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VIA ELECTRONIC FILING

PUC Filing Center
Public Utility Commission of Oregon
PO Box 2148
Salem, OR 97308-2148

Re: PacifiCorp's Prehearing Brief
Docket UE 170

Enclosed for filing please find PacifiCorp's Prehearing Brief in the above-referenced docket. A copy of this filing was served on all parties to this proceeding as indicated on the attached service list.

Very truly yours,

Katherine A. McDowell

KAM:knp
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BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON

UE 170

In the Matter of PACIFIC POWER & LIGHT (d/b/a PacifiCorp) Request for a General Rate Increase in the Company's Oregon Annual Revenues.	**PACIFICORP'S PREHEARING BRIEF**

Pursuant to Judge Logan's May 27, 2005 ruling and June 14, 2005 memorandum, PacifiCorp (or the "Company") submits this Prehearing Brief in advance of the July 20-22, 2005 hearing.

I. INTRODUCTION

After the various stipulations and updates in its filing described below, PacifiCorp now requests a revenue requirement increase in this case of approximately $75.9 million. This constitutes a 9.3 percent increase, or an overall net increase of 3.5 percent, considering the end of the UM 995 deferral sometime this summer. The outcome of this case is critical to PacifiCorp and its customers in terms of ensuring that PacifiCorp's credit ratings and financial status remain strong. The Company now anticipates the need for $1 billion annually in new capital expenditures, such as its 2005 64.5-MW Wolverine Creek wind project and $160 million in new distribution plant in Oregon between FY 2004 and the end of the test period in this case.

The Commission can grant PacifiCorp's revenue requirement request with a moderate, single-digit rate increase. Including the proposed rate change, PacifiCorp's overall average prices remain less than the overall average retail price in Oregon, a state which has some of the lowest electric prices in the United States. Without the rate change, PacifiCorp's prices will decrease on a net basis, an anomalous result considering PacifiCorp's higher costs, increased need for capital investment and more stringent credit rating requirements. By rejecting extremes and embracing the reasonable, realistic positions of the Company on

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cost of capital, FAS pension expense and taxes, the Commission can deliver a win/win outcome in this case: financial stability for PacifiCorp and the continuation of low rates for customers.

II. PROCEDURAL BACKGROUND

On November 12, 2004, PacifiCorp filed revised tariff schedules requesting a general rate increase of $102 million, or 12.5 percent overall, in the Company's Oregon annual revenues. This revenue requirement implemented the Revised Protocol allocation method, which reduced the Company's revenue requirement by approximately $12.7 million compared to the Modified Accord method.

Thanks to constructive engagement by Staff and intervening parties, the parties have resolved several major issues in this case. PacifiCorp has entered into four Stipulations in this case, each supported by Joint Testimony of the stipulating parties:

- The first Partial Stipulation, dated May 4, 2005, is among PacifiCorp, Staff, CUB, ICNU, and Fred Meyer. This stipulation resolved the following issues: (1) net power costs (this covered all but one NPC issue), (2) load forecast revision, (3) operating revenue, (4) incentive programs, (5) non-labor administrative and general costs, (6) other revenues, (7) Bridger coal costs, (8) FIT and SIT, (10) production activity deduction, (11) hydroelectric relicensing costs, (12) miscellaneous corrections, (13) allocation factor update, (14) Schedule 200 tail block, and (15) change in graveyard market caps for PacifiCorp's Transition Adjustment Mechanism. This Stipulation reduced PacifiCorp's revenue requirement in the November 12, 2004 filing to approximately $71 million.

- The Partial Requirements Stipulation, dated May 6, 2005, is among PacifiCorp, Staff, the Oregon Department of Energy, and ICNU. This stipulation resolved issues related to customers that generate electricity to meet some or all of their own power requirements. This stipulation did not address PacifiCorp's revenue requirement.

- The second Partial Stipulation, dated June 29, 2005, is among the same parties as the first Partial Stipulation. The second Partial Stipulation settled the employee benefits issue and resulted in a $2.41 million reduction in the Company's filed revenue requirement.

- The third Partial Stipulation, dated June 29, 2005, is between PacifiCorp and Staff. The third Partial Stipulation resolved issues pertaining to RVM power costs and a fuel handling charge that were excluded from the first Partial Stipulation. The third Partial Stipulation will result in an approximately $4.3

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> million increase to the Company's revenue requirement effective January 1, 2006, if the proposed Transition Adjustment Mechanism is approved. The third Partial Stipulation also reflects an agreement to allow the Company to correct its revenue requirement to include a fuel handling charge, an increase of $2.49 million. Finally, the third Partial Stipulation contains Staff's agreement to support PacifiCorp's position on the waiver of the New Resource Rule and the treatment of new QF contracts under the Revised Protocol.

Another major issue in this case, the status of the Klamath irrigators' special contracts, was effectively bifurcated from the case by the agreement of the parties, memorialized in the Prehearing Conference Memorandum issued by Chief Administrative Law Judge Michael Grant on June 30, 2005, to waive the UE 170 suspension period for this issue and rely on Schedule 33 as the interim rate for these customers pending a final Commission decision before April 2006.

In its sur-surrebuttal testimony, PacifiCorp updated its capital costs by decreasing its costs of long-term debt and preferred equity. It also updated its pension costs by increasing its FAS 87 expense, decreasing its FAS 106 expense and accepting Staff's pension administration adjustment. PacifiCorp's updated proposed revenue requirement presented in the sur-surebuttal testimony of Mr. Wrigley takes into account the effect of the three Partial Stipulations bearing on revenue requirement, the Klamath irrigators' interim rate and updated pension and capital costs.

This prehearing brief addresses the issues remaining in the case in the manner designated in Judge Logan's June 14, 2005 memorandum: (1) Cost of Capital, consisting of Capital Structure, Return on Equity ("ROE"), and Cost of Debt; (2) Pensions; (3) the Transition Adjustment Mechanism (also referred to as "RVM"); (4) Consolidated Tax Adjustments; (5) Recovery of Regional Transmission Organization ("RTO")-related costs; (6) Cost of Service; (7) Rate Spread and Rate Design; and (8) Miscellaneous Issues, including PacifiCorp's request for a waiver of the New Resource Rule.

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III. STATEMENT OF PENDING ISSUES

A. Cost of Capital

The governing standard for determining a utility's cost of capital remains as set out in the famous "*Hope*" case, *Federal Power Comm. v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944), codified in Oregon at ORS 756.040. According to *Hope*, the utility rate order should allow enough revenue to pay PacifiCorp's actual debt costs. In addition, the rate order should allow PacifiCorp an equity return that both (1) provides the Company with returns comparable with returns on investments having comparable risks and (2) maintains the Company's credit and ability to attract capital:

> "From the investor or company point of view, it is important that there be enough revenue not only for operating expenses, but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital."

Satisfaction of the second standard of *Hope*—the maintenance of PacifiCorp's credit ratings—is of key importance in this proceeding.

As noted above, the Company is now in a "build" cycle and needs to invest over $1 billion over the next several years. This major deployment of new capital is required if PacifiCorp is to continue to provide the high level of safe and reliable service that its customers now receive and expect to continue to receive. Given these capital requirements, the Company seeks a cost of capital allowance sufficient to maintain its current "A-level" senior bond ratings. As discussed below, the proposed treatment by Staff and intervenors of the Company's capital structure, its cost of long-term debt and preferred equity, and its allowed return on common equity, if adopted, can be expected to impair PacifiCorp's credit at this critical time in its investment cycle. Therefore, the following cost of capital issues remain outstanding:

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1. Capital Structure

PacifiCorp's rate increase request is based on its actual capital structure as of March 31, 2006. As updated for changes that have occurred subsequent to the filing of the Company's direct case, this capital structure consists of 49.44 percent long-term debt, 1.06 percent preferred equity and 49.50 percent common equity. This capital structure includes four common equity contributions totaling $500 million from ScottishPower planned for FY 2006, the first of which was made on June 30, 2005, in the amount of $125 million. The Commission approved PacifiCorp's issuance of equity in conjunction with these contributions on June 7, 2005 in Order 05-729. ScottishPower is required to make these contributions to PacifiCorp in FY 2006 under its agreement with Mid-American Energy Holdings Company.

Staff and CUB/ICNU seek to impose on PacifiCorp a hypothetical capital structure that completely excludes the $500 million in actual equity contributions. This position fails to acknowledge that the equity contributions have become a known and measurable event for the test year, one that is highly beneficial for PacifiCorp. Mr. Williams demonstrates that this new equity is required to maintain PacifiCorp's current credit ratings, because of PacifiCorp's capital investment needs, credit agencies' demands for increased equity ratios and their imputation of debt related to long-term PPAs.

2. Long-Term Debt

As updated for post-filing changes, PacifiCorp's proposed 2006 capital structure includes $324.4 million in new long-term debt issuances. PacifiCorp prices these new securities based on the cost of 20-year "A-rated" utility bonds, using the forward interest rates for such bonds as to the time of needed future issuance.

Staff acknowledges the need for the additional debt securities, but prices the securities based on the lower <u>current</u> interest rates applicable to a mix of <u>5-, 7- and 10-year</u> utility bonds. PacifiCorp objects to Staff's adjustments because the adjustments will

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preclude the Company from recovering the expected cost of its test year bond issuances, based on the best information available today. Mr. Williams explains why the Company's new bonds are expected to have an average life of 20 years, which also was the average life of the Company's bonds issued in 2004. Mr. Williams also explains that Staff's use of current interest rates ignores the best evidence of the actual future cost to service the test year bonds.

3. Cost of Preferred Equity

The only remaining dispute between Company and Staff witnesses with respect to preferred equity again arises from the Company's efforts to recover the actual cost of its capital. The issue is whether the Company should be allowed to recover the actual cost of retiring its Quarterly Income Debt Securities (or "QUIDS"), which have been treated as preferred equity in the Company's capital structure. In recommending rejection of these costs, Staff cited the Commission's holding in Order 01-787. In that Order, the Commission disallowed QUIDS retirement costs, but also stated (at page 19 of the Order): "If the Commission had been given persuasive evidence as to how customers specifically benefited from PacifiCorp's decision to redeem the QUIDS, we would be inclined to allow the expense." In response to this holding, the Company in this proceeding has explained how the redemption of QUIDS has benefited customers, and thus asks for inclusion of its remaining unamortized redemption expenses.

4. Cost of Common Equity

The Company seeks an allowed ROE on its common equity of 11.125 percent, in accordance with the testimony and analyses of its ROE expert Samuel C. Hadaway. Dr. Hadaway's recommendation is based on discounted cash flow analyses and a risk premium analysis. Staff witness Thomas Morgan and CUB/ICNU witness Michael Gorman each propose only a 9.5 percent allowed ROE.

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On a technical level, the ROE dispute may seem to center around a dispute over how to forecast long-term growth in earnings in discounted cash flow analyses of expected ROEs for companies comparable to PacifiCorp. The "growth" forecasting debate centers around how one should incorporate a recently-appearing discontinuity in Value Line's growth projections for comparable companies—with earnings growth in Value Line's 3- to 5-year projection period currently being forecast to be 1.6 percentage points lower per year than the Value Line forecast used in PacifiCorp's last general rate case. Staff and CUB/ICNU urge the Commission to make no adjustment in the longer-term forecast for this sudden drop in the nearer-term projections. Dr. Hadaway concludes that the presumption of a major long-term shift in growth rates is implausible and should be compensated for in the longer-term discounted cash flow growth forecasts.

However, the core issue in this proceeding is not a discounted cash flow forecast issue at all—instead, the key question is whether the Commission in today's very low interest rate environment should impose a comparably low ROE, without regard to the impact of such ROE on PacifiCorp's credit ratings. In his direct testimony, Dr. Hadaway presented a risk premium study, showing the historic relationship of long-term utility bond interest rates to allowed ROEs. The study demonstrates a consistent pattern—as interest rates increase, the spread between such interest rates and allowed ROEs narrows, and as interest rates decrease, the spread between such interest rates and allowed ROEs widens. Thus, allowed ROEs move up and down with utility long-term bond interest rates, but at a much slower rate in each direction. Based on an extensive risk premium study, Dr. Hadaway concluded that at current interest rates, his "risk premium" ROE would be 10.95 percent, although he noted that other risk premium studies would produce somewhat higher ROE estimates.

The risk premium analysis correlates reasonably closely with recent actual Commission ROE determinations across the nation. The average allowed ROE in 2004

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decisions nationwide was 10.73 percent. The average allowed ROE for the last quarter of 2004 and the first quarter of 2005 averaged 10.91 percent and 10.44 percent, respectively.

The testimony in this proceeding demonstrates why ROE determinations do not drop nearly as far in low interest periods as recommended by Messrs. Morgan or Gorman—ROEs in the 9 percent range simply will not support the bond ratings PacifiCorp needs to preserve. The analyses not only by Company witnesses, but also by CUB/ICNU witness Gorman on surrebuttal, convincingly demonstrate the incompatibility of proposed single-digit allowed ROEs with the rating agency metrics that would preserve PacifiCorp's "A-level" senior bond rating. In this proceeding, PacifiCorp will urge the Commission not to put it on the risky path of credit downgrades at a time when it faces unusually large capital requirements.

B. Pensions

Based upon prior Commission precedent, there is no disagreement among the parties that the Commission should determine PacifiCorp's pension costs in this case using its actuarially determined FAS pension costs. *See, e.g., In re PacifiCorp*, UM 1073, Order 03-233 at Appendix A, p. 2 (April 18, 2003) ("actuarially determined FAS pension costs are generally recoverable in rates as has been the case in past rate cases"). The dispute in this case centers on whether PacifiCorp's estimate for its 2006 FAS expenses is accurate. Staff and ICNU rely upon much lower 2004 actual FAS pension expenses in their adjustments than the projected 2006 FAS pension expense PacifiCorp filed in this case.

To address this concern, the Company updated its filing to rely on the most recent actual year of FAS pension expense, 2005. In the case of FAS 87, general pension expense, this produces a higher number than originally filed (and increase from $42.2 million to $49.9 million). In the case of FAS 106, post-retirement benefits, this produces a lower number than originally filed, because it incorporates savings from a new Medicare law (a decrease from $26.8 million to $24 million).

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In addition to updating its pension costs in the case to reflect its most recent actual FAS expenses, PacifiCorp has provided testimony from its actuary, Mr. Kopec of Hewitt Associates, stating that PacifiCorp's FAS pension expense for 2006 will be the same or higher as PacifiCorp's 2005 FAS pension expense.

To address the concern that PacifiCorp's 2006 FAS expense is inflated, Mr. Rosborough proposes a balancing account to address any variation between actual FAS pension expense and the level of expense set in this rate proceeding. The Company proposed similar treatment for its pension expense in UE 147, consistent with the balancing account approved for NW Natural in Order 03-507, but this concept was not included in the parties' Stipulation in that case.

The Company's actual FAS pension expense in the last two years has been significantly more than that reflected in rates. In 2004-05, the Company's actual FAS expense was almost $50 million greater than the amount now reflected in rates. To prevent significant future under recovery of PacifiCorp's FAS pension costs, the Commission should reset PacifiCorp's pension expense using its actual 2005 FAS pension expense, with a balancing account to ensure accuracy of this cost projection.

C. Transition Adjustment Mechanism/RVM

1. RVM Policy

In UM 1081, the Commission adopted an interim Transition Adjustment Mechanism and directed PacifiCorp to file a permanent Transition Adjustment Mechanism by November 15, 2004 for use beginning with the fall 2005 enrollment window. Consistent with this order, PacifiCorp conducted stakeholder workshops focused on development of a permanent RVM. The Company then filed an RVM proposal in this case that reflects the feedback from these workshops.

As set out in the testimony of Ms. Christy A. Omohundro, PacifiCorp designed its RVM to balance the need for a streamlined and straightforward mechanism with the view

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that the Transition Adjustment should neither subsidize nor hinder direct access. While CUB and ICNU oppose the mechanism, they have not proposed alternatives to it that fully address the complex issues involved. Staff generally supports PacifiCorp's proposed RVM on the basis that it accomplishes a reasonable balance of the interests implicated.

The Company's proposed RVM is based on calculating the difference between the weighted market value of the energy previously used to serve Direct Access customers and the cost of service rate under the customers' specific, energy-only tariff schedules. This calculation relies on GRID, PacifiCorp's power cost model. To avoid complexity and reduce regulatory impact, the proposed RVM impacts all customers, not just customers eligible for Direct Access.

Because it is in the best interest of all of PacifiCorp's customers to update relevant data to ensure that the final adjustment is as accurate as possible, PacifiCorp proposes to update net power costs and the proposed RVM at the end of this proceeding (around October 1, 2005). This update will be based on the Commission approved net power costs and new executed contracts through September 15, 2005. The Company will also file a limited update just prior to the November 2005 enrollment window that will incorporate the Company's most recent forward price curve.

Updating the Company's official forward price curve and net power costs in October, right before the Direct Access transition adjustment is calculated, ensures that the adjustment applied to departing customers is as accurate as possible and is in the best interest of all customers. In the future, the Company proposes to update net power costs each year to reflect changes in customer rates consistent with the update of the Transition Adjustment.

No matter what method is used, the calculation and approval of a transition adjustment is a complex matter. To minimize the time and resources involved in this process, PacifiCorp's proposed RVM is largely mechanical and is conceptually based on PGE's existing RVM. A Transition Adjustment Mechanism modeled after PGE's RVM

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makes sense because the Commission has already reviewed and approved PGE's RVM and because PGE's RVM has already been in place for three annual cycles. In addition, by basing its RVM on an existing and approved model, the Company can avoid the complexities (and concomitant costs) associated with a new and unfamiliar mechanism and process.

Staff objected to one aspect of PacifiCorp's RVM proposal, the exclusion of variable costs associated with new resources until the plant is providing utility service, as contemplated by Oregon statute, and matching fixed costs are included in the Company's rate base. As explained by Ms. Omohundro, PacifiCorp has agreed to include the variable costs of its new resources in the RVM even if the fixed costs are not yet in rates. The impact of this concession is a potential reduction in costs and a benefit to customers.

2. RVM Power Costs

The third Partial Stipulation between PacifiCorp and Staff resolves issues pertaining to RVM power costs. This settlement addresses the updates and changes to power costs that will occur if the RVM mechanism is adopted. The changes to power costs will be implemented on January 1, 2006, when the RVM goes into effect.

ICNU has opposed several of these updates and changes, and Mr. Widmer responds fully to these adjustments. As Mr. Widmer notes, if the RVM is rejected, PacifiCorp proposes that a number of the updates and changes to its power costs embedded in the third Partial Stipulation be introduced into net power costs set in this phase of UE 170.

D. Consolidated Tax Adjustments

As required by Commission rule OAR 860-027-0048, PacifiCorp proposes to set its tax expense in this case based upon the stand alone method for calculating utility taxation. No party to this case has questioned the accuracy of PacifiCorp's stand alone tax expense. Instead, Staff, ICNU, CUB and URP (collectively, "Staff and Intervenors") propose adjustments to PacifiCorp's tax expense based upon the tax liability of its parent, PacifiCorp Holdings, Inc. ("PHI"). These consolidated tax adjustments are in conflict with OAR 860-

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027-0048, long-standing Commission precedent and the Department of Justice's (DOJ) advice on the legality of consolidated tax adjustments.

The Commission should not disregard its own Administrative Rule, adopted just a few years ago, which requires the tax expense in utility rates to be calculated using the "stand alone" method. *See* OAR 860-027-0048 (requiring tax expense in utility rates to be calculated for regulatory and ratemaking purposes using "stand alone" method, whether or not utility is part of consolidated group for federal and state tax filing purposes).[1]

As PacifiCorp's tax expert, Mr. Bernard L. Uffelman, explains in his rebuttal testimony, ratemaking tax expense that is calculated under the stand alone method is based on the items of income and expense included in the regulated utility's revenue requirement calculation. In this way, both tax obligations and tax savings created by activities of non-regulated operations, including those created by affiliated entities such as parents, brother and sister affiliates and subsidiaries, are not allocated to customers. As Mr. Uffelman observes, this approach is consistent with ratemaking principles that segregate regulated and non-regulated operations, often referred to as "ring fencing."

This Commission has previously rejected attempts by a utility to include in rates tax liabilities of the utility's consolidated affiliates. *See Re Or. Exch. Carrier Ass'n*, Order

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[1] OAR 860-027-0048, entitled "Allocation of Costs by an Energy Utility," provides:

> (4) The energy utility shall use the following cost allocation methods when transferring assets or supplies or providing or receiving services involving its affiliates:
>
> * * *
>
> (h) Income taxes shall be calculated for the energy utility on a standalone basis for both ratemaking purposes and regulatory reporting. When income taxes are determined on a consolidated basis, the energy utility shall record income tax expense as if it were determined for the energy utility separately for all time periods.

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No. 93-325, 1993 WL 117620, at *6 (Mar. 12, 1993) *recons. denied*, Order No. 93-879, 1993 WL 390953 (Or Pub Util Comm'n June 28, 1993). Likewise, this Commission has also consistently rejected attempts to include in rates the tax savings of the utility's consolidated affiliates. *See, e.g., In re Util. Reform Project*, Order No. 03-214, App. A at 2 (Or Pub Util Comm'n Apr. 10, 2003). In every instance, the Commission has rejected proposed consolidated tax adjustments on the basis that such adjustments are contrary to the Commission's obligation to prevent cross-subsidization of regulated and unregulated activities. *See Re Affiliated Transactions for Energy Utils.*, Order No. 03-691, 2003 WL 23305011, at *1 (Or Pub Util Comm'n Dec. 1, 2003) (purpose of stand alone rule is to prevent cross-subsidization).

Staff and Intervenors nevertheless propose that the Commission disregard its own rule as well as long-standing precedent. Specifically, Staff, ICNU and CUB propose that PacifiCorp's tax expense, which is calculated for ratemaking purposes based on the expenses and revenues of regulated operations, be decreased to reflect a portion of the consolidated tax savings created by PHI's interest payments. Their proposal would allocate to PacifiCorp's customers tax savings created by PHI's interest payments on the debt used to finance ScottishPower's acquisition of PacifiCorp—debt that the Commission wholly excludes in calculating PacifiCorp's cost of service. URP goes even further, proposing that PacifiCorp's stand alone tax expense be decreased to reflect the total consolidated tax liability of the ScottishPower consolidated group. URP's proposal would allocate to PacifiCorp's ratepayers the tax savings created by all PacifiCorp's affiliates' losses, expenses, deductions and credits, plus the tax effects of deferred taxes resulting from accelerated depreciation of utility property. Either approach would allocate the tax benefits of PHI's losses to ratepayers, which allocation would not be consistent with the stand alone method or the sound principles upon which it is based.

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Furthermore, even if the Commission were to choose to change or inappropriately disregard its own rule, Staff and Intervenors have failed to establish the "burden" that the DOJ has advised is necessary to justify a consolidated tax adjustment. As Mr. Larry Martin, Staff and CUB observe in their testimony, the DOJ recently advised the Commission that it may order a consolidated tax adjustment only if the adjustment satisfies the "benefits and burdens" standard.

> "The benefits and burdens test can be simply stated as: the benefits of consolidated tax savings are given to ratepayers (by reducing the utilities tax allowance) if the customers bore the burden of paying the deductible expenses that generated the savings." Legality of Setting Utility Rates Based Upon the Tax Liability of Its Parent, Jason W. Jones, Dep't of Justice Memorandum at 7, Feb. 18, 2005.

Although Staff and CUB recognize the "benefits and burdens" standard, they fail to demonstrate the existence of the requisite burden. Both speculate that PHI's acquisition debt burdens customers by adversely impacting PacifiCorp's credit rating. Staff's and CUB's arguments ignore the fact that the net impact of ScottishPower on PacifiCorp's customers is *positive*, and instead speculate on the impact of one debt issue to the exclusion of the remainder of the debt and equity contained in ScottishPower's capital structure. As Mr. Williams explains, the relevant inquiry is whether PacifiCorp's capital financing costs have increased by virtue of the merger with ScottishPower. As to this issue, the credit agencies have been unambiguously clear—PacifiCorp's merger with ScottishPower has *improved* PacifiCorp's credit evaluation, and thus the merger has made possible a *lower* cost of capital than if the merger had not occurred. Absent a showing of a *negative* credit impact from the affiliation with ScottishPower, the Commission has no basis for making a downward adjustment.

Staff and CUB also speculate that PHI debt requirements may have led to an increase in PacifiCorp's dividend payout requirements, resulting in increased demands for cash at PacifiCorp and depressing PacifiCorp's credit metrics. Mr. Williams' testimony

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demonstrates that this speculation is wholly unsupported. Rather than requiring an increased dividend payout, ScottishPower has accepted major *reductions* in dividend levels from levels paid prior to the merger with ScottishPower. PacifiCorp went so far as to totally eliminate its dividend during fiscal 2003 following the Western Power Crisis. PacifiCorp then resumed its quarterly dividend payments at a $40 million level—half the rate it was paying before the dividend suspension—and has increased the dividend in steps to a current quarterly level of $51 million, which is still substantially less than its pre-merger dividend. At the same time, ScottishPower is contributing $125 million in additional equity to PacifiCorp each calendar quarter. Rather than burdening PacifiCorp's customers, the actions of ScottishPower have been highly supportive of PacifiCorp's credit quality.

If the Commission decides to change its tax policy, it should do so in an orderly, deliberate and forward-looking manner by opening a rulemaking to consider changes to its current stand alone utility taxation rule. In advance of a change in the Commission's rule, it should not approve ad hoc consolidated tax adjustments. In any event, it should not approve a consolidated tax adjustment that does not satisfy the benefits and burdens test.

E. Recovery of RTO-Related Costs

The Federal Energy Regulatory Commission ("FERC") has called on all transmission owners to join RTOs to boost competition and to bring consumers the lowest possible prices for electricity. Likewise, the Commission has made clear that it views the formation of an effective RTO as essential for a fair and efficient wholesale electricity market in the Northwest. PacifiCorp's participation in an RTO should provide system operation efficiencies, reliability benefits, improved planning and decision-making on system expansion, and "one-stop shopping" for transmission services.

The Oregon-allocated amount of the Company's total expenditures related to development of an RTO is properly included in this proceeding as ongoing regulatory expense. Current RTO-related costs are "useful" as required by Oregon statute, because the

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Company needs to comply with current FERC requirements in order to continue operations as a transmission provider.

Even if Grid West ultimately fails to receive the support of the region, the Pacific Northwest must continue to work jointly to plan a transmission system to accommodate the growing importance of renewables, continued load growth, Direct Access programs, and increasing congestion on the grid. That work will be done, and is being done, by the same people and resources currently deployed in support of an RTO. PacifiCorp must commit to this type of work and this level of resources if the region is to maintain the high reliability and flexibility that are the hallmarks of the Northwest system. PacifiCorp's customers directly benefit from the Company's transmission services and, consequently, from the ordinary, necessary, and reasonable expenditures that are associated with the provision of such services.

F. Cost of Service

PacifiCorp determines its target revenue requirements and allocates system costs to Oregon using the Revised Protocol. Costs allocated to Oregon are functionalized into categories, such as generation, transmission, and distribution, among others. PacifiCorp's cost of service analysis is presented by its witness Mr. David L. Taylor.

The major issue of controversy on cost of service is whether the Company's new QF contracts in this case, US Magnesium, Desert Power, Kennecott, and Tesoro, should be treated as "New" or "Existing" under the Revised Protocol. The Commission ratified the Revised Protocol on January 12, 2005 in Order No. 05-021 (UM 1050).

As described in Mr. Taylor's testimony, the Revised Protocol allocation methodology differs in three ways from the Modified Accord methodology. One category of costs that is affected by the Revised Protocol is QF Contracts. Under the Revised Protocol, the costs of New QF Contracts are allocated on a system basis. Conversely, the costs of Existing QF contracts are allocated on a situs basis. The treatment of QF Contracts is important in this

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case because the four QF Contracts at issue are not located in Oregon and their classification, as Existing QF Contracts would lower Oregon's allocated costs.

Because these contracts were entered into after the effective date of the Revised Protocol, PacifiCorp properly classified these contracts as "New QF Contracts." Although this results in allocation of these costs on a system basis, the net effect of implementation of the Revised Protocol in this case is positive for Oregon customers. As noted above, the revenue requirement as originally filed in this case was $12.7 million less than what it would have been under the Modified Accord method.

In the third Partial Stipulation, Staff agreed to support PacifiCorp's treatment of the four QF Contracts under the Revised Protocol. ICNU objects to PacifiCorp's classification, based on its interpretation of the effective date of the Revised Protocol. ICNU argues that the Revised Protocol's effective date is the date the Commission approved the ratification of the Revised Protocol—January 12, 2005. ICNU's interpretation of the effective date is erroneous because the Revised Protocol has a clearly defined effective date of June 1, 2004 and plainly classifies New QF Contracts as contracts that were entered into after that date. There is no mention in the Revised Protocol that the effective date is related in any way to the date that it is ratified by the states. Nor did the Commission change the "effective date" language of the Revised Protocol upon its approval. The Commission should conclude that PacifiCorp has properly treated these transactions as "New QF Contracts" and reject ICNU's adjustment.

G. Rate Spread and Rate Design

In order to minimize price impacts on customers from the requested rate increase, PacifiCorp seeks to implement a rate spread such that none of the major rate schedules will see an overall net rate increase greater than 9.9 percent or approximately 1.5 times the overall average net increase proposed in this case. The Company's witness, Mr. William R. Griffith provides testimony on behalf of the Company on this issue and on the issue of rate design.

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Mr. Griffith also provides testimony addressing CUB's proposal to address billing period variability by implementing a fixed, prorated billing cycle for all residential customers (the "All Bills" proposal). Initially, the Company responded to CUB's with a proposal to pro rate only those bills under 26 days and over 34 days, because of its concerns about the costs and complexity of an "All Bills" approach. Mr. Griffith's sur-surebuttal testimony reflects additional review of the issue by PacifiCorp and its agreement that an "All Bills" approach could be workable.

H. Miscellaneous Issues

1. New Resource Rule Waiver

PacifiCorp's request for a waiver of the New Resource Rule was made on a timely basis and addresses three competitively priced resources that compare favorably against market alternatives—the West Valley Lease, the Gadsby CTs and Currant Creek. In the testimony of Mark Tallman, PacifiCorp has provided significant evidence that each of these resources was priced below market at the time the resource was acquired. Staff witness William Wordley's testimony indicates that Staff's independent analysis of these three resources demonstrates that they are competitively priced as compared to market alternatives. Thus, the best interests of customers are served by granting the waiver.

ICNU claims that PacifiCorp's request for a waiver was untimely. PacifiCorp filed its request for a waiver in the round of testimony in UE 170 that immediately followed the Commission's order holding UM 1066 in abeyance and suggesting that utilities seek a waiver of the New Resource Rule in the interim. It is difficult to see how this is untimely, especially given the significant uncertainty that has surrounded the status and meaning of this rule since its adoption.

ICNU also objects to PacifiCorp's waiver on the basis that PacifiCorp has not yet developed a large customer opt-out proposal or an enhanced competitive bidding proposal that would offset the impacts of bringing new resources into rates at cost. The Commission's

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order holding UM 1066 in abeyance noted the importance of the outcomes of UM 1182, the competitive bidding docket, and UM 1056, the IRP docket, to the issues implicated by the New Resource Rule. *See* Order 05-133 at 2. Before commencing serious work on an opt-out or other proposal, PacifiCorp has focused its efforts on these dockets, with the hope that they will provide important policy direction to inform the application, design and feasibility of an opt-out proposal.

For all of these reasons, the Commission should grant PacifiCorp request for a waiver of the New Resource Rule in this docket.

IV. CONCLUSION

For the reasons set out above, PacifiCorp's requests that the Commission approve PacifiCorp's revised tariff schedules and approve its requested revenue requirement increase in this case.

DATED: July 13, 2005.

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CERTIFICATE OF SERVICE

I hereby certify that I served a true and correct copy of the foregoing document in Docket UE 170 on the following named person(s) on the date indicated below by email and first-class mail addressed to said person(s) at his or her last-known address(es) indicated below.

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