

Davison Van Cleve PC

Attorneys at Law

TEL (503) 241-7242 • FAX (503) 241-8160 • mail@dvclaw.com
Suite 400
333 S.W. Taylor
Portland, OR 97204

August 11, 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 Reply 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 Reply 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 11th day of August, 2005.

/s/ Sheila R. Ho
Sheila R. Ho

RATES & REGULATORY AFFAIRS PORTLAND GENERAL ELECTRIC RATES & REGULATORY AFFAIRS 121 SW SALMON STREET, 1WTC0702 PORTLAND OR 97204 pge.opuc.filings@pgn.com	JIM ABRAHAMSON COMMUNITY ACTION DIRECTORS OF OREGON 4035 12TH ST CUTOFF SE STE 110 SALEM OR 97302 jim@cado-oregon.org
GREG ADDINGTON KLAMATH WATER USERS ASSOCIATION 2455 PATTERSON STREET, SUITE 3 KLAMATH FALLS OR 97603 greg@cvcwireless.net	EDWARD BARTELL KLAMATH OFF-PROJECT WATER USERS INC 30474 SPRAGUE RIVER ROAD SPRAGUE RIVER OR 97639
KURT J BOEHM BOEHM KURTZ & LOWRY 36 E SEVENTH ST - STE 1510 CINCINNATI OH 45202 kboehm@bklawfirm.com	LISA BROWN WATERWATCH OF OREGON 213 SW ASH ST STE 208 PORTLAND OR 97204 lisa@waterwatch.org
LOWREY R BROWN CITIZENS' UTILITY BOARD OF OREGON 610 SW BROADWAY, SUITE 308 PORTLAND OR 97205 lowrey@oregoncub.org	PHIL CARVER OREGON DEPARTMENT OF ENERGY 625 MARION ST NE STE 1 SALEM OR 97301-3742 philip.h.carver@state.or.us
JOHN CORBETT YUOK TRIBE PO BOX 1027 KLAMATH CA 95548 jcorbett@yuroktribe.nsn.us	JOAN COTE OREGON ENERGY COORDINATORS ASSOCIATION 2585 STATE ST NE SALEM OR 97301 cotej@mwvcaa.org
JOHN DEVOE WATERWATCH OF OREGON 213 SW ASH STREET, SUITE 208 PORTLAND OR 97204 john@waterwatch.org	JASON EISDORFER CITIZENS' UTILITY BOARD OF OREGON 610 SW BROADWAY STE 308 PORTLAND OR 97205 jason@oregoncub.org

EDWARD A FINKLEA CABLE HUSTON BENEDICT HAAGENSEN & LLOYD LLP 1001 SW 5TH, SUITE 2000 PORTLAND OR 97204 efinklea@chbh.com	DAVID HATTON DEPARTMENT OF JUSTICE REGULATED UTILITY & BUSINESS SECTION 1162 COURT ST NE SALEM OR 97301-4096 david.hatton@state.or.us
JUDY JOHNSON PUBLIC UTILITY COMMISSION PO BOX 2148 SALEM OR 97308-2148 judy.johnson@state.or.us	JASON W JONES DEPARTMENT OF JUSTICE REGULATED UTILITY & BUSINESS SECTION 1162 COURT ST NE SALEM OR 97301-4096 jason.w.jones@state.or.us
MICHAEL L KURTZ BOEHM, KURTZ & LOWRY 36 E 7TH ST STE 1510 CINCINNATI OH 45202-4454 mkurtz@bklawfirm.com	JIM MCCARTHY OREGON NATURAL RESOURCES COUNCIL PO BOX 151 ASHLAND OR 97520 jm@onrc.org
KATHERINE A MCDOWELL STOEL RIVES LLP 900 SW FIFTH AVE STE 1600 PORTLAND OR 97204-1268 kamcdowell@stoel.com	BILL MCNAMEE PUBLIC UTILITY COMMISSION PO BOX 2148 SALEM OR 97308-2148 bill.mcnamee@state.or.us
DANIEL W MEEK DANIEL W MEEK ATTORNEY AT LAW 10949 SW 4TH AVE PORTLAND OR 97219 dan@meek.net	NANCY NEWELL 3917 NE SKIDMORE PORTLAND OR 97211 ogec2@hotmail.com
MICHAEL W ORCUTT HOOPA VALLEY TRIBE FISHERIES DEPT PO BOX 417 HOOPA CA 95546	STEPHEN R PALMER OFFICE OF THE REGIONAL SOLICITOR 2800 COTTAGE WAY, RM E-1712 SACRAMENTO CA 95825
STEVE PEDERY OREGON NATURAL RESOURCES COUNCIL sp@onrc.org	MATTHEW W PERKINS DAVISON VAN CLEVE PC 333 SW TAYLOR, STE 400 PORTLAND OR 97204 mwp@dvclaw.com
JANET L PREWITT DEPARTMENT OF JUSTICE 1162 COURT ST NE SALEM OR 97301-4096 janet.prewitt@doj.state.or.us	THOMAS P SCHLOSSER MORISSET, SCHLOSSER, JOZWIAK & MCGAW 801 SECOND AVE, SUITE 1115 SEATTLE WA 98104-1509 t.schlosser@msaj.com
GLEN H SPAIN PACIFIC COAST FEDERATION OF FISHERMEN'S ASSOC PO BOX 11170 EUGENE OR 97440-3370 fish1ifr@aol.com	DOUGLAS C TINGEY PORTLAND GENERAL ELECTRIC 121 SW SALMON 1WTC13 PORTLAND OR 97204 doug.tingey@pgn.com

<p>PAUL M WRIGLEY PACIFIC POWER & LIGHT 825 NE MULTNOMAH STE 800 PORTLAND OR 97232 paul.wrigley@pacificorp.com</p>	
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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)
_____)

**REPLY BRIEF OF
THE INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES**

August 11, 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 Reply Brief responding to the issues raised in the Opening Brief ("Brief") of PacifiCorp (or the "Company"). ICNU's Brief recommended and provided the legal and evidentiary basis for the Oregon Public Utility Commission ("Commission") to reject the majority of PacifiCorp's proposed revenue requirement increase and order a rate increase of approximately \$1 million. ICNU's Brief also explained why the Commission should deny PacifiCorp's request for an annual resource valuation mechanism ("RVM") and adopt ICNU's proposed transition adjustment mechanism. ICNU anticipated most of the arguments raised by PacifiCorp in its Brief, and this Reply Brief will only respond to arguments not addressed in ICNU's Brief.

II. ARGUMENT

A. PacifiCorp's \$57 Million Revenue Requirement Increase Should Be Reduced to Approximately \$1 Million

PacifiCorp appears to be confused regarding the Company's proposed rate increase and ICNU's proposed adjustments. PacifiCorp's confusion is not surprising given the Company's late filed revisions and last minute efforts to increase its revenue requirement with adjustments like the fuel handling increase and RVM power cost adjustments. PacifiCorp asserts that the Company is requesting a revenue requirement increase of approximately \$52.5 million. PacifiCorp Brief at 1. Later in its Brief the Company admits that it is requesting an additional \$4.3 million to \$4.9 million in RVM

related power cost increases. Id. at 28 n.5. Therefore, PacifiCorp is actually requesting a rate increase of approximately \$57 million—not \$52.5 million.

PacifiCorp also asserts that ICNU’s remaining proposed adjustments total \$93.3 million and would result in an approximately \$16.1 million rate reduction. Id. at 31. PacifiCorp is incorrect and appears to be relying upon ICNU’s Prehearing Brief, which was submitted prior to ICNU, Staff, PacifiCorp and the Citizens’ Utility Board (“CUB”) entering into the Fourth Partial Stipulation that resolved pension, rate spread, and cost of capital/return on equity (“ROE”) issues. See ICNU Prehearing Brief at 3-4. ICNU supports the revenue requirement reduction contained in the Fourth Partial Stipulation and is no longer advocating for its original pension and ROE adjustments as a result of the partial settlement. ICNU’s remaining adjustments total approximately \$56.5 million, and would result in an approximately \$1 million revenue requirement increase. ICNU Brief at 1, 3-4.

B. The Commission’s Administrative Rules Do Not Preclude ICNU’s Proposed Tax Adjustment

PacifiCorp argues that the Commission cannot accept ICNU’s adjustment without deviating from the rule regarding the calculation of tax expense, OAR § 860-027-0048. PacifiCorp Brief at 4-5, 9-10. PacifiCorp is incorrect—as explained in ICNU’s Brief, ICNU’s proposal is consistent with the stand-alone approach. ICNU Brief at 9-12. In addition, the Commission is not precluded from accepting ICNU’s adjustment, even if it is inconsistent with the stand-alone approach.

PacifiCorp erroneously argues that, if the Commission makes an adjustment to PacifiCorp’s income tax allowance that is not based on the stand-alone

approach, then the Commission's order will be subject to reversal because: 1) the Commission must follow its own rules; and 2) the Commission has not reserved its ability to waive OAR § 860-027-0048. PacifiCorp Brief at 9-10. PacifiCorp's argument is misleading because it is based on case law that does not apply in the context of OAR § 860-027-0048.

The cases that PacifiCorp cites to support its argument involve situations in which a rule required particular action by an agency, as opposed to a party before the agency. PacifiCorp cites Harsh Inv. Corp. v. State, 88 Or. App. 151 (1987), in which an agency disbursed funds in violation of its rule prohibiting agency disbursement absent evidence of mortgage insurance, and Peek v. Thompson, 160 Or. App. 260 (1999), in which a parole board failed to affirm a parole release date in violation of a rule requiring the board to affirm if it did not make a specific finding. PacifiCorp Brief at 9-10. In contrast, OAR § 860-027-0048 requires particular action by the utility, not by the Commission—the rule requires the utility to calculate its taxes on a stand-alone basis for ratemaking purposes.

In this situation, the Commission may set PacifiCorp's rates without requiring PacifiCorp to calculate its taxes on a stand-alone basis, even if doing so would be inconsistent with the Commission's past practice. ONRC Action v. Columbia Plywood, 332 Or. 216, 224-225 (2001) (agency retained authority to accept permit renewal application despite applicant's failure to comply with agency rule requiring renewal applications to be filed at least 180 days before existing permit expired); In re Lay, 142 Or. App. 469, 473 (1996) (agency that takes action within the scope of its

delegated authority can act inconsistently with an agency rule, an officially stated agency position, or a prior agency practice, as long as the agency explains the inconsistency).

PacifiCorp and all the parties to this proceeding have been provided notice that the Commission is in the process of reviewing its policy regarding utility taxes and how to apply this policy to Oregon electric utilities. See, e.g. Staff/1000, Conway-Johnson/3-4; PPL/1806 (Treatment of Income Taxes in Utility Ratemaking); PPL/1807 (Department of Justice (“DOJ”) Memorandum). The Commission has also informed the Oregon Legislature that it is aware of the problems associated with its past application of the stand-alone tax rule and that changes may be necessary. See, e.g. Commission Letter to the Oregon Legislature regarding recommendation on treatment of utility income taxes (Mar. 22, 2005). Therefore, the Commission has the authority and has informed all parties that it may deviate from prior Commission precedent. Adopting ICNU’s recommendation regarding income taxes, however, is not in violation of the stand-alone rule. ICNU Brief at 9-12.

C. ICNU’s Proposed Tax Adjustment Does Not Implicate “Constitutional Concerns”

The Commission should also disregard PacifiCorp’s suggestion that a change in the Commission’s policy regarding utility income taxes would implicate “constitutional concerns.” PacifiCorp Brief at 12. Notably, PacifiCorp does not actually argue that ICNU’s (or CUB’s) proposed tax adjustment is unconstitutional. Instead, PacifiCorp recites a vague warning from the Oregon DOJ that its actions could be unconstitutional if the Commission were to arbitrarily pick and choose the way it treats utilities’ expenses and investments. Id. This is nothing more than a recitation of the

fundamental principle that the Commission must not set rates in an arbitrary and capricious manner.

PacifiCorp, like the DOJ, quotes *dicta* from the U.S. Supreme Court’s opinion in Duquesne Light Co. v. Barasch, 488 U.S. 299 (1989). In Duquesne, the Supreme Court said that “a State’s decision to arbitrarily switch back and forth between methodologies in a way which required investors to bear the risk of bad investments at some times while denying them the benefit of good investments at others would raise serious constitutional questions.” Duquesne, 488 U.S. at 315. In a later decision, Verizon Communications, Inc. v. FCC, 535 U.S. 467 (2002), the Supreme Court explained the meaning of this *dicta*: “In other words, there may be a taking challenge distinct from a plain-vanilla objection to arbitrary or capricious agency action if a rate making body were to make opportunistic changes in rate setting methodologies just to minimize return on capital investment in a utility enterprise.” Verizon Communications, 535 U.S. at 527. Hence, the “constitutional questions” that the Court referred to in Duquesne would only arise if the Commission adopted a rate setting methodology that was “arbitrary, opportunistic, or undertaken with a confiscatory purpose.” Id. at 528.

There is no suggestion in this case that the Commission would have any confiscatory purpose for adjusting PacifiCorp’s income tax allowance to reflect the taxes that PHI avoids paying on PacifiCorp’s income. As ICNU explained in its Brief, ICNU’s proposed adjustment is based on PacifiCorp’s cost of service, and the adjustment would not deprive PHI of the tax benefit created by the PacifiCorp/PHI corporate structure. ICNU Brief at 6-9. Instead, ICNU’s adjustment would prevent the cross-subsidization

that would occur if customers were required to pay amounts for income taxes that are never paid to taxing authorities. Id. at 7-9.

D. PacifiCorp's Arguments About Cost-of-Service Principles and the Benefits/Burdens Test Are Incomplete and Misleading

PacifiCorp argues that ICNU's proposed adjustment would be "contrary to the Commission's statutory obligation to prevent cross-subsidization between regulated and nonregulated operations." PacifiCorp Brief at 5. PacifiCorp goes on to discuss the concept of cross-subsidization for several pages. Id. at 4-8. However, PacifiCorp never explains specifically how ICNU's (or CUB's) proposed adjustment will result in cross-subsidization. In contrast, ICNU has explained why the inclusion in rates of amounts for taxes that are never paid is inconsistent with cost-of-service principles and results in a windfall to PHI. ICNU Brief at 14-15.

PacifiCorp argues at length that the Commission must apply the "benefits/burdens test" if it makes an adjustment to PacifiCorp's income tax allowance that takes consolidated tax savings into account. PacifiCorp Brief at 10-11. The record in this proceeding has demonstrated that, even under the benefits/burden test, ratepayers are burdened by PacifiCorp's debt at PHI and should benefit from the tax savings associated with the loan. Staff/1000, Conway-Johnson/4-7, 12-16; CUB/200, Jenks/3, 5-9; Hearing transcript at 191-93 (Conway).

Moreover, the Company repeatedly reminds the Commission that the DOJ has advised the Commission that the benefits/burdens test is necessary, but PacifiCorp stops short of citing a single case that directly supports its proposition. PacifiCorp Brief at 10-11. Contrary to PacifiCorp's claims, the City of Charlottesville v. FERC, 774 F.2d

1205 (1985), does not stand for the proposition that the benefits/burdens test is required. ICNU Brief at 9-12. Applying the benefits/burdens test in the manner proposed by PacifiCorp could bring about an absurd result of requiring ratepayers to pay for something that is not a legitimate cost of utility service. ICNU Brief at 13-15.

The Oregon Legislature has recognized in the recently passed Senate Bill 408 that customers should not be charged for taxes that are never paid to taxing authorities. S.B. 408, 2005 Reg. Sess., 73rd Leg. Assem. (Or. 2005). The Legislature declared: “Utility rates that include amounts for taxes should reflect the taxes that are paid to units of government to be considered fair, just and reasonable.” *Id.* § 2(f). ICNU urges the Commission to follow the Legislature’s policy guidance and remove from customers’ rates income taxes that will never be paid by PHI.

E. The Plain Language of the Revised Protocol Requires All of PacifiCorp’s Existing QF Contracts to Be Allocated on a Situs Basis

PacifiCorp asserts that the “proposed” effective date of June 1, 2004, in the Revised Protocol is the actual effective date because the OPUC did not specifically modify this term when it adopted the Revised Protocol. PacifiCorp Brief at 33. PacifiCorp supports its argument with the fact that the Revised Protocol was filed on May 20, 2004, about two weeks before the “proposed” effective date of June 1, 2004. The fact that the Revised Protocol was filed before the “proposed” effective date proves nothing because utilities typically file new proposals or tariffs with effective dates soon after the filed date. A utility filing does not become effective on the utility’s proposed effective date unless approved by the Commission, or legally allowed to go into effect, prior to the proposed effective date. The Revised Protocol did not go into effect automatically and

was not approved until January 12, 2005; therefore, it could not be in effect prior to the Commission's approval.

PacifiCorp also asserts that the terms of the Revised Protocol would have stated that the document was “to become effective upon ratification of each state” if that is what “the parties intended” PacifiCorp Brief at 33. PacifiCorp then claims “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.” *Id.* PacifiCorp's Brief ignores that the Revised Protocol more than “mentions” that the effective date is related to the date the Revised Protocol is ratified by the states, but specifically states that the Revised “Protocol shall only be in effect for a State upon final ratification by its Commission.” ICNU/512 at 16 (emphasis added). PacifiCorp's Brief fails to mention this language and the Company's interpretation of the “proposed” effective date would render this provision of the Revised Protocol meaningless.

F. PacifiCorp Has Failed to Demonstrate that Its Regional Transmission Organization (“RTO”) Costs Are Reasonable or Benefit Current Ratepayers

PacifiCorp requests full recovery of its RTO costs based on the mistaken belief that the Federal Energy Regulatory Commission (“FERC”) “requires all transmission owners to join RTOs.” PacifiCorp Brief at 40-41. PacifiCorp appears to be the only utility in the Northwest that is unaware that FERC has essentially overturned this requirement and is no longer seeking to force all electric utilities to join RTOs. Over the past few years, after facing strong opposition by many agencies and utilities in the Northwest, FERC has retreated from its RTO and Standard Market Design proposals. See e.g. Remedying Undue Discrimination through Open Access Transmission Serv. and

Standard Elec. Market Design, 112 F.E.R.C. ¶ 61,073 (July 19, 2005); Bonneville Power Admin. et al., 112 F.E.R.C. ¶ 61,012 (July 1, 2005); FERC White Paper: Wholesale Power Market Platform (Apr. 28, 2003). PacifiCorp's failure to understand its federal regulatory responsibilities provides an additional basis for the Commission to place the RTO costs in a deferred account and subject them to a prudence review when an RTO is benefiting Oregon ratepayers.

G. The Commission Should Reject All of PacifiCorp's RVM Adjustments

ICNU is opposed to PacifiCorp's annual RVM, its RVM power cost update, and PacifiCorp's last minute effort to include its RVM adjustments in the general rate case. ICNU submitted testimony specifically challenging five of PacifiCorp's RVM related adjustments: 1) outage update period; 2) planned outages; 3) thermal ramping; 4) deferred maintenance; and 5) station service. ICNU Brief at 33; ICNU/100, Falkenberg/3. ICNU has addressed most of the arguments raised in PacifiCorp's Brief regarding these five RVM adjustments, and this Reply Brief responds to PacifiCorp's assertion that its outage update period adjustment should be made in its RVM.^{1/}

PacifiCorp states that its outage update period adjustment should be accepted because it was pursuant to procedural schedule in this case. See PacifiCorp Brief at 30. PacifiCorp's November rate case filing included heat and outage rates based on the Company's 48-month average for the period that ended March 31, 2004. PPL/600, Widmer/13; ICNU/100, Falkenberg/36. On March 15, 2005, PacifiCorp updated its 48-month heat and outage rates to the time period that ended September 30,

^{1/} PacifiCorp has agreed that it would inappropriate to include the outage update period adjustment in the general rate case. PPL/611, Widmer/6-7.

2004. ICNU/100, Falkenberg/36-37. PacifiCorp could have provided the information to parties earlier than the March 15, 2005 update. Id. at Falkenberg/36-38. Instead, PacifiCorp provided this update after the parties had already reviewed PacifiCorp's original filing, thereby requiring the parties to conduct significant discovery and additional time consuming analysis to investigate the prudence of the proposed changes. Id. Similar to the fuel handling adjustment, PacifiCorp also had the opportunity to review whether this update would increase or reduce rates prior to deciding whether to make the filing. Id. at Falkenberg/37. The Commission should not permit PacifiCorp to use the RVM process to make this type of late-filed, prejudicial adjustment solely designed to increase its revenue requirement.

H. PacifiCorp Has Failed to Demonstrate that the Full Costs of West Valley and Gadsby Should Be Included in Rates

PacifiCorp argues that the Commission should reject ICNU's proposed prudence disallowances for West Valley and the Gadsby combustion turbines ("CTs").^{2/} PacifiCorp Brief at 34-37. Based on a result-orientated analysis first provided in its surrebuttal testimony, PacifiCorp asserts that West Valley is prudent because its costs are lower than certain market alternatives. See id. at 37. However, PacifiCorp's after-the-fact analysis does not refute the fact that lower cost alternative resources were available at the time PacifiCorp could have terminated the West Valley lease. See ICNU/111, Falkenberg/10-11.

^{2/} PacifiCorp also requests that the Commission reject ICNU's "proposed adjustments related to the prudence of [Currant Creek]." PacifiCorp Brief at 35. While ICNU has proposed a disallowance for Currant Creek based on the Market Price Rule, ICNU has not challenged the prudence of Currant Creek in this proceeding and recommends that Currant Creek should be subject to a prudence review after the project's completion. ICNU Brief at 23-24, 27 n.10; ICNU/100, Falkenberg/10 n.3.

The Commission should impose a \$7.5 million disallowance for the Gadsby CTs regardless of whether Company sought to include the savings associated with Gadsby in its UE 147 rate case. PacifiCorp asserts that customers benefited from the Company's nonpayment of the Gadsby CTs because the nonpayment lowered its expenses for 2002, the base year for its UE 147 rate case. PacifiCorp Brief at 36. Ratepayers have not benefited from lower rates because the nonpayment was a one-time event that should have been removed from PacifiCorp's normalized power costs.^{3/}

I. PacifiCorp Has Failed to Demonstrated that Its Proposed Transition Adjustment Appropriately Values PacifiCorp's Freed-Up Resources

PacifiCorp raises new arguments to support its proposed transition adjustment mechanism asserting that: 1) ICNU has not proposed a "practical alternative" to PacifiCorp's transition adjustment; 2) ICNU has failed to present a transmission adder; 3) ICNU's proposal violates the Commission's order in UM 1081; and 4) ICNU's position is inconsistent with its testimony in UM 1081. These assertions are erroneous, and should not distract the Commission from the fact that ICNU's proposed transition adjustment will more accurately value PacifiCorp's freed-up resources, and may allow direct access an opportunity to succeed in PacifiCorp's service territory.

PacifiCorp asserted that ICNU has not proposed a "practical alternative" for the calculation of the transition adjustment. PacifiCorp Brief at 2, 24. The Company also states that ICNU has not made a proposal to cover the transmission costs that are not included in GRID and suggests that ICNU make such a proposal in an annual RVM. Id.

^{3/} PacifiCorp's UE 147 power costs were settled with a "black box" settlement with an overall power cost number that did not detail the specific adjustments.

at 26. Contrary to these claims, ICNU witnesses Randall Falkenberg proposed a specific methodology that calculates the transition adjustment. ICNU/100, Falkenberg/55-56; ICNU/107C. PacifiCorp never disputed in its testimony that Mr. Falkenberg's proposal was not practical or could not be utilized by the Company to calculate a transition adjustment. Mr. Falkenberg's proposal also includes a proposed transmission cost adder, the exact the type of proposal PacifiCorp claims ICNU has not made. Id.

PacifiCorp argues that ICNU's proposed transition adjustment is inconsistent with the Commission's order in UM 1081 because it is different from the interim methodology approved by the Commission and does not reflect the Company's actual operational response to direct access. PacifiCorp Brief at 24. The methodology adopted in UM 1081 was not intended to be a long-term solution, but a short-term methodology intended to "inform the design of further improvements" in the transition adjustment. Re Investigation into Direct Access, OPUC Docket No. UM 1081, Order No. 04-516 at 1 (Sept. 14, 2004). The Commission specifically deferred the questions of how to properly value "avoided transmission" and whether PacifiCorp should avoid purchases for departing load by anticipating direct access load loss. Id. at 10-12. ICNU's proposal is consistent with the Commission's order in UM 1081 because it reflects how PacifiCorp should respond operationally if the Company appropriately planned for direct access customers.

Finally, PacifiCorp cites ICNU's testimony in UM 1081 out of context to argue that ICNU has advocated that PacifiCorp should utilize an RVM exactly like Portland General Electric Company's ("PGE") RVM. See PacifiCorp Brief at 25, 27.

The question of whether PacifiCorp would have an annual RVM was not an issue in UM 1081, and thus, ICNU did not take a position on this issue in UM 1081. In testimony in UM 1081, ICNU recognized that PGE bases its transition adjustment on the assumption that it avoids purchases for load that elects direct access. In both UM 1081 and this proceeding, ICNU has argued that PacifiCorp should also base its transition adjustment mechanism on the assumption that the Company will avoid power purchases for customers that elect direct access. However, basing PacifiCorp's transition adjustment on avoided purchases does not mean that the Company should have an annual RVM as part of its transition adjustment mechanism or that PacifiCorp should adopt all aspects of PGE's transition adjustment. The Commission should not be persuaded to rule on this very important issue based on selective quotes from another ICNU witness from a different proceeding.

III. CONCLUSION

PacifiCorp has not met its burden of proof to demonstrate that it should receive more than an approximately \$1 million revenue requirement increase. The Commission should remove from the Company's proposed \$57 million rate increase the costs associated with income taxes that are not paid to any taxing authorities; RTO expenses that do not benefit current ratepayers; all the RVM power cost updates; the one-sided fuel handling adjustment; new imprudent and above market Utah resources; the duplicative UM 995 outages; and the existing Utah QF contracts. The Commission should also reject the Company's proposed RVM and transition adjustment because they are harmful to all ratepayers and will act as barriers to direct access.

Dated this 11th day of August, 2005.

Respectfully submitted,

DAVISON VAN CLEVE, P.C.

/s/ Melinda J. Davison

Melinda J. Davison

Irion Sanger

Sarah Yasutake

333 S.W. Taylor, Suite 400

Portland, Oregon 97204

(503) 241-7242 phone

(503) 241-8160 facsimile

mail@dvclaw.com

Of Attorneys for the Industrial Customers of
Northwest Utilities