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VIA ELECTRONIC FILING

PUC Filing Center
Public Utility Commission of Oregon
PO Box 2148
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Re: PacifiCorp's Posthearing Reply Brief
Docket UE 170

Enclosed for filing please find an original and five copies of PacifiCorp's Posthearing Reply Brief in the above-referenced docket. A copy of this filing was served on all parties to this proceeding as indicated in the attached certificated of service.

Very truly yours,

Katherine A. McDowell

KAM:knp
Enclosure
cc: Service List

BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON

UE 170

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

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Table of Contents

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In reply to the opening briefs of the Oregon Public Utility Commission Staff ("Staff"), the Citizens' Utility Board of Oregon ("CUB") and the Industrial Customers of Northwest Utilities ("ICNU"), PacifiCorp respectfully submits the following comments.

I. Reply re PacifiCorp's Stand-Alone Tax Expense

Staff's, CUB's and ICNU's proposed consolidated tax adjustments are contrary to law and Commission policy and unsupported by the evidence in this case.

A. The Commission Does Not Have the Discretion to Adopt Staff's, CUB's or ICNU's Proposed Tax Adjustments.

1. Current law requires the Commission to set electric utility rates on a stand-alone basis. ORS 757.646(2)(c) (requiring Commission to adopt rules that "prohibit[] cross-subsidization between competitive operations and regulated operations"); OAR 860-027-0048 (requiring calculation of utility tax expense on stand-alone basis). This means that the tax expense in rates must reflect the utility's stand-alone tax liability "as though it were operating without the holding company." *In re Util. Reform Project*, UCB 13, Order No. 03-401 at 6 (Or Pub Util Comm'n July 9, 2003).

2. The Commission does not have the discretion to disregard its rules. *Harsh Inv. Corp. v. State*, 88 Or App 151, 157, 744 P2d 588 (1987); *Peek v. Thompson*, 160 Or App 260, 264-65, 980 P2d 178 (1999). Indeed, administrative rules have the force and effect of statutes. *Harsh Inv.*, 88 Or App at 157; *Peek*, 160 Or App at 264-65. Nor may the Commission waive a rule absent an express waiver provision in the rules themselves. *Harsh Inv.*, 88 Or App at 158. The stand-alone tax rule contains no such provision. OAR 860-027-0048. Accordingly, the Commission must adhere to the stand-alone tax rule until it changes the rule pursuant to the rulemaking procedures of the Oregon Administrative Procedures Act. *See Harsh Inv.*, 88 Or App at 157-58; ORS 183.325-.410.

3. CUB's discussion about whether the Constitution or courts can or do require a particular approach to taxes misses the point. (*See* CUB Opening Brief at 9-10.) The

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Commission requires a particular approach to taxes. OAR 860-027-0048. Having thus limited its discretion, the Commission cannot adopt an alternative approach absent a rule change. *See Harsh Inv.*, 88 Or App at 157-58.

4. Nor does Senate Bill 408 expressly or implicitly repeal the stand-alone tax rule. *See* SB 408, 73d Or Legislative Assembly, Reg Sess (2005). The bill provides for the use of an automatic adjustment clause to account for differences between taxes paid to government and taxes authorized to be collected in rates. *Id.* § 3(6). The bill does not direct the Commission to change its approach to setting tax expense in base rates. On the contrary, Senate Bill 408 directs that the conversion from base rates that reflect normalized tax expense to adjusted rates that reflect "actual" tax expense occur through a separate automatic adjustment clause. In any event, Senate Bill 408 expressly sets the initial automatic adjustment based on taxes paid to units of government and collected in rates on or after January 1, 2006. *Id.* § 4(2). Thus the Commission's stand-alone tax rule controls this case, notwithstanding the passage of Senate Bill 408.

5. Perhaps in recognition of the stand-alone tax rule, CUB and ICNU both argue that their proposed adjustments are "consistent with" the stand-alone methodology. (CUB Opening Brief at 16-18; Opening Brief of ICNU at 9-12.) But CUB and ICNU, as well as Staff, propose a departure from the stand-alone tax rule. The stand-alone tax rule requires the Commission to:

- "record income tax expense as if it were determined for the regulated activity separately for all time periods." OAR 860-027-0048.
- "look at the utility as a stand-alone enterprise * * * [*i.e.*, consider] only the regulated utility's [tax] liability *as though it were operating without the holding company*." *In re Util. Reform Project*, Order No. 03-401 at 6 (emphasis added).
- base the tax expense in rates on the cost of regulated operations and *ignore the tax effects of the parent's operations*. *See In re Util. Reform Project*, Order No. 03-214, app A at 2 (Or Pub Util Comm'n Apr. 10, 2003).

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- exclude from rates the tax liabilities or savings resulting from nonregulated operations. *Re Or. Exch. Carrier Ass'n*, Order No. 93-325, 1993 WL 117620 at *6 (Or Pub Util Comm'n Mar. 12, 1993), reconsideration den, Order No. 93-879, 1993 WL 390953 (Or Pub Util Comm'n June 28, 1993).

- base the tax expense in rates "on the items of income and expense included in the regulated utility's revenue requirement calculation." (Staff/1000/Conway-Johnson/2.)

- "calculate[] taxes based on the regulated revenues and operating costs of the utility itself, *without regard to the utility's unregulated activities or the operations of its parent and other affiliated companies*." (PPL/1806/2 (White Paper) (emphasis added).)

6. In contrast, Staff and intervenors propose to adjust the stand-alone tax expense based on a deductible expense of PacifiCorp Holdings, Inc. ("PHI"), a member of PacifiCorp's consolidated group:

- CUB proposes to reduce PacifiCorp's stand-alone tax expense based on the alleged value to customers *of PHI's interest deduction*. (CUB/100, Jenks/1-2; Cross-Examination of Bob Jenks, Tr. 166-67.)
    - CUB's proposal is designed to align the tax expense in rates with the federal taxes that are paid by the consolidated group. (PPL/1804/4 (CUB response to PacifiCorp discovery request 1.13).)
    - CUB is "attempting to get the Commission to recognize the tax deduction at the holding company." (Tr. 155.)
- Likewise, ICNU proposes to reduce PacifiCorp's stand-alone tax expense based on "actual taxes paid" *by the consolidated group*. (Opening Brief of ICNU at 5-7.)
    - "The significance of the [PHI] loan * * * is that the interest that PHI pays * * * is deductible on the consolidated income tax returns." (*Id.* at 6.)
    - ICNU's proposal is based on PHI's tax structure. (ICNU/200, Selecky/17.)
    - Arguing against application of the benefits and burdens test in this case, ICNU claims: "There is no requirement that this test be employed whenever a consolidated tax adjustment is made." (Opening Brief of ICNU at 13.)
- Staff proposes to reduce PacifiCorp's stand-alone tax expense "to include a portion of the consolidated tax savings" based on the alleged burden on customers *of PHI's debt*. (Staff/1000, Conway-Johnson/14, 16.)

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7. ICNU's reliance on the case *City of Charlottesville v. FERC*, 774 F2d 1205 (DC Cir 1985), for the proposition that the parent interest deduction should be considered when setting rates on a stand-alone basis is entirely misplaced. (Opening Brief of ICNU at 9-12.) Not only is *Charlottesville* non-binding authority, the case supports the opposite principle—*i.e.,* under the stand-alone methodology, the regulator does *not* adjust the utility's tax expense based on the tax liabilities or losses, including deductions, created by the utility's non-regulated activities or by the non-regulated members of the consolidated group. *Id.* at 1207-08. As explained in *Charlottesville*, under the stand-alone method employed by the Federal Energy Regulatory Commission ("FERC"), FERC "segregates the regulated utility" and determines "the taxable income and deductions of the consolidated group *specifically attributable to the utility's jurisdictional activities*" then applies "the statutory tax rate * * * to the tax base to yield the stand-alone tax allowance. * * * [T]he tax base * * * is not reduced by the tax losses of other affiliates." *Id.* at 1207 (emphasis added). In other words, "'when an expense is included in the cost of service, the corresponding tax deduction is also allocated to the ratepayers.'" *Id.* at 1211 (citation omitted).

8. The Virginia and Indiana orders cited by ICNU also do not support the proposition that ICNU's proposed adjustment is "consistent with" the stand-alone methodology. (*See* Opening Brief of ICNU at 10-11 (characterizing Virginia and Indiana as "jurisdictions following the stand-alone approach").) The opposite is true. These decisions demonstrate that Virginia and Indiana do *not* follow the stand-alone approach. *Virginia v. United Water Va., Inc.*, 191 PUR4th 288, (Va State Corp Comm'n, 1999); *Re Utility Center*, Cause No. 41968, 2003 Ind PUC LEXIS 209 (Ind Util Regulatory Comm'n Dec. 10, 2003) (increasing authorized tax expense pursuant to settlement agreement). Instead, these jurisdictions appear to follow a modified consolidated approach, something this Commission cannot do absent a rule change.

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B. ICNU's Argument That Its "Actual Taxes Paid" Approach Is Consistent with Cost-of-Service Principles Ignores Long-Standing Precedent to the Contrary.

1. "The 'stand-alone' calculation is used so that the taxes in utility rates are based on the costs of providing the regulated utility service." (PPL/1806/2 (White Paper).) "[T]ax effects of the utility's non-regulated operations, as well as the utility's parent and subsidiaries, are ignored for purposes of setting rates, *so that rates reflect only the costs of providing utility service.*" (*Id.* at 7 (emphasis added).)

2. The stand-alone tax rule was promulgated pursuant to the Commission's statutory obligation to "prohibit[] cross-subsidization between competitive operations and regulated operations." *See* ORS 757.646(2)(c); OAR 860-027-0048; *see also In re PacifiCorp*, UI 221, Order No. 03-726, app A at 5 (Or Pub Util Comm'n Dec. 12, 2003) (compliance with OAR 860-027-0048 prevents "cross-subsidization").

3. Indeed, it has been this Commission's policy for over a decade that any approach to utility taxes that allocates tax liabilities or savings resulting from nonregulated operations to ratepayers would be contrary to the statutory obligation to prevent cross-subsidization between regulated and nonregulated operations. *See Re Or. Exch. Carrier Ass'n*, 1993 WL 117620 at *6. *See also* Order 03-214, App A at 5:

> "'Non-utility operations involve financial risks that are different from a utility's regulated operations. When these risks are not borne by the ratepayers, it is unfair to make use of the business losses generated in those nonregulated entities to reduced the utility's cost in determining the rates to be charged for utility services. By the same token, when a company's nonjurisdictional activities are profitable, the ratepayers have no right to share in those profits, but neither are they required to pay any of the income taxes that arise as a result of those profits. Thus, a "stand alone" method (as opposed to a consolidated effective tax rate method) for computing the income tax expense component of cost of service is the proper and equitable method to be followed for ratemaking purposes.'" (Citation omitted.)

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4. Without regard to relevant Oregon authority, ICNU's cost-of-service argument relies heavily on *FPC v. United Gas Pipeline Co.*, 386 US 237 (1967). (Opening Brief of ICNU at 6-8.) This is despite the fact that "*United Gas* is not current [law] and its relevance, if any, is limited." (PPL/1807/1 (Department of Justice (the "DOJ") memorandum regarding the Utility Reform Project's comments on tax treatment in utility ratemaking, dated Mar. 22, 2005).) Contrary to ICNU's assertions, *United Gas* does not stand for the proposition that cost-of-service principles require an "actual taxes paid" approach to utility tax expenses. Instead, as the DOJ recently advised:

> "*United Gas* stands for the limited point that the FPC had the statutory authority to apply a formula that considered a consolidated tax structure. The limited nature of *United Gas* becomes more apparent when combined with the rest of the story; that the original normalization requirements were added to the [Internal Revenue] Code after *United Gas*, at which time the FPC quickly back-tracked from its previous position and determined that the stand-alone approach was more appropriate, and the Supreme Court issued a seminal case regarding constitutional concerns in ratemaking, which were not raised or addressed in *United Gas*."

(*Id.* at 3.)

5. ICNU's cost-of-service argument belies ICNU's claim that its proposal is consistent with the stand-alone method. ICNU's argument is actually a fundamental objection to the stand-alone method itself. (*See* Opening Brief of ICNU at 6-9 (arguing against inclusion of "phantom" or "hypothetical" taxes in rates—*i.e.,* taxes computed on a stand-alone basis).) The Commission rejected the "actual taxes paid" arguments in Order 03-214, on the basis that the "actual taxes paid" approach is inconsistent with the stand-alone method, is ultimately inequitable for ratepayers and could potentially result in confiscatory rates. Order 03-217, App A at 2-5. There, the Utility Reform Project argued, as ICNU now argues, that the utility (in that case Portland General Electric ("PGE")) overcollected taxes because the utility's consolidated group did not actually pay to government the amount of taxes collected in rates. The Commission dismissed this contention on the basis that the

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taxes in rates "were set on a 'stand alone' basis" and were therefore "accurately calculated * * * using PGE's test year revenues, expenses and rate base." *Id.* at 3.

C. In Any Event, the Commission Should Reject Intervenors' Proposed Tax Adjustments Because They Are Unsupported by the Evidence.

1. As explained in PacifiCorp's Opening Posthearing Brief, intervenors' proposed tax adjustments are flawed and entirely speculative. (PacifiCorp's Opening Posthearing Brief at 13-20; *see also* CUB Opening Brief at 13-14 (listing "potential" harms from PHI debt, including "possibility" that PHI debt "could" lead to improper maintenance and increased outages, pressure to make dividend payments, imprudent cost cutting and reduced financial investment, but pointing to nothing in the record to support this speculation).)

2. Rather than identifying facts in the record of this case to support its speculation that "debt load storage at the utility's parent creates *potential* harms increasing the *possibility* of higher rates and reduced reliability," CUB cites the Commission's order in UM 1121. (CUB Opening Brief at 14 (emphasis added).) The Commission did not consider the effect of PHI's debt on PacifiCorp in UM 1121, as that docket had nothing to do with PacifiCorp. *See In re Oregon Electric Util. Co.*, UM 1121, Order No. 05-114 (Or Pub Util Comm'n Mar. 10 2005). But the Commission has considered whether and to what extent PacifiCorp's parent debt burdens PacifiCorp—in UM 918. There, the Commission determined that PacifiCorp's relationship with ScottishPower plc UK ("ScottishPower") benefits, rather than burdens, customers. *See In re Application of ScottishPower plc and PacifiCorp*, UM 918, Order No. 99-616 at 20 (Or Pub Util Comm'n Oct. 6, 1999) (finding that merger "will not harm PacifiCorp's customers, will not result in the degradation of PacifiCorp's service, will not result in higher rates to PacifiCorp's customers, will not weaken PacifiCorp's financial structure, and will not diminish PacifiCorp's utility assets * * * [and] provides net benefits to customers"). Intervenors fail to demonstrate how that

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conclusion is now incorrect, especially in light of the fact that PHI's debt is nearly half the amount considered by the Commission in UM 918. (*See* Cross-Examination of Bob Jenks, Tr. 176-77 (debt has decreased from $4.8 billion to $2.375 billion).)

3. In its Opening Brief, ICNU reiterates its argument that PHI's use of assets generated by PacifiCorp to pay PHI's interest expense somehow entitles PacifiCorp customers to a share of the tax savings resulting from those payments. (Opening Brief of ICNU at 6-7 ("Because 94.72% of PHI's assets are related to PacifiCorp's jurisdictional activities, this percentage of [PHI's] deductible interest expense should be reflected in PacifiCorp's rates.").) *Charlottesville* expressly rejects the notion, however, that the parent company's use of profits generated by the utility to fund an expense burdens ratepayers, thereby entitling them to a share of the tax savings resulting from that expense. *See* 774 F2d at 1218 (it is "unquestionably true" that shareholders may reinvest profits as they see fit, in the utility or in other business ventures; shareholders' use of profits does not affect rates).

4. Likewise, Staff and CUB reiterate in their opening briefs their argument that credit rating agencies consider the financial strength of the entire consolidated group when evaluating PacifiCorp's credit, and therefore that PHI debt impacts PacifiCorp's credit rating, thereby increasing PacifiCorp's capital costs. (Staff's Post-Hearing Brief at 6; CUB Opening Brief at 12-14.) PacifiCorp demonstrated in its Opening Posthearing Brief that this argument is flawed and unsupported—there is no evidence in the record to support the assertion that PacifiCorp's cost of capital would be lower "but for" its parent's financial structure. (PacifiCorp's Opening Posthearing Brief at 13-20.) Indeed, the evidence shows that PacifiCorp's cost of capital would be higher "but for" the support of its parent. (*Id.*)

5. Furthermore, the appropriate way to address increased debt costs, if any were demonstrated, would be through an adjustment to PacifiCorp's cost of capital. However, CUB, Staff and ICNU have settled this issue. The parties to the fourth Partial Stipulation agreed that a reasonable overall rate of return is 8.057 percent and, "for all Oregon regulation

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purposes, until such time as the Commission issues a general rate order subsequent to UE 170, PacifiCorp will use the weighted cost of capital set at 8.057 percent rate of return * * * and the capital components including the capital structure as set forth in the [Stipulation]." (UE 170, fourth Partial Stipulation at 3-4.) They cannot now argue that a tax adjustment is justified because the return is artificially high. *See Charlottesville*, 774 F2d at 1219-20. In *Charlottesville*, in response to an argument that economic activities of a member of the consolidated group increased the parent's cost of debt and equity (on which the utility's capital structure was based), thereby supporting a tax adjustment, the court responded:

> "[A] superior way to protect the ratepayers is to adjust the rate of return to take account of these concerns. * * * '[N]othing prevented the parties from raising their concerns that the return was too high when that issue was presented to the Commission for decision. But they did not. Instead, they settled.' FERC thus declined to use the tax allowance calculation to correct a rate of return calculation better dealt with directly during the settlement process (or in litigation over the proper rate of return)."

Id. at 1220 (citations omitted).

6. Rather than identifying competent evidence of the requisite burden, CUB and ICNU attack the requirement itself. (CUB Opening Brief at 8-10[1]; Opening Brief of ICNU at 12-15 ("There is no requirement that [the benefits and burdens] test be employed whenever a consolidated tax adjustment is made.").) CUB and ICNU make these arguments despite the Department of Justice's advice to the contrary. (*See* Staff/1002, Conway-Johnson/3 (DOJ

[1] CUB also argues that the Commission should disregard the benefits and burdens requirement because "there is no 'benefit/burden' test performed by the Commission to determine a) whether the costs to customers [of filing consolidated taxes, corporate secretarial and shareholder services, and group finance and corporate strategy] is justified and b) the amount of the costs paid for by customers." (CUB Opening Brief at 12 & n 2.) This statement simply is not true. *See In re PacifiCorp*, Order No. 03-726, App A at 5 (reviewing and approving corporate cross charges as in the public interest, in part because the cost of such services cannot exceed premerger costs and is limited to the lower of cost or market).

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memorandum regarding legality of setting utility rates based on tax liability of parent, dated Feb. 18, 2005) ("A policy that considers the benefits and burdens of the utility's participation in a consolidated tax group, consistent with the *Hope* standard, would result in [a] decision that would be consistent with *Duquesne* and administrative law requirements."); PPL/1807/1 (DOJ memorandum regarding Utility Reform Project's comments on tax treatment in utility ratemaking, dated Mar. 22, 2005) (the Commission may change its current stand-alone policy only "so long as the [new] policy is rational, including taking into account the benefits and burdens of its policy, and meets minimum constitutional requirements"); *id.* at 3 (acknowledging that state regulators may choose between different methods of calculating tax allowances, but "whichever method is chosen it should be *applied* in a way that matches benefits and burdens" (emphasis in original)).)

II. Reply re Transition Adjustment Mechanism

1. ICNU argues that PacifiCorp's RVM addresses a "non-existent problem" because there has been little past Direct Access participation and because "PacifiCorp and Staff are proposing an [RVM] that will result in zero future [D]irect [A]ccess load." (Opening Brief of ICNU at 30.) In its order in UM 1081, the Commission required PacifiCorp to revise its Transition Adjustment mechanism to address concerns that it did not accurately capture the value of Direct Access load loss. The Commission's order was in response to a process in UM 1081 that pinpointed the need for PacifiCorp to develop a less conjectural, more precise Transition Adjustment mechanism to serve as a building block for the development of Direct Access. PacifiCorp's RVM proposal in this case is directed at complying with this order. Given the amount of time and effort the Commission and the parties have devoted to Transition Adjustment-related issues over the last two years, it is hardly fair to call it a "non-existent problem."

2. ICNU asserts in its Opening Brief at 31 that an annual RVM will unnecessarily shift the power cost risk from shareholders to ratepayers. The RVM does not

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shift power cost risk; rather, it reduces regulatory lag. Depending on whether power costs are increasing or decreasing, the reduction in lag could benefit either shareholders or ratepayers. In any event, as explained by Staff witness Maury Galbraith, whatever shift might occur is not so great as to outweigh the advantages of PacifiCorp's RVM proposal. (Staff/700, Galbraith/12.)

3. An annual RVM will not provide PacifiCorp with an "opportunity to game the system," nor will it prohibit prudence reviews, as ICNU fears, because PacifiCorp's proposed RVM provides the time and process necessary for a complete review of all power cost issues. (Staff/700, Galbraith/19.) As to ICNU's claim that PacifiCorp has provided mere "nebulous rationales" to support an annual power cost update as a part of its RVM, it is clear that without such an update, PacifiCorp's RVM would not accurately capture the value of Direct Access load loss. In this scenario, the RVM would compare updated market values with outdated cost-of-service rates to determine the Transition Adjustment, a mismatch that could hurt either departing or remaining customers depending on the direction of market prices.

4. ICNU advocates a "market-plus" Transition Adjustment mechanism that has already been rejected by the Commission in UM 1081. (PacifiCorp's Opening Posthearing Brief at 24-25.) ICNU has provided no explanation of how its proposed "market-plus" mechanism in this case can be reconciled with the Commission's order in UM 1081. (*See* Tr. 95-97.) ICNU's arguments in support of its own Transition Adjustment mechanism as set out in ICNU's Opening Brief at 37-43 should be rejected.

5. ICNU unreasonably protests the fact that "PacifiCorp has not filed an RVM tariff that identifies the specific types of costs that are appropriate to include in the RVM." (Opening Brief of ICNU at 32.) PacifiCorp's filing was very clear as to how it proposed to update power costs and calculate the Transition Adjustment, and, to the extent that ICNU has disputed these proposals, they are now before the Commission for decision. As pointed out by PacifiCorp's RVM witness, Christy Omohundro, under PacifiCorp's proposed RVM, the

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Company will calculate the Transition Adjustment just prior to the open enrollment window and update its Transition Adjustment tariff accordingly. (Tr. 125.)

6. CUB's position is that PacifiCorp's proposed RVM should not apply to residential customers, because residential customers are not eligible for, and cannot benefit from, Direct Access. (CUB Opening Brief at 18.) PacifiCorp and Staff have demonstrated that it is impracticable and potentially prejudicial to update cost-of-service rates for some but not all customers. (*See, e.g.,* Staff/700, Galbraith/14-22.) The Commission should reject CUB's request for a residential customer carve-out from the RVM.

III. Reply re RVM Net Power Costs Updates

ICNU incorrectly states that PacifiCorp has not provided any justification for why the thermal ramping, deferred maintenance and station service adjustments should not be made in the annual RVM, but should occur if the RVM is rejected. (Opening Brief of ICNU at 34.) As set out in Mark Widmer's sur-surrebuttal testimony, these three adjustments should be incorporated into the general rate case net power costs because it is as important during a general rate case as it is for an RVM proceeding to include the most current information available. (PPL/611, Widmer/6.) If new contracts are entered into or terminated, errors are discovered, or other information pertinent to the test period becomes available during the case, that information should also be included in rates. (*Id.*) The reason that PacifiCorp is not asking to include the planned outages and the outage period update adjustments in the general rate case is that those adjustments are specific to the RVM process. (*Id.*, Widmer/6-7.)

A. Planned Maintenance Update

1. ICNU states that the Commission should "set planned maintenance outages on the 48-month average instead of the Company's proposed maintenance schedule." (Opening Brief of ICNU at 34.) Mr. Widmer's rebuttal testimony explains that ICNU's proposed adjustment is unreasonable, because the outage period contributes to the accuracy of the

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Company's net power costs and RVM by basing them on the most current information available. (PPL/609, Widmer/9-10.) Contrary to ICNU's assertions in its Opening Brief at 35, the outage period adjustment is not a late-filed, selective update. (PacifiCorp's Opening Posthearing Brief at 30-31.)

B. Thermal Ramping and Station Service Updates

1. ICNU incorrectly asserts that the Commission should reject PacifiCorp's thermal ramping and station service updates because PacifiCorp's underlying assumption that there is a surplus of coal-fired generation in GRID has not been established. (Opening Brief of ICNU at 35-36.) As PacifiCorp explains in its Opening Posthearing Brief and in the rebuttal testimony of Mr. Widmer, GRID was in fact overstating coal generation.

2. ICNU's argument that the thermal ramping adjustment is similar to a PGE lost-generation proposal that the Commission previously rejected is unsupported, as set out in Mr. Widmer's rebuttal testimony. (PPL/609, Widmer/16.)

C. Deferred Maintenance

1. ICNU's objections to this adjustment are addressed in PacifiCorp's Opening Posthearing Brief at 29. Contrary to ICNU's assertion, PacifiCorp did not implicitly acknowledge 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, but only agreed to remove these adjustments as part of the settlement with Staff in the third Partial Stipulation.

IV. Reply re Treatment of Qualifying Facility ("QF") Contracts Under the Revised Protocol

1. ICNU incorrectly asserts that PacifiCorp's four QF contracts should be classified as "Existing QF Contracts" under the Revised Protocol. As set out in PacifiCorp's Prehearing Brief and Opening Posthearing Brief, the Revised Protocol has a clearly defined effective date of June 1, 2004, and not the date that each state commission ratified the

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Revised Protocol. (PacifiCorp's Prehearing Brief at 16-17; PacifiCorp's Opening Posthearing Brief at 31-34.) Furthermore, as set out in those briefs, this interpretation is consistent with the understanding of the parties involved in the Multi-State Process in UM 1050. Staff agrees with PacifiCorp's interpretation of the Revised Protocol and correctly recommends that the Commission reject INCU's proposed adjustment related to the QF contracts. (Staff's Post-Hearing Brief at 3.)

2. PacifiCorp objects to ICNU's reference to and reliance on a response to a data request from the current Washington rate case (UE-032065) in ICNU's Opening Brief, because this document was not properly entered into the evidentiary record. (*See* Opening Brief of ICNU, Attachment A (attaching *In Re PacifiCorp*, PacifiCorp Response to ICNU Data Request 2.136, No. UE-050684 (Wash PUC July 27, 2005)).) ICNU did not request an amendment to the evidentiary record, thus the Commission should dismiss ICNU's argument in reliance on this document.

Nevertheless, even if the Commission allows ICNU to include this document in the record, ICNU's argument that PacifiCorp itself has taken the position that applying a June 1, 2004 effective date to the Revised Protocol would constitute "retroactive ratemaking" is false and misleading. In data request 2.136, PacifiCorp stated that "applying the Revised Protocol retroactively would be inconsistent with the Commission's order [citation omitted] and would constitute retroactive ratemaking" because docket UE-032065 was initiated *before* June 1, 2004 and the Revised Protocol states that it will apply to all "PacifiCorp retail general rate proceedings initiated *subsequent* to June 1, 2004." (Emphasis added.) This problem clearly does not exist in this docket because PacifiCorp's current Oregon rate case was initiated in November 2004, *after* the Revised Protocol's effective date. Therefore retroactive ratemaking is not a concern in this case, and ICNU's arguments related to that point are irrelevant to the issue of PacifiCorp's treatment of its QF contracts and should be dismissed.

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3. ICNU states that PacifiCorp's credibility is strained because "the Company filed its recent Utah rate case originally treating at least one of these QFs as 'existing.'" (Opening Brief of ICNU at 19, n 7.) This statement is inaccurate. As explained in David Taylor's sur-surrebuttal testimony, PacifiCorp reflected the pricing and terms of the US Magnesium contract in the Utah rebuttal case as a "New QF Contract," just as it did in this case. (PPL/418, Taylor/3.)

V. Reply re Prudence of New Generation Resources

1. ICNU incorrectly states that PacifiCorp entered into the West Valley lease merely to benefit PacifiCorp's affiliate PPM Energy, Inc. ("PPM") and that the Company's "primary goal" in all matters regarding this lease was to burden its ratepayers. (Opening Brief of ICNU at 28.) As explained in PacifiCorp's Opening Posthearing Brief at 36-37 and in the testimony of Mark Tallman, this statement is entirely inaccurate, because the West Valley lease clearly has met and continues to meet the "lower of cost or market" standard and therefore benefits PacifiCorp's ratepayers. Staff agrees and maintains its position that the acquisition and extension of the West Valley lease was prudent. (Staff's Opening Prehearing Brief at 4.)

2. ICNU alleges that PacifiCorp and Staff oppose the Gadsby rate reduction, and have failed to present persuasive evidence that PacifiCorp acted appropriately and in the best interests of customers in its negotiations with General Electric ("GE"). ICNU is incorrect. As demonstrated by PacifiCorp and Staff, the acquisition of the Gadsby CTs was the better alternative to the Pratt & Whitney installation *even excluding* GE's offer to terminate the lease, which saved the Company, and thereby ratepayers, $7.5 million. (*See* PacifiCorp's Opening Posthearing Brief at 35-36; Staff's Post-Hearing Brief at 4.)

VI. Reply re Waiver of the New Resource Rule

1. ICNU suggests that PacifiCorp waited to seek a waiver of the New Resource Rule to "game" the system to "include higher market prices in rates," and that in contrast,

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PGE properly sought a waiver of the rule before construction of Port Westward. (Opening Brief of ICNU at 25.) This is an unfair and unsupported allegation because, as explained by PacifiCorp in its Opening Posthearing Brief, 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. (PacifiCorp's Opening Posthearing Brief at 38.) Similarly, Staff's witness Bill Wordley explained that PGE's timing of its request for a waiver had "nothing to do" with where the Port Westward plant was in terms of construction, but had to do with the lag of the resolution of the issue in UM 1066. (Tr. 133.)

2. ICNU states that PacifiCorp has failed to analyze or present evidence that waiver of the New Resource Rule would be consistent with the reasons for its adoption. (Opening Brief of ICNU at 25.) This statement is not true, because PacifiCorp provided an extensive analysis of the reasons that a waiver of the New Resource Rule is consistent with Oregon law in its comments in UM 1066, which are incorporated by reference in PacifiCorp's application for a waiver of the New Resource Rule that is a part of this docket.

3. ICNU argues that PacifiCorp's and Staff's interpretation that the New Resource Rule "can be waived if a resource was prudently acquired" would render the rule meaningless. (*Id.*) This misstates PacifiCorp's interpretation of the rule. PacifiCorp explained in its application for a waiver that PacifiCorp could meet the standard for a waiver set out in OAR 860-038-0001(4)—namely, "good cause." PacifiCorp demonstrated "good cause" based on the fact that a waiver would benefit Oregon customers and is consistent with Oregon law. PacifiCorp did not state that a waiver should be based on a prudence review.

4. ICNU complains that PacifiCorp has not addressed the Commission's concerns expressed in UM 1066 about a utility favoring its own resources. ICNU also states that PacifiCorp admited "that it is ignoring the Commission's directive to develop a workable opt-out tariff" by September 30, 2005 when it stated that it will not commence serious work

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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. (Opening Brief of ICNU at 27.) These statements are wrong; PacifiCorp is not, and has no intentions of, ignoring the Commission's directive in UM 1066.

As set out in Mr. Tallman's sur-surrebuttal testimony, PacifiCorp's decision to focus its efforts on UM 1182 and UM 1056 before working up a large customer opt-out proposal is consistent with the direction of the Commission in Order 05-133, indicating that these dockets are integral to the policies implicated by the New Resource Rule. (PPL/903, Tallman/1.) PacifiCorp is currently using the information gleaned from workshops in these dockets to develop an opt-out proposal in accordance with the Commission's directive in UM 1066.

VII. Reply re Fuel Handling Charge

1. ICNU asserts that PacifiCorp's fuel-handling adjustment is arbitrary and late filed, and suggests that PacifiCorp only concocted this "error" to make up for the cost adjustment related to the Camas facility (James River). (Opening Brief of ICNU at 20.) This argument is unfounded because the Company's omission of the fuel-handling charge was an inadvertent omission, which was promptly corrected in PacifiCorp's rebuttal testimony. (PacifiCorp's Opening Posthearing Brief at 39.) It is hard to see how an inadvertent omission that is promptly corrected subjects the parties in this case to "continually re-evaluate a moving target rate increase," as ICNU alleges. (Opening Brief of ICNU at 20.) Staff concurs with PacifiCorp's request to include fuel-handling costs. (Staff's Post-Hearing Brief at 7.)

2. ICNU's argument that PacifiCorp never provided detailed work papers to justify this adjustment is equally unfounded, because the Company provided its work papers in response to Staff's Data Request 433. (PacifiCorp's Opening Posthearing Brief at 39.)

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VIII. Reply re UM 995 Deferral Period Outages

1. ICNU incorrectly asserts that PacifiCorp will double-recover its costs if all outages that occurred during the UM 995 deferral period are not removed from rates. (Opening Brief of ICNU at 21.) In its Opening Posthearing Brief at 40, the Company explains that its inclusion of the UM 995 deferral period outages will not result in a "double count" of these outages. Staff concurs with PacifiCorp's calculations and recommends that the Commission reject ICNU's proposed adjustment regarding the UM 995 deferral period plant outages. (Staff's Post-Hearing Brief at 6.)

IX. Reply re RTO Costs

1. ICNU asserts that PacifiCorp's RTO costs should be removed from rates and placed in a deferred account until an RTO is operating and benefits Oregon ratepayers. (Opening Brief of ICNU at 22.) As set out in the testimony of its policy witness, D. Douglas Larson, as well as in PacifiCorp's Opening Posthearing Brief at 41, PacifiCorp's customers directly benefit from the Company's efforts to aid in the formation of an RTO for the Pacific Northwest. Staff agrees, and recommends that the Commission accept PacifiCorp's treatment of RTO costs. (*See* Staff's Post-Hearing Brief at 7.)

2. ICNU's allegation in its Opening Brief at 23 that PacifiCorp has not justified why "Oregon should address [RTO costs] differently" than Washington is unsupported. Mr. Larson specifically explained at the July 20 hearing that PacifiCorp's rate case filed three months ago in Washington included RTO costs on an expense basis identical to the way they are being treated in the Oregon rate case. (Tr. 39.)

3. ICNU states that FERC is no longer actively promoting a Northwest RTO; in support of this statement, ICNU cites to a July 1, 2005 declaratory order by FERC. (Opening Brief of ICNU at 23 citing 112 FERC ¶ 61,012 (2005).) ICNU's statement in reliance on this declaratory order is misplaced, because the FERC declaratory order does not state that FERC no longer actively promotes a Northwest RTO. To the contrary, this order addresses a

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petition for declaratory order filed by the Bonneville Power Administration, PacifiCorp and Idaho Power Company, seeking FERC's guidance with respect to certain issues identified as being of critical importance to the further development of Grid West.

X. Conclusion

For all of the reasons stated in PacifiCorp's testimony, at the hearings, in PacifiCorp's Prehearing and Opening Posthearing briefs, and in the foregoing Posthearing Reply Brief, PacifiCorp requests that the Commission grant PacifiCorp's rate change as requested.

DATED: August 11, 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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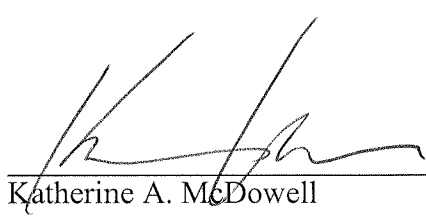

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