM and PacifiCorp's last minute effort to boost its general rate case revenue requirement with the RVM adjustments.

Overall, PacifiCorp is requesting an approximately $57 million revenue requirement increase.[3/] ICNU believes that the evidence in this proceeding demonstrates, at best, that the Company is entitled to a rate increase of about $1 million. PacifiCorp's rate request inappropriately includes tax costs that ratepayers pay to the Company, but are never paid to any taxing authorities. PacifiCorp's revenue requirement should also be reduced to exclude the imprudent and above market costs of new Utah resources, regional transmission organization ("RTO") costs which do not benefit current Oregon ratepayers, existing Utah Qualifying Facilities ("QFs"), the fuel handling adjustment, the UM 995 outages, and all RVM-related power cost adjustments. The Commission also should reject the annual RVM and adopt a transition adjustment mechanism that fairly and

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3/ PacifiCorp is requesting $56.8 million if the Commission accepts the annual RVM ($52.5 million would occur in October 2005, and an additional $4.3 million in RVM increases in January 2006). If the Commission rejects the annual RVM, PacifiCorp is requesting that its RVM adjustments be included in the general rate case for a total $57.4 million increase ($52.5 million plus $4.9 million in RVM adjustments).

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accurately values resources freed-up by direct access. ICNU's remaining revenue requirement recommendations are summarized in the table below:

ICNU Proposed Adjustments Oregon Basis (in thousands)	
Consolidated Tax Adjustment	$27,580
Existing Utah QF Contracts	$7,669
MSP New Resources	$5,487
RVM Power Costs	$4,900
Fuel Handling Adjustment	$2,490
RTO Expense	$900
UM 995 Outages	$7,500
Total ICNU Proposed Adjustments	**$56,526**

III. LEGAL STANDARD

PacifiCorp has the burden of proof to establish that its proposed rates are just and reasonable. ORS § 757.210(1) (2003); Pac. Northwest Bell Tel. Co. v. Sabin, 21 Or. App. 200, 213 (1975). The Commission also has the independent responsibility to ensure that PacifiCorp's customers are only charged just and reasonable rates. ORS § 756.040(1) (2003); Pac. Northwest Bell Tel. Co., 21 Or. App. at 213. The burden of proof is borne by the Company "throughout the proceeding and does not shift to any other party." Re PacifiCorp, OPUC Docket No. UE 116, Order No. 01-787 at 6 (Sept. 7, 2001). When other parties dispute the proposed rates, PacifiCorp retains the burden to show that all its suggested changes are just and reasonable. Id.

The Commission sets a utility's rates based on its cost of service. OPUC Docket No. UE 116, Order No. 01-787 at 5 (citing American Can Co. v. Lobdell, 55 Or.

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App. 451 (1982)). Cost of service is "the utility's reasonable operating expenses to provide utility service." Id. (citing Pac. Northwest Bell Tel. Co., 21 Or. App. 200). PacifiCorp must demonstrate that its expenses are reasonable and prudent before the Commission will allow their inclusion in rates. Re US West Communications, Inc., OPUC Docket Nos. UT 125/UT 80, Order No. 00-191 at 15 (Apr. 14, 2000). The Commission examines prudence based on existing circumstances and what the Company either knew or should have known at the time it was making its decision. Re Northwest Natural Gas Co., OPUC Docket No. UG 132, Order No. 99-697 at 52 (Nov. 12, 1999). The Commission reviews the prudence of both the utility's decision making and the amount of money expended. Id. In addition to removing imprudent costs, the Commission will exclude abnormal events that are not expected to reoccur and known future changes that are included in the proposed test period. Re Portland General Electric Co., ("PGE") OPUC Docket No. UF 3518, Order No. 80-021 at 24 (Jan. 14, 1980).

IV. ARGUMENT

1. Phantom Income Taxes Should be Excluded from Rates

The Commission should reduce PacifiCorp's Oregon jurisdictional revenue requirement by $27.58 million to account for income taxes currently being collected from Oregon ratepayers for income tax amounts that are not paid to taxing authorities. The unique corporate structure of PacifiCorp and its parent company, PacifiCorp Holdings, Inc. ("PHI"), was designed in such a way that little or no taxes are actually paid on profits generated by PacifiCorp's regulated utility operations. ICNU/200, Selecky/15. Nevertheless, PacifiCorp asks the Commission to require

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ratepayers to pay PacifiCorp for phantom taxes that will never be paid to the taxing authorities. The collection of phantom income taxes should be rejected because it is consistent with ratemaking principles, Commission regulations, and long-standing precedent.

A. Cost-of-Service Principles Dictate that Amounts for Income Taxes Not Owing to Taxing Authorities Should Not Be Included in Rates

The current debate over PacifiCorp's proper income tax allowance is a product of the scheme implemented by PacifiCorp's parent company to minimize the taxes on PacifiCorp's income. After ScottishPower acquired PacifiCorp in 1999, it created PHI as a non-operating, direct, wholly owned subsidiary of ScottishPower. ScottishPower capitalized PHI through an intercompany acquisition-related loan, and PHI then used that loan to acquire ScottishPower's shares of PacifiCorp. The significance of the loan between ScottishPower and PHI is that the interest that PHI pays to ScottishPower on the loan is deductible on the consolidated income tax returns that PHI files on behalf of PacifiCorp and other PHI affiliates. These interest deductions erase or significantly reduce the consolidated group's taxable income, with the result being that the group avoids paying a certain amount of taxes on PacifiCorp's income. ICNU/200, Selecky/15.

ICNU's proposed income tax adjustment is calculated based on PHI's annual tax deductible interest expense of $160.31 million. ICNU/200, Selecky/17. Because 94.72% of PHI's assets are related to PacifiCorp's jurisdictional activities, this percentage of the deductible interest expense should be reflected in PacifiCorp's rates.

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For 2006, the Oregon jurisdictional rate base is 28.88% of the total Company rate base, so the rates of Oregon jurisdictional customers should reflect 28.88% of the deductible interest expense. This equals approximately $43.86 million, which, using an Oregon composite tax rate of 37.95%, reduces Oregon's tax by $16.64 million and its revenue requirement by $27.58 million. Id.

Under ICNU's proposal, PHI will retain the tax benefit that flows from the corporate structure set up by ScottishPower, and little or no taxes will be paid on PacifiCorp's income. ICNU simply requests that ratepayers not be required to bestow an additional benefit upon PHI, in the form of amounts included in rates for taxes that are never paid because of PHI's interest deductions. Because these amounts are not owing to any taxing authority, they do not constitute a legitimate and known cost of providing utility service, and they should not be included in rates. ICNU/211, Selecky/3.

Ratepayers should not be required to pay taxes that are not part of the Company's actual cost of service. Because taxes are costs, if a utility pays income taxes, it generally can recover from ratepayers the amount of the taxes paid. BP W. Coast Prods. v. FERC, 374 F.3d 1263, 1286 (D.C. Cir. 2004). When a utility is part of a consolidated group, and the members of the group file a consolidated return, if "the out-of-pocket tax cost of the regulated affiliate is reduced, there is an immediate confrontation with the ratemaking principle that limits cost of service to expenses actually incurred." FPC v. United Gas Pipeline Co., 386 U.S. 237, 244 (1967).

PacifiCorp argues that ICNU's adjustment is inconsistent with cost-of-service principles, but in United Gas, the U.S. Supreme Court explained that the opposite

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is true. Id. The Court specifically rejected the argument, like the one advanced by PacifiCorp, that tax savings resulting from applying nonjurisdictional losses to jurisdictional income in a consolidated return should not be used to reduce a utility's cost of service, "even if on a consolidated basis system losses exceed system gains and neither the affiliated group nor any member in it has any tax liability." Id. at 243-44. The Court explained:

> Rates fixed on this basis would give the [utility] company and its stockholders not only the fair return to which they are entitled but also the full amount of an expense never in fact incurred. In such circumstances, the Commission could properly disallow the hypothetical tax expense and hold that rates based on such an unreal cost of service would not be just and reasonable.

Id. at 244.

The Court also rejected two other arguments similar to those that PacifiCorp has put forth in opposition to ICNU's proposal. First, the Court found it proper to set rates that recognize the tax savings associated with filing a consolidated return without recognizing the expenses associated with the consolidated group's loss:

> Ratemaking is, of course subject to the rule that the income and expense of unregulated and regulated activities should be segregated. But there is no suggestion in these cases that in arriving at the net taxable income of [the utility] that the Commission violated this rule. Nor did it in our view in determining the tax allowance.

Id. at 243. This contradicts PacifiCorp's argument that accepting ICNU's proposal would compromise the "careful separation of regulated utilities and non-regulated affiliates." PPL/1300, Martin/5.

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Second, the Court rejected the argument made by PacifiCorp in the current case that not including the utility's "hypothetical" tax expense in rates would deprive unregulated entities of the benefit of losses to which they are entitled:

> Nor did the Commission 'appropriate' or extinguish the losses of any member of the affiliated group, regulated or unregulated. Those losses may still be applied to system gains and thereby be turned into instant cash. . . .[T]he losses of unregulated companies are in no way destroyed. They remain with the system, readily available to reduce the taxes of the profitable affiliates to the maximum extent allowed by the tax law.

United Gas, 386 U.S. at 247; see, e.g., PPL/1700, Larson/15.

B. ICNU's Proposal Is Consistent with the Stand-Alone Approach

ICNU's proposed adjustment does not contradict the Commission rule that utility income taxes must be calculated on a stand-alone basis. See OAR § 860-027-0048. In City of Charlottesville v. FERC, 774. F.2d 1205 (D.C. Cir. 1985), the D.C. Circuit explained that under the stand-alone approach, a utility's income tax allowance is not reduced by losses of other affiliates, but it can be reduced by other deductions of the consolidated group:

> The utility's tax base is determined by identifying the taxable income and deductions of the consolidated group specifically attributable to the utility's jurisdictional activities. The statutory tax rate (which, in the case of regulated utilities, will almost always be the maximum rate), is then applied to the tax base to yield the stand-alone tax allowance. Usually, as in the present case, a stand-alone calculation will produce a higher tax allowance than a flow-through methodology, because the tax base, and hence the effective tax rate, is not reduced by the tax losses of other affiliates.

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City of Charlottesville, 774 F.2d at 1207-08.

As the D.C. Circuit noted, the stand-alone approach does not always result in a higher tax allowance to the utility. In this case, it results in a lower tax allowance because the deduction at issue is taken by PHI's consolidated group for interest paid on the PacifiCorp acquisition loan. Unlike the "tax losses of other affiliates" that the D.C. Circuit indicated should not reduce a utility's stand-alone tax allowance, PHI's interest deduction is specifically attributable to PHI's ownership of PacifiCorp, the jurisdictional entity. In fact, approximately 95% of PHI's assets are related to PacifiCorp's jurisdictional activities. ICNU/200, Selecky/17. Under the City of Charlottesville approach, a deduction "specifically attributable to the utility's jurisdictional activities" is used to adjust the utility's tax allowance. Therefore, because PHI's interest deduction is attributable to PacifiCorp's jurisdictional activities, the deduction should reduce PacifiCorp's tax allowance.

As the City of Charlottesville decision demonstrates, the stand-alone approach does not preclude commissions from looking to the consolidated return when setting rates. See City of Charlottesville, 774 F.2d at 1207-08 (utility's tax base determined with reference to "the taxable income and deductions of the consolidated group"). In addition, some jurisdictions that PacifiCorp identifies as following the "traditional" stand-alone approach adjust the utility's income tax allowance based on a tax benefit resulting from the utility's participation in a consolidated return. See PacifiCorp/1400, Uffelman/4-7. For example, the Virginia commission has reduced a utility's federal income tax expense based on interest deductions made by the utility's parent for debt on the parent's investment in the utility. Virginia v. United Water Va., Inc., Va. State Corp. Comm'n Case No. PUE970544, 1999 Va. PUC LEXIS 328 at *12-13 (1999).

In Indiana, when a utility files a consolidated return with its parent, "to reflect the benefits enjoyed by the utility as a result of paying taxes on a consolidated basis," the Commission imputes to the utility a portion of the parent corporation's interest cost. Re Utility Center, Ind. Util. Regulatory Comm'n Cause No. 41968, 2003 Ind. PUC LEXIS 209 at *24-25 (2003). The specific amount is determined "with reference to the parent corporation's investment in the utility, the portion of the corporation's capital structure attributable to the debt and the average cost of that debt." Id. at *25. These decisions demonstrate that other jurisdictions following the stand-alone approach allow the parent's utility rates to reflect the consolidated tax filing under certain circumstances.

Finally, an adjustment to PacifiCorp's income tax expense based on PHI's interest deductions is justified because PHI's interest deduction is not an economic detriment to PHI. In City of Charlottesville, the court held that the stand-alone approach does not violate cost-of-service principles as long as the "theoretical" income tax liability of a regulated utility constitutes an expense caused by jurisdictional activities. City of Charlottesville, 774 F.2d at 1215-16. The court explained that the tax "expense" could take the form of either a cash payment of tax assessments or an "economic detriment" created by "the consumption of otherwise usable tax losses to forestall those assessments." Id. at 1215. In other words, if the parent company were to use losses of unregulated affiliates to offset taxable income generated by the utility, that would

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constitute an economic detriment that could be justifiably charged to ratepayers under cost-of-service principles. On the other hand, if a "real economic detriment" did not exist, it would be proper to disallow inclusion of the expense in rates. See id. at 1216.

When PHI deducts its interest expense from the consolidated group's taxable income, doing so does not constitute an "economic detriment" to PHI as contemplated in City of Charlottesville. PHI is not using otherwise usable losses of unregulated affiliates to forestall tax assessments. See ICNU/211, Selecky/3-4. On the contrary, the loan between PHI and ScottishPower exists for the very purpose of creating interest expense deductions to permanently reduce the amount of PacifiCorp's income that would otherwise be taxable to PHI. ICNU/200, Selecky/15. It would be unreasonable to conclude that PHI suffers an "economic detriment" when it takes deductions for payments on a loan that was created for the purpose of allowing PHI to take those deductions. The interest deductions are therefore not an "expense" of PHI that is properly chargeable to ratepayers, and consistent with the D.C. Circuit's reasoning in City of Charlottesville, the stand-alone approach does not justify including in rates amounts for taxes that are eliminated by virtue of PHI's interest deductions.

C. The "Benefits Burden Test" Is Neither Required Nor Appropriate in this Context

PacifiCorp's prefiled testimony on the income tax issue is replete with references to a "benefits/burdens" test. Adopting the approach taken by the Oregon Department of Justice in comments submitted to the OPUC in February 2005, PacifiCorp argues that the Commission "cannot consider consolidated taxes when setting rates unless

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the consolidated adjustment meets the benefits-burdens requirement." PPL/1300, Martin/6. The Commission is not required to follow the benefits/burdens test. The benefits/burdens test is essentially one method for determining whether an expense is properly included in a utility's cost of service. City of Charlottesville, 774. F.2d at 1217. There is no requirement that this test be employed whenever a consolidated tax adjustment is made.

While the D.C. Circuit in the City of Charlottesville case approved of the benefits/burdens test, contrary to PacifiCorp's assertions, the court did not hold that a commission must apply the "benefits/burdens" test any time it considers consolidated taxes when setting rates, or even that it is required to do so under the stand-alone approach. See PPL/1700, Larson/14; PPL/1300, Martin/6; PPL/1400, Uffelman/10. The D.C. Circuit's holding in City of Charlottesville was that the benefits/burdens test is one reasonable method for calculating utility income taxes under the stand-alone approach. City of Charlottesville, 774 F.2d at 1221. However, the court pointed out that the benefits/burdens test is not the only reasonable method of estimating the tax liability of a regulated affiliate:

> There are a number of plausible ways to make that estimation—ranging, perhaps, from an approach that would give the utility's ratepayers the benefit of all tax deductions of the consolidated group offset against the utility's income (since the deductions would have been worthless without the income) to an approach that would give ratepayers the benefit of none of them (since the utility would have had no deductions on its own). Within certain rational limits that have clearly not been exceeded here, which approach to choose is more a matter of regulatory policy than of logic. The approach the Commission has chosen, allowing those

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> deductions made possible by charges to the ratepayers, is an entirely reasonable one, beyond our authority to upset.

Id. (emphasis added). Hence, the D.C. Circuit did not hold that the benefits/burdens analysis must always be applied in the context of calculating utility income taxes for ratemaking purposes; it merely held that it was a reasonable approach under the circumstances.

Whatever its usefulness might be in other contexts, under the circumstances presented by the present case, the benefits/burdens test does not provide a useful means for analyzing the amount of income tax expense to be included in PacifiCorp's cost of service. Even if it is true that PHI bears the burden of paying the interest on the ScottishPower loan, it does not follow that PHI will lose its corresponding tax benefit if the Commission recognizes that ratepayers should not be required to pay amounts for income taxes that PHI is not required to pay. As PacifiCorp notes many times in its testimony, the benefit that flows from the interest expense is tax relief, or a tax deduction; a reduction in the consolidated group's taxable income. PPL/1300, Martin/13, 18; PPL/1700, Larson/15; PPL/1400, Uffelman/12. Nothing that the Commission does will affect the tax benefit that PHI receives as a result of its interest expense, because the tax benefit does not entitle PHI to payments from ratepayers. See United Gas, 386 U.S. at 247.

ICNU's adjustment may result in less income against which PHI will be able to offset its losses, but this extra income is not something to which PacifiCorp is entitled to receive in rates. The Commission's function is "to fix just and reasonable

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rates, not to insure that other affiliates [are] made whole for their tax losses out of income from regulated enterprises." Id. at 241. As a result, while PacifiCorp argues that disallowing amounts in rates for taxes that PacifiCorp will not pay would create a "windfall benefit" for ratepayers, the opposite is true. Id. at 244. Calculating PacifiCorp's income tax expense without regard to the interest deductions that permanently reduce or eliminate PacifiCorp's taxable income would grant PHI a windfall and would be contrary to the principles that ratepayers should only be charged for reasonable and prudent costs incurred in providing service and that they should not subsidize unregulated activities. Id. at 244; see id. at 247. ICNU's income tax adjustment ensures that customers' rates are just and reasonable.

2. The Utah QF Contracts Are Existing QF Contracts under the Revised Protocol and Must Be Allocated on a Situs Basis

Contrary to the plain language of the Revised Protocol, PacifiCorp has proposed to allocate four Utah-based QF contracts on a system-wide basis, rather than on a situs basis. The four challenged Utah QF contracts are the US Magnesium, Desert Power, Kennecott, and Tesoro contracts. Each of these QF contracts was executed prior to January 12, 2005, the date the Commission approved the Revised Protocol.[4/] ICNU/100, Falkenberg/7-8. Properly assigning these four existing QF contracts on a situs basis would reduce PacifiCorp's requested Oregon rate increase by approximately $7.7 million.

4/ The delivery dates for the QF contracts are: October 2004 (Kennecott), September 2004 (Tesoro and Desert Power), and January 2005 (US Magnesium). ICNU/100, Falkenberg/7-8.

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The question of whether the costs of these QF contracts should be assigned to Utah on a situs basis turns on whether they are "existing contracts" as defined in the Revised Protocol. Id. The Revised Protocol assigns costs in excess of embedded costs for existing QF contracts on a situs basis, but for new QF contracts the costs are assigned on a system-wide basis. ICNU/100, Falkenberg/5-6.

"Existing" QF contracts are defined with reference to the effective date of the Revised Protocol:

> **"Existing QF Contracts"** means Qualifying Facility Contracts entered into prior to the effective date of this Protocol, but not such contracts renewed or extended subsequent to the effective date of this protocol.

ICNU/100, Falkenberg/6 (emphasis added); ICNU/512 at 19 (Revised Protocol). Under the Revised Protocol, the earliest "effective date" is January 12, 2005, the date the Commission approved the Revised Protocol. ICNU/100, Falkenberg/6. Since all four of the contracts were entered into before the Revised Protocol was approved and effective, they must be allocated on a situs basis.

The Commission must apply rules of contract interpretation and/or statutory construction in order to determine the proper effective date for the Revised Protocol. The Revised Protocol has contractual qualities, in that the parties to the Revised Protocol agreed to support its ratification and use by the OPUC. ICNU/512 at 3. At the same time, it has qualities of a statute or rule in that it was ratified by the Commission for determining cost and revenue allocation in PacifiCorp's rate cases. Id. at

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2. Therefore, it is appropriate to apply rules of contract interpretation and statutory construction[5/] when interpreting the Revised Protocol.

The Commission must begin its analysis with the plain language of the Revised Protocol, bearing in mind that it must give effect to all parts of the Revised Protocol. Yogman v. Parrott, 325 Or. 358, 361 (1997) (contract); Re Rulemaking to Amend OAR Chapter 860, OPUC Docket No. AR 375, Order No. 00-303 at 10-11 (2000) (statute). If the meaning of the Revised Protocol is unambiguous after this inquiry, the Commission's analysis is at an end. Coats v. State, 188 Or. App. 147, 150-151 (2003) (contract); Abdul Abu-Adas, 325 Or. at 485 (regulation).

Section D of the Revised Protocol unambiguously provides that "[t]he Protocol shall only be in effect for a State upon final adoption by its Commission." ICNU/100, Falkenberg/6-7. In other words, the effective date could differ for each state, depending upon when each state adopted the Revised Protocol.[6/] The earliest possible effective date for Oregon is January 12, 2005, the date the OPUC first approved the Revised Protocol. ICNU/100, Falkenberg/7.

PacifiCorp argues that the effective date is June 1, 2004, because that date was named as a "proposed" effective date in the Revised Protocol. PPL/412, Taylor/3. PacifiCorp does not adequately explain why this is the only term in the Revised Protocol that includes the modifier "proposed." In addition, if June 1, 2004 was intended to be the

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5/ Rules of statutory construction also apply to construction of administrative rules. Abdul Abu-Adas v. Employment Dep't, 325 Or. 480, 485 (1997).

6/ This conclusion is bolstered by the fact that PacifiCorp agreed to "continue to bear the risk of inconsistent allocation methods among the States," until each state had adopted the Revised Protocol. ICNU/100, Falkenberg/7.

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date that distinguished new from existing QF contracts, then the Revised Protocol could have simply said so instead of referring to the "effective date."

The parties may have proposed an effective date of June 2004, but the plain language of Section D provides that the effective date would not take place in any state until that state adopted the Revised Protocol. The Commission should not allow PacifiCorp to disregard the specific terms in the Revised Protocol. Re Metro One Telecommunications, OPUC Docket No. IC 1, Order No. 00-623 at 6 (2000) (refusing to disregard specific terms of an interconnection agreement); OPUC Docket No. AR 375, Order No. 00-303 at 10-11 ("statutes must be construed so as to give effect to each provision").

The flawed nature of PacifiCorp's argument is illustrated by the following example: PacifiCorp could not have filed a rate case in Oregon in September 2004, before the OPUC had adopted the Revised Protocol, and claimed that the Revised Protocol automatically was effective retroactive to June 1, 2004. PacifiCorp itself has taken the position that applying the Revised Protocol in this manner retroactive to June 1, 2004, "would constitute retroactive ratemaking." Re PacifiCorp, WUTC Docket No. UE-050684, PacifiCorp Response to ICNU Data Request 2.136 (July 27, 2005) (Attachment A). Yet at the same time, PacifiCorp argues that the Revised Protocol automatically applies retroactively to the QF contracts at issue in this case. PPL/412, Taylor/3. Accepting PacifiCorp's line of reasoning, the effective date of the Revised Protocol for purposes of the QF contracts was June 1, 2004, while the effective date for purposes of the current rate case was January 12, 2005.

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The Commission should not allow PacifiCorp to manipulate the language of the Revised Protocol in this way. The language of the Revised Protocol is unambiguous, so there is no reason for the Commission to accept PacifiCorp's strained interpretation. See OPUC Docket No. IC 1, Order No. 00-623 at 5 (refusing to accept a "strained interpretation" of language that is "clear and specific"). The Commission also should be wary of PacifiCorp's position because the Company's Utah rate caps mean that if these contracts are treated as existing QF contracts in this proceeding, the Company will likely not be able to recover the costs of these contracts from Utah customers.[7/] Tr. 23: 22-25 (Larson).

Oregon should not pay for these Utah QFs as a matter of both law and public policy. Under the Revised Protocol, Oregon is already shouldering the full burden of the existing Oregon QFs. See Re PacifiCorp, OPUC Docket No. UM 1050, Staff/100, Hellman/11 (July 2, 2004); ICNU/512 at 7-8, 19. Oregon ratepayers should not be required to also pay for part of the costs of Utah's existing QFs.

3. The Commission Should Reject PacifiCorp's Arbitrary, Late-Filed Fuel Handling Adjustment

PacifiCorp has proposed increasing its original filed revenue requirement by approximately $2.5 million to reflect an alleged failure to include fuel handling costs in its filing. PPL/1600, Wrigley/4-5. The Commission should reject the fuel handling adjustment because its costs have not been supported as reasonable, and it would set poor

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7/ PacifiCorp's credibility on this issue is further strained because the Company filed its recent Utah rate case originally treating at least one of these QFs as "existing" while treating the QFs as "new" in Oregon.

public policy by providing inappropriate incentives to utilities to include "forgotten" costs in the middle of future rate cases. PacifiCorp suspiciously identified the fuel handling "error" at the same time it agreed to make an offsetting $2 million power cost adjustment related to the Camas facility (James River). ICNU/107, Falkenberg/2; PPL/1600, Wrigley/4. PacifiCorp, however, never provided detailed workpapers or other information to justify this adjustment. ICNU/100, Falkenberg/35; ICNU/109, Falkenberg/1.

PacifiCorp should not be permitted to make this type of mid-rate case filing that increases its revenue requirement, because it unfairly requires parties subject to a limited schedule to continually re-evaluate a moving target rate increase. Despite this harm, PacifiCorp asserts that such changes should be allowed to ensure that costs are accurate as possible. PPL/1600, Wrigley/5. However, the practical effect of allowing such changes will lead to inaccurate, higher rates because utilities will have an opportunity to review all the alleged "errors" or "updates" and will likely only file those which increase rates. For example, in this proceeding PacifiCorp increased its overall filing by over $14 million, but discovered few, if any, overall adjustments that decreased its revenue requirement request.[8/]

[8/] PacifiCorp asserted that it "unilaterally" reduced its revenue requirement by $3.7 million since its original filing. ICNU/525. However, these adjustments were made after first being challenged by Staff and/or ICNU, or were part of larger adjustments that increased overall costs.

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4. PacifiCorp Will Double Recover Its Costs If All Outages that Occurred During the UM 995 Deferral Period Are Not Removed From Rates

To prevent PacifiCorp from double recovering its costs, the Commission should require the Company to remove all power plant outages that occurred during the UM 995 deferral period. The UM 995 power cost deferral included the actual costs associated with all the power plant outages that occurred from November 2000 to September 2001. Oregon ratepayers have already paid the costs of each of these outages through the amortization of this deferred account that occurred from February 2001 to July 2005. Removing all of the outages would ensure that customers are not charged for these outages a second time and reduce the Company's revenue requirement request by approximately $7.5 million.

In UM 995, the Commission approved a power cost deferral for PacifiCorp. PacifiCorp was permitted to recover approximately $130 million in excess net power costs. Re PacifiCorp, OPUC Docket Nos. UM 995, UE 121 and UC 578, Order No. 02-469 (July 18, 2002). The power cost deferral allowed PacifiCorp to defer all of its excess net power costs and "[e]very single outage that occurred increased actual power costs, and thereby resulted in a larger deferral balance." ICNU/111, Falkenberg/22; ICNU/100, Falkenberg/39. Therefore, customers have already paid the Company for these outages. Id.

PacifiCorp has removed the largest outage during the deferral period, the Hunter 1 power plant outage that occurred from November 2000 to September 2001, but has included all other outages during the deferral period. ICNU/100, Falkenberg/38-39;

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PPL/609, Widmer/3. PacifiCorp's original justification for the removal of the Hunter 1 outage was that "[t]he Company's outage rate modeling is simply a four-year amortization of outage costs." ICNU/100, Falkenberg/39; ICNU/110. Since the outage rate PacifiCorp proposes was originally "intended to provide a four-year amortization of the very same costs being recovered in the UM 995 deferral, it is a double count." ICNU/111, Falkenberg/20.

In order to justify the recovery of its remaining outages during the UM 995 deferral period, PacifiCorp provided an alternative rationale to support recovery of these costs in its rebuttal testimony. PPL/609, Widmer/3. PacifiCorp now asserts that the Hunter 1 outage was the only outage removed because it was more significant than the other outages. Id.; ICNU/111, Falkenberg/21. However, this argument is irrelevant because there is no dispute that all the Company's outages during the deferral period increased power costs and were paid for by ratepayers. ICNU/111, Falkenberg/21-22.

5. PacifiCorp's RTO Costs Should Be Removed from Rates and Placed in a Deferred Account Until an RTO Is Operating and Benefits Oregon Ratepayers

RTO costs are not currently benefiting Oregon ratepayers, and PacifiCorp should not be authorized to recover these costs until an RTO is operating. The Commission should establish an account for deferring these RTO costs and subject them to a comprehensive prudency review once an RTO is providing benefits to Oregon ratepayers. ICNU/200, Selecky/18. PacifiCorp's revenue requirement in this proceeding should be reduced by approximately $3 million on a system-wide basis and approximately $900,000 on an Oregon allocated basis to remove these costs.

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PacifiCorp alleges that it will spend over $3 million on RTO costs during the 2006 test period, despite the fact that an RTO will not and is not expected to be operating in the near future. ICNU/200, Selecky/4, 18-19. The Federal Energy Regulatory Commission is no longer actively promoting a Northwest RTO or its RTO-related standard market design. See, e.g. Bonneville Power Admin. et al., 112 F.E.R.C. ¶ 61,012 (July 1, 2005). PacifiCorp is taking a leading role in the development of a Northwest RTO by spending significant amounts on RTO development. See Tr. 14 (Larson).

ICNU's position that these costs should be deferred and subject to a prudency review a later date is consistent with how these costs are being addressed in PacifiCorp's Washington service territory. Id. at 14, 38-39 (Larson). PacifiCorp has not provided sufficient justification as why Oregon should address these costs differently.

6. Waiver of the Market Price Rule Will Harm Ratepayers and the Implementation of Direct Access

The Commission should comply with its existing rule that requires new resources to be placed in rates at market prices instead of cost. The costs of the West Valley lease, the Gadsby combustion turbines ("CTs") and the Currant Creek project are above market and compliance with OAR § 860-038-0080(i)(b) ("Market Price Rule")

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would reduce the Company's Oregon revenue requirement by approximately $5.5 million.[9/] ICNU/100, Falkenberg/2-4.

PacifiCorp's November 2004 general rate case filing included the West Valley lease, the Gadsby CTs, and the Currant Creek resource in rates at cost rather than market. PacifiCorp's filing constituted a prima facie violation of the Market Price Rule, and nearly six months later the Company filed an application to waive the rule ("Application"). On June 23, 2005, ICNU submitted a response ("Response") to PacifiCorp's Application requesting that the Commission comply with the Market Price Rule, because: 1) the Application was filed too late in the proceeding; 2) these resources have not previously been placed in rates at cost; 3) direct access customers would be inappropriately subjected to PacifiCorp's new resource decisions and new stranded costs; 4) PacifiCorp's vertical and horizontal market power would be increased; and 5) customers would be harmed. Response at 1-2. ICNU does not wish to repeat arguments already made in its Response, and specifically incorporates them into this brief. Instead, ICNU will address issues raised by subsequent filings and testimony.

Waiving the Market Price Rule after a utility has constructed or purchased a resource provides the utility with inappropriate incentives if the term "market price" means the current market price. PacifiCorp could wait until a general rate proceeding and seek to include its new resources at cost if market prices were low or include the new

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9/ ICNU's market price adjustment is larger than the proposed prudency disallowance for the Company's new resources. If the Commission complies with the Market Price Rule, then it need not address ICNU's prudency disallowances for West Valley and Gadsby. ICNU/100, Falkenberg/33-34.

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resources at market if market prices were high. This is precisely what PacifiCorp has proposed as its costs are above market, and it has now sought to include its resources in rates at cost. In contrast, PGE recently obtained a waiver of the Market Price Rule for its Port Westward facility prior to the construction of the facility. Re PGE, OPUC Docket No. LC 33, Order No. 04-376 (July 20, 2004). If market prices exceed the cost of building Port Westward, PGE will not be able to game the system and include the higher market prices in rates. PGE's request to waive the Market Price Rule was filed prior to the Commission holding UM 1066 in abeyance and demonstrates that PacifiCorp could have and should have sought waiver of the rule prior to seeking to include the costs in rates.

PacifiCorp and Staff have failed to analyze or present evidence that waiver of the Market Price Rule would be consistent with the reasons for its adoption. The Market Price Rule was critical to implementing two key goals of Senate Bill ("SB") 1149: 1) creating a competitive generating market; and 2) insuring fair and reasonable transition charges and credits. See Tr. 136: 13-17 (Wordley). An essential purpose of the rule is to protect direct access customers from the effects of new resource decisions by utilities. In contrast, the Market Price Rule was not designed to determine whether utility resources were prudently acquired because the Commission is already required to remove all imprudent costs from rates. Staff and PacifiCorp's interpretation that the Market Price Rule can be waived if a resource was prudently acquired would render the rule meaningless.

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When the Commission ruled in UM 1066 that the Market Price Rule would remain in effect, the Commission reaffirmed that it is concerned about direct access and a competitive generation market. The Commission specifically stated that it is "concerned, however, that the use of a cost standard will cause a utility to favor its own proposed resources." Re Investigation Into Regulatory Policies Affecting New Resource Development, Docket No. UM 1066, Order No. 05-133 at 2 (Mar. 17, 2005). The Commission also indicated that it was aware of the negative impact that inclusion of new resources at cost could have on direct access customers and transition adjustments when it required the utilities to "file either an opt-out tariff for our review or a consensus report explaining that an opt-out is not workable" by September 30, 2005. Id.

PacifiCorp and Staff have not even attempted to address these issues or comply with the Commission's direction in UM 1066. In analyzing whether the New Resource Rule should be waived, Staff only considered whether PacifiCorp's new resources were prudent and admitted that it would only recommend against the waiver of the rule if the resource was not the least cost or otherwise imprudent. See Tr. 148-49 (Wordley); Staff/800, Wordley/3-5. Staff did not consider whether waiver would impact direct access, the Company's transition adjustment or cause PacifiCorp to favor its own resources. Tr. 137-38 (Wordley). Staff's witness was not even aware that the Commission had required PacifiCorp to file an opt-out tariff. Id. Staff's recommendation should be rejected because it considered the wrong standard.

PacifiCorp has failed to meet its burden of proof to establish that waiver of the Market Price Rule is in the public interest, will not create new stranded costs, or will

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otherwise not harm customers. Similarly, PacifiCorp did not consider the underlying purposes for the Market Price Rule in requesting waiver. PacifiCorp asserts that its new resources are prudent and competitively priced, but it did not review how waiver would impact direct access, PacifiCorp's new resource decisions, or its transition adjustment mechanism. See PacifiCorp Prehearing Brief at 18-19.

PacifiCorp also admits that it is ignoring the Commission's directive to develop a workable opt-out tariff. Id.; PPL/903, Tallman/4-5. PacifiCorp asserts that it will not commence "serious work on an opt-out" until it receives "important policy direction" from the Commission following the completion of the competitive bidding and least cost planning dockets. See PPL/903, Tallman/4-5. It is difficult to understand how PacifiCorp will be able to incorporate "policy directions" from the Commission when final comments in these proceedings are not due until September 30, 2005, the same date the Commission ordered PacifiCorp to file an opt-out proposal. Re Investigation Regarding Competitive Bidding and Integrated Resource Planning Requirements, OPUC Docket Nos. UM 1182 and UM 1056, Consolidated Ruling (July 11, 2005). New resources should not be included in rates at cost until the Commission has approved a workable opt-out mechanism for customers eligible for direct access.

7. The Commission Should Exclude the Imprudent Costs Associated with the West Valley Lease and Gadsby CTs

The Commission should remove from PacifiCorp's revenue requirement the imprudent and non-beneficial costs associated with the West Valley lease and Gadsby

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CTs.[10/] The West Valley lease is an imprudent, high cost contract that has benefited PacifiCorp's affiliate Pacific Power Marketing ("PPM") to the detriment of Oregon ratepayers. PacifiCorp also inappropriately increased the costs of the exceptionally high cost of Gadsby CTs in order to obtain a one-time benefit for the Company's shareholders. Imprudence disallowances would reduce rates by approximately $1.7 million for the West Valley lease and $0.25 million for the Gadsby CTs. ICNU/100, Falkenberg/4.

A. The High Cost West Valley Lease Was Entered Into to Benefit PacifiCorp's Affiliate PPM and Harms Oregon Ratepayers

The West Valley lease is an imprudent, high cost resource that PacifiCorp should have terminated when the Company had the opportunity to do so. PacifiCorp's primary goal in all matters regarding the West Valley lease has been to burden PacifiCorp's captive ratepayers with the output from this above market resource. A careful review demonstrates that PacifiCorp failed to make a prudent effort to terminate the West Valley lease.

The West Valley project was developed by PPM to sell power during the Western market crisis of 2000-2001. ICNU/100, Falkenberg/10-11. After the power cost crisis had abated, PPM was caught with an expensive project and unable to sell the output until PacifiCorp agreed to enter into the lease. The West Valley lease contained a termination option under which PacifiCorp could have terminated the lease in its third year. Id. at Falkenberg/20. PacifiCorp should have considered all reasonable alternatives

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[10/] ICNU has not challenged the prudency of Currant Creek and recommends that Currant Creek should be subject to a prudence review after its completion. ICNU/100, Falkenberg/10 n.3.

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to terminate the West Valley lease because it is one of the highest cost resources on the Company's system. Id. at Falkenberg/10-11, 19.

PacifiCorp imprudently failed to utilize the early termination option in the lease. PacifiCorp delayed reviewing termination options, did not perform necessary analyses, and failed to consider options that could have allowed the Company to obtain lower cost resources. Id. at Falkenberg/21-26. The Company could have obtained a lower cost replacement for the West Valley lease if PacifiCorp had not "drug its feet" on considering other options. Id. at Falkenberg/22-23. When PacifiCorp finally considered other options to the West Valley lease, the bidding process was biased to eliminate all other options. Id. at Falkenberg/27-29; ICNU/111, Falkenberg/10-12.

B. PacifiCorp Structured the Gadsby CT Purchase to Receive a One-time Benefit to Shareholders Instead of a Long-term Benefit to Ratepayers

When PacifiCorp purchased the high cost Gadsby CT units, the Company obtained a one-time savings of $7.5 million from General Electric ("GE") that flowed to shareholders instead of a permanent cost reduction that would have reduced the rate base of the Gadsby CTs. The Commission should recognize that PacifiCorp obtained a short-term shareholder benefit to the detriment of ratepayers and order a $7.5 million decrease in the level of the Gadsby plant investment.

When purchasing the Gadsby CTs, the Company agreed with the seller, GE, to an early termination of a rental agreement for temporary CTs at the Gadsby location. ICNU/100, Falkenberg/30. This cost reduction directly benefited shareholders and was never reflected in rates. Id. Instead of the one-time benefit to shareholders,

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PacifiCorp should have sought and obtained a lower price for the Gadsby CTs. ICNU/100C, Falkenberg/31; ICNU/105C; ICNU/111, Falkenberg/13-15.

PacifiCorp and Staff oppose the Gadsby rate base reduction, but fail to present persuasive evidence that PacifiCorp did not face a conflict of interest or that customers have not been harmed. Staff reviewed the direct testimony and the Company's one page summary of its analysis, but did not review the Company's workpapers, conduct discovery, or analyze the underlying confidential data that supports ICNU's recommendation. ICNU/517; ICNU/518; ICNU/519. In contrast, the Utah Division of Public Utilities' Staff conducted a more extensive review and supported a similar $7.5 million disallowance. See ICNU/111, Falkenberg/14-15. PacifiCorp does not offer evidence to dispute the existence of a conflict of interest, but merely asserts that the Company was interested in obtaining the best deal for ratepayers. See id. at Falkenberg/13. The Commission should impose a disallowance for the Gadsby CTs and reject Staff and PacifiCorp's conclusory assertions.

8. PacifiCorp Has Failed to Demonstrate that an Annual RVM is Necessary or Will Not Harm Ratepayers

PacifiCorp's proposed annual RVM is unnecessary, harmful to ratepayers, and unduly burdensome. PacifiCorp and Staff allegedly support an annual RVM to address the potential problem that, if power prices suddenly drop, then customers who elect direct access could be subsidized by remaining customers. This is a non-existent problem because there has been little past direct access participation, and PacifiCorp and Staff are proposing a transition adjustment mechanism that will result in zero future

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direct access load. While there are no tangible benefits, an annual RVM will harm ratepayers by shifting the risk of power cost increases and Utah load growth to Oregon customers, and increasing the regulatory burden on the Commission and customers.

As explained by Mr. Falkenberg, "if net power costs increase, ratepayers assume risks the shareholders would ordinarily bear." ICNU/100, Falkenberg/57. Staff's testimony confirms that an annual RVM will "shift power cost risk from shareholders to ratepayers." Staff/700, Galbraith/11. PacifiCorp also admits that an annual RVM will reduce the regulatory lag by allowing the Company to update its power costs prior to a new rate case. PPL/702, Omohundro/3. Since shareholders currently bear the risk that power costs will change between rate cases, an RVM will shift this risk to ratepayers. See Tr. 124 (Omohundro).

An annual RVM also will be problematic and burdensome, and will reduce the ability of Staff and intervenors to analyze the prudency of PacifiCorp's resource acquisitions. The RVM process has an abbreviated schedule, but in "terms of the complexity of issues, and amount of time and discovery required, it differs little from a general rate case." ICNU/100, Falkenberg/57. The RVM may prevent Staff and intervenors from reviewing the Company's power cost updates and provide PacifiCorp an opportunity to game the system. CUB/100, Jenks/23-26; CUB/200, Jenks/17-21. Staff and PacifiCorp also agree that the RVM process will make it "more difficult to conduct prudence reviews," and do not dispute that the RVM will increase the regulatory burden upon Staff and intervenors. Staff/700, Galbraith/19; see PPL/701, Omohundro/7. This burden would be further increased because the PacifiCorp and PGE schedules would

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overlap and the "parties will have the complexity of dealing with two RVM cases at the same time." ICNU/111, Falkenberg/16.

The fact that PGE has an RVM is an insufficient justification to provide PacifiCorp with an RVM. PGE's RVM process should not be considered a model because it "has been fraught with numerous problems related to the scope of costs to be included, modeling methods, and prudence issues." ICNU/100, Falkenberg/56; ICNU/111, Falkenberg/16. In addition, addressing these issues in a PacifiCorp RVM would be even more difficult because "PacifiCorp is a much larger and more complex system," and because "it operates in six states . . . ." ICNU/111, Falkenberg/16. For example, PacifiCorp's proposed RVM may shift additional costs associated with Utah load growth to Oregon ratepayers. <u>See</u> CUB/100, Jenks/26-27; CUB/200, Jenks/21-22. In addition, unlike PGE, PacifiCorp has not filed an RVM tariff that identifies the specific types of costs that are appropriate to include in the RVM proceeding. Tr. 125-26 (Omohundro). The issue of whether certain costs should be updated would likely be a highly disputed issue in any PacifiCorp RVM proceeding.

Although PacifiCorp and Staff acknowledge that many of these risks and harms are real, they assert that the benefits of an annual RVM outweigh its costs. PacifiCorp asserts that an annual update of its net power costs is in the best interest of all customers and could benefit ratepayers if power prices are reduced. PPL/701, Omohundro/3-4; PPL/702, Omohundro/3. This argument ignores that power costs have trended upward. In addition, PacifiCorp specifically refused to analyze whether an

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annual RVM would have increased or reduced rates if it had been in effect in the past. ICNU/526; ICNU/527.

PacifiCorp has provided nebulous rationales to support an annual RVM that do not justify its significant costs and harms. PacifiCorp claims that an annual RVM would more accurately reflect the impact of direct access and ensure that rates reflect current costs. PPL/701, Omohundro/8-9; PPL/702, Omohundro/1; ICNU/531. Staff supports an RVM and minimizes its harms, but never explains why an annual RVM is necessary for direct access and how it will minimize costs, especially since it seems obvious that the opposite will occur. Neither Staff nor PacifiCorp identify "any specific problems that would result if there was not an annual RVM." ICNU/111, Falkenberg/16.

9. The Commission Should Reject PacifiCorp's RVM Related Power Cost Adjustments

PacifiCorp filed two RVM related power cost updates in this proceeding that increased its net power costs by approximately $10.7 million. Originally, these adjustments were planned to take effect on January 1, 2006, and only if the RVM was adopted by the Commission. ICNU has challenged five of these adjustments, including: 1) outage update period; 2) planned outages; 3) thermal ramping; 4) deferred maintenance; and 5) station service. Rejection of these adjustments would have reduced the RVM related power cost increase by $8.4 million.

On June 29, 2005, Staff and PacifiCorp entered into the third partial stipulation that, *inter alia*, agreed to reduce PacifiCorp's RVM related power cost update from $10.7 million to $4.3 million. This reduction was based on the Company and Staff

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agreeing to ICNU's planned outages, thermal ramping, deferred maintenance, and station service adjustments. Staff-PacifiCorp/100, Wordley-Widmer/2. However, PacifiCorp only agreed to make these adjustments to its RVM related power cost update if the Commission approved its remaining RVM adjustments and increased overall power costs by $4.3 million.

In sursurrebuttal testimony in July, PacifiCorp requested for the first time that the Commission include its RVM related adjustments in the general rate case. PPL/611, Widmer/6-7. PacifiCorp is requesting that all of its RVM related power cost updates be included in the general rate case, except its outage update period and planned outages updates. Id. Specifically, PacifiCorp is requesting that three of its adjustments (thermal ramping, deferred maintenance, and station service) that will not be made if the Commission adopts its RVM proposal, should be included in the general rate case if the Commission rejects the RVM. This would increase the Company's power costs by $4.9 million instead of $10.7 million. PacifiCorp has not provided any justification why these adjustments should not be made in the annual RVM, but should occur if the RVM is rejected.[11/]

A. The Commission Should Reject PacifiCorp's Planned Maintenance Update

The Commission should set planned maintenance outages on the 48-month average instead of the Company's proposed maintenance schedule. The 48-month average is more likely to reflect the conditions expected to occur when rates are in effect

11/ PacifiCorp's contradictory filings and proposals regarding the RVM update demonstrate the unnecessary confusion and problems that could result from providing PacifiCorp an annual RVM.

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and is supported by practice in the past several cases. In addition, PacifiCorp's effort to utilize scheduled rather than average historical maintenance is a late filed, selective update proposed only to increase the Company's revenue requirement in this proceeding. The Company is unlikely to have made this one-sided adjustment if its net power costs had decreased. The change to the maintenance schedule would result in an approximately $3.9 million increase to the Company's now requested $52.5 million revenue requirement increase.

PacifiCorp's November rate case filing included heat and outage rates based on the Company's 48-month average because it results in smoothing out "annual fluctuations in unit operation and performance." PPL/600, Widmer/13. This is consistent with the Company's previous rate cases and "has been used for over 10 years." Id. In March 2005, PacifiCorp changed its method of computing planned outages from the 48-month average to the Company's planned schedule for 2006.

The 48-month average is more accurate and is consistent with the requirement that expenses should reflect the normalized conditions that are expected to occur during the test year. History has established that "PacifiCorp can and does change maintenance schedules. Thus, the year-ahead maintenance schedule is unlikely to be followed in actual practice." ICNU/111, Falkenberg/28.

B. The Commission Should Reject the Thermal Ramping and Station Service Updates Because They Are Intended to Address Non-existent Problems

PacifiCorp updated its net power costs to make adjustments to thermal ramping and station service based on a mistaken assumption that GRID was producing an

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excess of coal-fired generation. ICNU/100, Falkenberg/41; ICNU/111, Falkenberg/24-26. PacifiCorp addresses this alleged problem by creating "phantom outages" and adding a zero revenue sales transaction. ICNU/100, Falkenberg/41. The thermal ramping update increases rates by approximately $664,000 and the station service update increases rates by approximately $756,000. Id. at Falkenberg/4. PacifiCorp has already implicitly acknowledged that these updates were inappropriate by agreeing to remove them from its January 1, 2006 RVM rate increase. Staff-PacifiCorp/100, Wordley-Widmer/2.

PacifiCorp's thermal ramping and station service updates are "extremely unusual and contrary to standard industry practice." ICNU/100, Falkenberg/41. PacifiCorp's thermal ramping adjustment is similar to a PGE lost generation proposal that the Commission previously rejected. Re PGE, OPUC Docket No. UE 139, Order No. 02-772 at 23-24 (Oct. 30, 2002). PacifiCorp's underlying assumption that there is a surplus of coal-fired generation in GRID has not been established. and the Company bases its analysis on flawed information. ICNU/111, Falkenberg/26. Essentially, PacifiCorp is proposing a resulted-orientated data manipulation to solve a problem that does not exist. Id.

C. The Commission Should Reject PacifiCorp's Flawed Deferred Maintenance Update

PacifiCorp has proposed a GRID update that would abandon its past maintenance outage modeling and increase net power costs by approximately $1.1 million. ICNU/100, Falkenberg/4, 45-47. Historically, PacifiCorp has modeled maintenance outages as part of the weekend outage rate because it recognizes that these

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outages could be deferred to a more advantageous time. Id. at Falkenberg/46. PacifiCorp has proposed a change because the Company claims that maintenance outages occur in both on and off peak periods. PPL/604, Widmer/2. PacifiCorp's proposal is "conceptually flawed" because it ignores the fact that such "outages can be deferred until times when market prices are more favorable." ICNU/100, Falkenberg/46. Historic practice also demonstrates that the Company defers outages from the more expensive July and August months and that the majority of energy lost due to maintenance outages occurs during low load hours and weekends. Id. at Falkenberg/46-47; ICNU/111, Falkenberg/26-28. Similar to the thermal ramping and station service updates, PacifiCorp has also implicitly acknowledged the unreasonableness of the deferred maintenance update by agreeing to remove it from the power cost increase that would occur if the Commission approved the RVM. Staff-PacifiCorp/100, Wordley-Widmer/2.

10. PacifiCorp's Transition Adjustment Will Circumvent the Intent of the Legislature by Preventing Any Customers from Utilizing Direct Access

The Commission should adopt ICNU's proposed transition adjustment because it will more accurately value PacifiCorp's freed-up resources and may allow direct access an opportunity to succeed in PacifiCorp's service territory. See ICNU/100, Falkenberg/55-57. The Commission has been provided with two clear options regarding the appropriate transition adjustment in this proceeding. First, the Company and Staff recommend a transition adjustment based on the Company's GRID computer model that consistently undervalues PacifiCorp's resources and ensures that customers will never elect direct access. In contrast, ICNU has submitted a proposal that uses the price for

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standard products and recognizes that direct access load will result in a net reduction of purchases. ICNU's transition adjustment is realistic and is the only proposal that could remedy an uneconomic transition adjustment that has been a barrier to direct access participation.

A. PacifiCorp's Transition Adjustment Should Fully Value the Company's Resources

ICNU's proposed avoided purchase transition adjustment is the only methodology that: 1) accurately reflects how PacifiCorp should respond to direct access; and 2) may provide direct access customers with the full value of PacifiCorp's economic utility investment. ICNU's proposal reflects actual operational responses and "appropriate planning" because it recognizes "that when the system is appropriately planned, departure of direct access load will result in a net reduction in purchases." ICNU/100, Falkenberg/55. An avoided purchase transition adjustment also does not artificially reduce the value of the PacifiCorp's freed-up resources by excluding transmission costs or forcing PacifiCorp to sell power that it acquired to serve customers that elect direct access.

PacifiCorp and Staff proposed a transition adjustment mechanism that would calculate the transition adjustment based on the difference between a GRID model run with the full Oregon load and a GRID model run with a 25-megawatt ("MW") load reduction. PPL/700, Omohundro/3; Staff/600, Galbraith/2-4. The comparison would provide a "weighted market value" of the energy associated with any direct access load. PPL/700, Omohundro/3, 5-7; Staff/600, Galbraith/2-4. A credit would be obtained by

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subtracting the customers' cost of service rate from the "weighted market value." Id. Although PacifiCorp provided an illustration regarding how its transition adjustment would work in its testimony, the Commission cannot verify how the proposal would actually be calculated because the Company has not filed a proposed transition adjustment tariff. See Tr. 125-26 (Omohundro).

The PacifiCorp/Staff transition adjustment mechanism fails to capture the value of PacifiCorp's freed-up resources because the GRID model: 1) does not simulate planning and operational changes that would occur if customers elected direct access; 2) does not reflect changes in PacifiCorp's transmission costs; and 3) may include other biases that inherently undervalue PacifiCorp's resources used to serve direct access customers. Essentially, the PacifiCorp/Staff proposal suffers from substantially the same failings that caused past transition adjustment mechanisms to act as a barriers to direct access.

B. PacifiCorp's Failure to Plan for Direct Access Load Loss Undervalues the Company's Freed-Up Resources

The GRID based transition adjustment does not assume any direct access load loss nor does it anticipate the operational changes associated with a functioning direct access program. ICNU/100, Falkenberg/55; PPL/609, Widmer/8; Staff/700, Galbraith/7-9. This failure to plan on direct access load loss "creates a 'self-fulfilling prophecy' whereby direct access never leads to a change in resource plans, thus the value of freed up resources is always too low to allow competition to get started." ICNU/100, Falkenberg/54. PacifiCorp agrees that, "[i]f the Company planned for direct access and

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the planned for load reduction occurred, the value credited would likely be closer to the market price of power." ICNU/529. Based on PacifiCorp's original transition adjustment, the failure to plan direct access load loss reduces the value of the Company's freed up resources by about $2.70 per MW hour ("MWh"). ICNU/100, Falkenberg/56.

PacifiCorp and Staff argue that the Company should not plan on direct access load loss because: 1) this issue should be addressed in PacifiCorp's current least cost plan ("LCP"); 2) the combination of a required cost of service rate and an annual election window require a short-term operational transition adjustment; and 3) the Company does not know how many customers will elect direct access. Staff/700, Galbraith/7-10; PPL/609, Widmer/7-9; ICNU/529. Staff's attempt to shift this issue to PacifiCorp's LCP docket is troubling. There is no reason PacifiCorp's implementation of its LCP cannot accommodate any changes required by the Commission's final order in this proceeding. More importantly, Staff ignores that the Commission recognized that a fundamental issue in this proceeding would be "whether PacifiCorp should anticipate direct access load in order to avoid acquisition for departing load." Re Investigation into Direct Access, OPUC Docket No. UM 1081, Order No. 04-516 at 12 (Sept. 14, 2004).

PacifiCorp and Staff's proposal is also inconsistent with SB 1149. The assertion that the separate statutory requirements for an annual selection and a cost of service rate cause direct access to always be uneconomic is nonsensical. The Legislature would not pass a law providing that customers have a legal right to choose alternative energy suppliers, but that right is meaningless because of a separate statutory provisions. The Commission is required to read statutes as a whole in order to give effect to all

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provisions of the law and establish a consistent legislative policy. Oregon v. Guzek, 322 Or. 245, 268-70 (1995); ORS § 174.010 (2003). The Commission should reasonably interpret SB 1149 in its entirety and require PacifiCorp to implement a transition adjustment that assumes a functioning, realistic direct access program.

C. Direct Access Eligible Customers Should Be Compensated for the Full Value of PacifiCorp's Transmission Resources

ICNU's proposed transition adjustment mechanism passes through to direct access customers the value of transmission resources that are currently utilized to serve these customers. ICNU witness Falkenberg calculated a conservative value for these resources of $1.08/MWh. ICNU/100, Falkenberg/56; ICNU/111, Falkenberg/20. In contrast, PacifiCorp assumes that some of PacifiCorp's transmission rights cannot be marketed, and thus, customers that elect direct access should not be compensated for any of their value. This interpretation is inconsistent with SB 1149's requirement that the Commission calculate the value of the PacifiCorp's economic utility investment from the perspective of the departing customers, not the Company or the remaining ratepayers.

PacifiCorp asserts that the full value of freed up transmission resources should not be passed on to direct access customers because: 1) GRID includes some transmission costs; and 2) certain transmission contracts may not be assignable or sellable to other parties. PPL/609, Widmer/7-8. Although GRID models some transmission costs, the "vast majority of transmission costs" are not included in GRID because it fails to "accurately assess whether reductions in purchases produce lower transmission costs in a scenario where direct access load leaves the system." ICNU/100, Falkenberg/53.

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PacifiCorp admits that the GRID model does not calculate a value for much of its transmission resources, but asserts there is little benefit that can be passed on to direct access customers because these costs are fixed through long-term transmission agreements. PPL/609, Widmer/7-8. PacifiCorp's assertion that these transmission contracts are not assignable or sellable has not been proven. In addition, the Company's argument would reduce, but not eliminate the value of these resources. ICNU/111, Falkenberg/20. At a minimum, these fixed transmission resources have value to PacifiCorp because load growth will require the Company to acquire additional transmission and the Company will be able to avoid future transmission costs if customers elect direct access. Id. Direct access customers should not receive zero value for these resources because the Company asserts that it cannot recapture their full value.

PacifiCorp's position is also inconsistent with SB 1149's requirement that freed-up resources be broadly interpreted and valued based on the benefits they provide to direct access customers, not the utility. The definition of "economic utility investment" encompasses a wide array of utility assets and resources, and requires the Commission to focus on the value of the utility's resources from the perspective of the direct access customer, not the utility or remaining ratepayers. ORS § 757.600(10) (2003). Thus, PacifiCorp's "economic utility investments" are equal to the full value of the freed-up resources to the direct access customer, not the value that the utility would assign them.

PacifiCorp is currently serving customers eligible for direct access with its transmission resources and these customers will continue to benefit from them if they

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remain on cost-of-service rates. Under PacifiCorp's proposal, a direct access customer will no longer receive any value for these resources if the customer takes service from an alternative energy supplier. Regardless of whether PacifiCorp can sell or transfer these resources, SB 1149 and the Commission's rules require that direct access customers not lose the benefits of these resources because they stop purchasing power from PacifiCorp.

V. CONCLUSION

PacifiCorp's revenue requirement request of $52.5 million should be reduced to reflect additional adjustments related to taxes, RTO expenses, RVM power costs, fuel handling costs, new imprudent and above market Utah resources, the UM 995 outages, and existing Utah QF contracts. These reductions result in an approximate $1 million revenue requirement increase. The Commission should reject the Company's proposed RVM because it is unnecessary and harmful, and adopt ICNU's transition adjustment because it is the only proposal that is consistent with SB 1149 and may allow customers a realistic opportunity to elect direct access.

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Dated this 4th day of August, 2005.

Respectfully submitted,

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ATTACHMENT A

PacifiCorp Response to ICNU Data Request 2.136 in WUTC Docket No. UE-050684

ICNU Data Request 2.136

Does PacifiCorp propose to make the Revised Protocol retroactive to June 1, 2004 if the document is approved by the Commission in this proceeding? If yes, please explain why that would not result in a refund to Washington customers for the rates that went into effect in Docket No. UE-032065.

Response to ICNU Data Request 2.136

No. Applying the Revised Protocol retroactively would be inconsistent with the Commission's Order in Docket No. UE-032065 and would constitute retroactive ratemaking. In addition, Section II of the Revised Protocol states:

> ***"II. Proposed Effective Date***
>
> *The Protocol will be effective and apply to all PacifiCorp retail general rate proceedings initiated subsequent to June 1, 2004."*

Since Docket No. UE-032065 was initiated prior to June 1, 2004, it would be inconsistent with the terms of the Revised Protocol to apply it in that case.

Responder: Gregory N. Duvall
Witness: Gregory N. Duvall