

# 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

July 13, 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 Prehearing 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 Prehearing 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 13th day of July, 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 YUROK 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  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

ROBERT VALDEZ  
PO BOX 2148  
SALEM OR 97308-2148  
bob.valdez@state.or.us

PAUL M WRIGLEY  
PACIFIC POWER & LIGHT  
825 NE MULTNOMAH STE 800  
PORTLAND OR 97232  
paul.wrigley@pacificcorp.com

**BEFORE THE PUBLIC UTILITY COMMISSION  
OF OREGON**

**UE 170**

In the Matter of	)	
	)	
PACIFIC POWER & LIGHT	)	PREHEARING BRIEF OF THE
(dba PACIFICORP)	)	INDUSTRIAL CUSTOMERS OF
	)	NORTHWEST UTILITIES
Request for a General Rate Increase in the	)	
Company's Oregon Annual Revenues	)	
_____	)	

Pursuant to Administrative Law Judge Logan's June 14, 2005, and July 7, 2005 Rulings, the Industrial Customers of Northwest Utilities ("ICNU") hereby submits this Prehearing Brief describing its position in this proceeding on the remaining contested issues, including a brief description of the evidence that will be presented to the Oregon Public Utility Commission ("Commission" or "OPUC") during the hearings scheduled for July 22-24, 2005.

**I. INTRODUCTION**

ICNU recommends that the Commission order an overall rate reduction for PacifiCorp of approximately \$16.1 million. PacifiCorp originally requested an approximately \$102.2 million Oregon revenue requirement increase, which would have resulted in an average 12.5% base rate increase and a 21.6% industrial customer rate increase. PacifiCorp filed two resource valuation mechanism ("RVM") power cost updates that cumulatively increased its rate request by approximately \$10.7 million. Under PacifiCorp's original proposal, these adjustments would occur in January 2006 and

would only take place if the Commission approves the RVM. Thus, PacifiCorp's overall revenue requirement increase was approximately \$112.9 million.

The Company, Staff, the Citizens' Utility Board ("CUB"), ICNU, and Fred Meyer have entered into two partial stipulations that have resolved specific issues, including issues relating to some power cost disputes, employee benefits, non-labor administrative and general costs, and incentive program costs. These two stipulations have reduced PacifiCorp's revenue requirement request by approximately \$33.5 million.

In its rebuttal testimony PacifiCorp further increased its rate increase request requesting increases related to fuel handling and pensions. In sursurrebuttal testimony, PacifiCorp accepted Staff's pension administrative cost adjustment, further increased its pension expenses, and has made additional adjustments. While ICNU has not fully determined the actual revenue requirement impact of all of PacifiCorp's late-filed adjustments, PacifiCorp appears to have requested an additional \$2.5 million related to fuel handling costs and an additional \$1.1 million related to pension expense.

In sursurrebuttal testimony, the Company also appears to have changed its position regarding the RVM cost increases. PacifiCorp is now requesting that the RVM related adjustments should be made even if the Commission rejects the RVM. This would further increase rates in September 2005 by including the RVM costs, which had been planned for January 2006, in the general rate case.

PacifiCorp and Staff have also entered into a third partial stipulation that addresses fuel handling costs and RVM issues between those parties. ICNU opposes the third partial stipulation, pursuant to which Staff and PacifiCorp agreed to the fuel

handling adjustment that PacifiCorp proposed in its rebuttal testimony. In addition, in the third partial stipulation, the Company and Staff agreed to make many, but not all, of ICNU's proposed RVM related adjustments. The RVM related adjustments agreed to by PacifiCorp and Staff would reduce the RVM power cost increase from \$10.7 million to \$4.9 million.

Overall, including the RVM increase, PacifiCorp is now requesting an approximately \$77.2 million revenue requirement increase.<sup>1/</sup> This represents an approximately 10% average base rate increase, and an over 18% rate increase for industrial customers.

The evidence to be introduced at hearing will demonstrate that PacifiCorp's requested Oregon revenue requirement should be further reduced by approximately \$93.3 million, resulting in an approximately \$16.1 million rate reduction. Although differing in amount and methodology, ICNU, CUB, and Staff are all proposing revenue requirement reductions related to PacifiCorp's pension expense, taxes, and return on equity/capital structure. In addition, ICNU supports additional reductions related to PacifiCorp's net power costs, new high cost Utah resources, regional transmission expenses ("RTO"), and existing Utah Qualifying Facility ("QF") contracts. ICNU also proposes that the Commission adopt a rate spread and rate design that does not inappropriately penalize large customers. Finally, ICNU recommends that the Commission adopt a transition adjustment mechanism that fairly and accurately values

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<sup>1/</sup> Although ICNU has not had the opportunity to verify the accuracy of the figures or the review all the changes in the Company's sursurrebuttal testimony, PacifiCorp's sursurrebuttal testimony asserts that the Company's overall revenue requirement request is currently \$75.9 million.

resources freed-up by direct access, and that the Commission reject the Company's proposed RVM. ICNU's specific revenue requirement recommendations are summarized in the table below:

<b>ICNU Proposed Adjustments Oregon Basis (in thousands)</b>	
Return on Equity/Capital Structure	\$33,900
Pension and Other Retirement Expense	\$5,789
RTO Expense	\$900
Consolidated Tax Adjustment	\$27,580
GRID Net Power Costs	\$9,538
Fuel Handling Adjustment	\$2,400
MSP New Resources	\$5,487
MSP QF Contracts	\$7,669
<b>Total ICNU Proposed Adjustments</b>	<b>\$93,263</b>

## **II. ICNU POSITIONS ON CONTESTED ISSUES**

### **A. PacifiCorp Has Arbitrarily Inflated Its Cost of Capital by Relying Upon Unnecessary Equity Infusions and Unrealistic Economic Forecasts**

ICNU supports reasonable adjustments to PacifiCorp's overall capital structure and return on equity ("ROE") that would more accurately reflect the conditions that are expected to occur during PacifiCorp's forecasted test year. Specifically, evidence will demonstrate that a 9.5% ROE is reasonable, will allow PacifiCorp to attract necessary capital, and most accurately reflects the decline in equity markets. In addition, PacifiCorp's proposed capital structure should be adjusted to exclude a proposed \$500 million equity infusion from PacifiCorp Holdings Inc. ("PHI") because the equity infusion is not known and measurable, nor will it improve PacifiCorp's credit quality or lower its cost of capital. ICNU proposes an overall rate of return of 7.81%, a ROE of



9.5%, and a fiscal year (“FY”) 2006 capital structure that excludes the projected \$500 million capital infusion, which would result in a \$33.9 million Oregon revenue requirement reduction.

**1. PacifiCorp’s Proposed Equity Infusion Is Unlikely to Improve the Company’s Credit Quality**

ICNU supports a reasonable overall cost of capital for PacifiCorp based on PacifiCorp’s projected FY 2006 capital structure, excluding a projected \$500 million equity infusion from its corporate parent, PHI. This capital structure would be 46.2% common equity, 52.6% debt, and 1.2% preferred stock. In addition to being consistent with PacifiCorp’s expected actual capital structure, the evidence will show that this capital structure has been recognized by the credit rating agencies as supporting PacifiCorp’s current bond rating, and is comparable to the common equity ratios of comparable utility groups.

The primary difference between ICNU’s and PacifiCorp’s proposed capital structures is that the Company includes four quarterly equity infusions, starting in June 2005, by PHI that could increase PacifiCorp’s common equity balance by \$500 million. The evidence will demonstrate that it is unclear whether PHI will make all the claimed equity infusions during the test period. More importantly, increasing PacifiCorp’s reliance on higher cost common equity and reducing its reliance on debt is unlikely to improve PacifiCorp’s credit quality or lower its cost of capital without comparable adjustments at ScottishPower. The practical effect of the equity infusion may only be to increase PacifiCorp’s cost of capital by including more expensive common equity capital.

ICNU's proposed capital structure will be shown to be reasonable because it should allow PacifiCorp to maintain its credit rating, is consistent with changes at the consolidated ScottishPower companies, and is comparable to other utility groups. Rating agency reports will establish that PacifiCorp's current capital structure and financial ratios support its "A-" bond rating. Evidence will also establish that utilizing PacifiCorp's FY 2006 capital structure, without the projected equity infusion, is within the reasonable range of comparable utilities and sufficient to maintain its bond rating. Finally, ICNU's proposed capital structure is consistent with the consolidated debt ratio of ScottishPower and its consolidated companies.

**2. PacifiCorp's Proposed Return on Equity Fails to Accurately Reflect the Changes in the Equity Markets**

The evidence sponsored by ICNU, CUB, and Staff will establish that the reasonable return on common equity for PacifiCorp is 9.5%. In contrast, PacifiCorp's proposed 11.125% ROE will be shown to be inconsistent with prevailing low interest rates and based on unrealistic expectations of future economic growth. In fact, PacifiCorp's proposal also supports a 9.5% ROE, once it is adjusted to include the consensus economists' predictions and more accurate interest rates. Finally, a 9.5% ROE is consistent with financial ratios for a strong "BBB" or weak "A" credit rating, and should be sufficient to allow PacifiCorp to maintain its current "A-" credit rating.

**B. PacifiCorp Has Dramatically Overestimated the Increases in Its Pension and Retirement Benefits Expenses**

PacifiCorp's expenses related to pension and other retirement benefits are significant causes of the Company's overall rate increase proposal. All parties agree that

these expenses have increased, and ICNU's proposal reflects a large increase in pension and other retirement expenses. However, the evidence that PacifiCorp will present has been selectively updated on rebuttal, fails to account for expected interest rate increases, relies upon unreasonably low returns on pension assets, and fails to account for other savings. Overall, the evidence that will be presented by ICNU demonstrates that PacifiCorp's pension and other retirement benefit expenses should be reduced by approximately \$5.8 million on an Oregon jurisdictional basis. In addition, ICNU's position is that pension and retirement benefit costs should not be placed in a "balancing account" or other deferral. Although based on a different rationale, ICNU's proposed reduction is similar to Staff's overall pension adjustment.

**1. PacifiCorp's Forecasted Pension and Other Retirement Expenses Fail to Accurately Reflect Future Returns on Assets and Interest Rates**

The evidence will establish that the Company's total electric pension expense should be \$27 million, and its post retirement benefits other than pension (FAS106) should be \$18.1 million. This would result in an approximately \$5.4 million reduction in PacifiCorp's original revenue requirement increase request. PacifiCorp originally requested pension expense of \$42.2 million and FAS106 expense of \$26.8 million, but increased its pension expense to \$48.4 million in its rebuttal testimony and further increased it to \$49.9 million in its sursurrebuttal testimony. The Commission should ignore the one-sided, late-filed increases because they are selective updates that should have been filed in PacifiCorp's direct case. In addition, these selective adjustments do not reflect an actual pension cost increase, but a change in the Company's estimated discount rate. It is important to note that all of the parties' proposals regarding

pensions reflect significant cost increases, as PacifiCorp's pension expense was \$0.5 million in 2002 and \$14.8 million in 2003.

The key differences between PacifiCorp's and ICNU's pension expense projections are the discount rate utilized to present the value of benefits, and the expected return on pension fund assets. The different discount rate also is the basis for the difference in FAS106 expenses. A discount rate is an interest rate used for the time value of money. ICNU's recommendation for pension and FAS106 expense starts with PacifiCorp's calendar year ("CY") 2004 pension expense, which included a 6.25% discount rate. Evidence to be submitted by ICNU and PacifiCorp will demonstrate that interest rates are rising, and thus, it would be reasonable to increase the CY 2004 discount rate to 6.75%. In addition, in estimating its future pension expenses, PacifiCorp will assume low investment returns on its pension assets. Evidence will establish that PacifiCorp should, at a minimum, rely upon a 8.75% return on expected assets to calculate its investment returns. The overall reasonableness of a 8.75% return will be supported by the fact that the Company's actual 2004 return on pension assets was 10.5%.

**2. The Commission Should Reduce the IBEW 57 Pension Expense Because PacifiCorp Will Fail to Demonstrate that It Will Make Future Contributions**

PacifiCorp's case includes a forecast that it will make \$3 million in contributions in both 2005 and 2006 to the IBEW pension fund. However, the evidence will establish that PacifiCorp did not make an IBEW 57 contribution in 2005, and PacifiCorp has not demonstrated that it will make any contributions during the test year.

Therefore, it is reasonable to reduce the IBEW 57 test year pension expense by 50%, to \$1.5 million. This would result in an approximately \$330,000 Oregon revenue requirement reduction.

**C. The Proposed Transition Adjustment Mechanism Fails to Accurately Value PacifiCorp's Resources, and the Resource Valuation Mechanism Is Unnecessary and Harmful to Ratepayers**

ICNU recommends that the Commission adopt ICNU's transition adjustment mechanism and reject PacifiCorp and Staff's proposal for an annual resource valuation mechanism ("RVM"). The Commission has never approved a transition adjustment mechanism for PacifiCorp that provides direct access customers with a realistic opportunity to elect to obtain electricity service from an alternative supplier. The evidence will show that the PacifiCorp/Staff proposed transition adjustment mechanism, which is based on PacifiCorp's GRID computer model, does not fairly value the power that is freed-up by customers electing direct access. In addition, the GRID based transition adjustment mechanism fails to simulate the planning changes that are necessary to allow direct access to succeed. Essentially, the PacifiCorp/Staff proposal will be shown to violate Senate Bill 1149 because it will always undervalue freed-up resources and prevent any customers from ever electing direct access.

ICNU proposes that the Commission approve a transition adjustment mechanism that does not rely upon the GRID model, but recognizes that the departure of direct access load will result in a net reduction of purchases. The evidence will demonstrate that ICNU's transition adjustment is realistic, consistent with Senate Bill 1149, and is the only option that will provide direct access customers in PacifiCorp's

service territory with a realistic opportunity to elect to receive electricity from alternative suppliers.

ICNU also opposes an annual RVM because the evidence will show that it is unnecessary, harmful to ratepayers, and unduly burdensome. PacifiCorp supports an annual RVM to address the potential problem that, if power prices precipitously drop, then customers who elect direct access could be subsidized by remaining customers. Given the lack of past direct access participation, and the fact that PacifiCorp and Staff are promoting a transition adjustment that will preclude any customers from electing direct access, an annual RVM would remedy a non-existent problem. In contrast, the evidence will establish that an annual RVM is likely to harm ratepayers by shifting the risk of power cost increases from shareholders to customers, and increasing the regulatory burden on the Commission and customers.

**D. PacifiCorp's Rates Should Not Be Artificially Increased to Include Income Taxes that Will Never Be Paid**

Based on sound cost of service principles, ICNU recommends that PacifiCorp's rates only include income taxes that PacifiCorp or ScottishPower actually pay to the taxing authorities. ScottishPower has established a corporate structure for PacifiCorp that is designed to minimize PacifiCorp's taxable income and allow shareholders to retain a portion of the money ratepayers pay for taxes. Calculating PacifiCorp's taxes on a stand-alone basis and ignoring this tax benefit will continue to allow ScottishPower's investors to earn excessive returns and retain income taxes that are never paid to the taxing authorities. Recognizing only legitimate and known tax costs

that are actually incurred to serve customers would result in a \$27.58 million Oregon jurisdictional basis revenue requirement reduction.

Evidence will establish that, contrary to PacifiCorp's assertions, ICNU's income tax proposal is not related to PacifiCorp's unregulated operations and does not create deferred taxes that PacifiCorp must later recover. Removing income taxes that will never be paid from PacifiCorp's rates will be shown to not take into account the profits, losses, or credits that result from unregulated operations. In addition, ICNU's proposal is not based on timing differences, losses carried forward or otherwise creating deferred taxes that must later be repaid, but simply reflects PacifiCorp's actual corporate structure.

**E. Regional Transmission Organization ("RTO") Costs Should Be Deferred Until An RTO Is Operating and Benefits Oregon Ratepayers**

ICNU's position is that RTO costs are not currently benefiting Oregon ratepayers, and PacifiCorp should not be permitted to recover these costs until an RTO is operating. Although the Commission could simply disallow these costs, ICNU believes that it would be appropriate to defer them and subject them to a comprehensive prudence review once an RTO is operating and providing benefits to future Oregon ratepayers. Excluding RTO expenses would reduce PacifiCorp's Oregon revenue requirement by approximately \$900,000.

**F. The Commission Should Reject PacifiCorp's Arbitrary and One-sided Power Cost and Fuel Handling Cost Adjustments**

The majority of ICNU's issues related to PacifiCorp's power costs have been resolved through settlement agreements between the parties; however, there are

three remaining issues: 1) the power plant outages during the UM 995 deferral period; 2) PacifiCorp's outage and heat rate update; and 3) PacifiCorp's late-filed fuel handling costs. Elimination of the deferral period outages would reduce PacifiCorp's Oregon revenue requirement by approximately \$7.5 million, and reversal of PacifiCorp's outage and heat rate update would result in an approximately \$2.0 million Oregon revenue requirement reduction. Allowing PacifiCorp to include the fuel handling costs in rates would increase Oregon rates by approximately \$2.5 million.

In Docket No. UM 995, PacifiCorp was authorized to defer its excess net power costs from November 2000 to September 2001. This excess net power cost deferral included all power plant outages that occurred during this time period, and PacifiCorp is currently recovering in rates the costs associated with those outages. The evidence will demonstrate that, while PacifiCorp removed the costs of the Hunter 1 outage that occurred during the deferral period, the Company has not excluded the remaining outages from its net power costs. In order to eliminate double recovery, ICNU recommends that all outages that occurred during the deferral period should be removed from the Company's net power costs.

ICNU believes the Commission should reject PacifiCorp's updates to the fuel handling costs, and the outage and heat rates because they are selective, late-filed adjustments. In addition, the evidence will demonstrate that these adjustments have not been adequately supported. Finally, the outage and heat rate update will be shown to be inconsistent with Commission precedent and past Company practices.



**G. The Commission Should Exclude the Imprudent and Above-Market Costs of PacifiCorp's New Utah Resources**

ICNU recommends that the Commission comply with existing law and require that all imprudent, non-beneficial and above-market costs of PacifiCorp's new resources—West Valley, Gadsby, and Currant Creek—be removed from Oregon retail rates. An imprudence disallowance for West Valley would reduce Oregon's revenue requirement by approximately \$1.7 million, and a Gadsby disallowance would result in a \$0.247 million reduction. In addition, the costs of all three resources are above market, and compliance with the Oregon rule requiring new resources to be included at market would reduce PacifiCorp's Oregon revenue requirement request by approximately \$5.5 million. Since the market price adjustment is larger than the prudence adjustment for each new resource, the Commission need not address the prudence issues if it excludes the above-market costs of West Valley, Gadsby, and Currant Creek.

**H. PacifiCorp's Rate Spread and Rate Design Unfairly Penalizes Large Customers**

PacifiCorp's proposed rate spread and rate design unnecessarily penalizes large industrial customers by increasing their base rates nearly double the average rate increase. Based on PacifiCorp's original revenue requirement request, large industrial customers' rates would have increased on average 21.6%, while the average rate increase would have been 12.5%. The larger rate increase for industrial customers is based on PacifiCorp's marginal cost study, which classifies a large portion of the generation and transmission on an energy basis, as compared to the jurisdictional study. The evidence will show that this inappropriate focus on the energy component minimizes the economic

consequences regarding the timing and growth of energy usage, and results in price signals that lack a relationship to the marketplace. ICNU proposes that the Commission reconcile the functional marginal costs, which would have resulted in an 18.6%, rather than a 21.6%, rate increase for industrial customers under the Company's original revenue requirement request. Finally, ICNU opposes PacifiCorp's time of day pricing for large customers because, as the evidence will show, it is simply an effort to boost revenues for energy sold to large customers during peak periods. While the off-peak rate is lower, the evidence will show that customers that shift their usage to off-peak hours will not benefit from because the Company's cost study does not distinguish between on-peak and off-peak energy usage.

**I. PacifiCorp Has Ignored the Plain Language of the Revised Protocol and Has Improperly Allocated the Costs of Existing Utah QFs to Oregon Ratepayers**

Contrary to the terms of the Revised Protocol, four Utah based Qualifying Facility ("QF") contracts have been allocated on a system-wide basis, rather than on a situs basis. The four challenged Utah QF contracts are the US Magnesium, Desert Power, Kennecott, and Tesoro contracts. Properly assigning these four existing QF contracts on a situs basis, as required by the Revised Protocol, would reduce PacifiCorp's requested Oregon rate increase by approximately \$7.7 million.

The evidence will demonstrate that, under the Revised Protocol, the four challenged QF contracts are existing QF contracts that should be assigned on a situs basis. The Revised Protocol allocates a portion of the costs for existing QF contracts on a situs basis, and assigns the costs of new QF contracts on a system-wide basis. Existing QF contracts are those that were entered into prior to the effective date of the Revised

Protocol. The terms of the Revised Protocol establish that the earliest effective date is the date the Commission approved the Revised Protocol, or January 12, 2005. Since the four challenged contracts were entered into prior to this date, their costs should be allocated on a situs basis.

### **III. CONCLUSION**

ICNU believes that the evidence presented at the hearing will establish that PacifiCorp has dramatically overstated its revenue requirement request and should be ordered to reduce its overall rates by approximately \$16 million, including reductions related to cost of capital/ROE, taxes, pensions and other retirement benefits, RTO expenses, power costs, new Utah resources, and existing Utah QF contracts. In addition, the Commission should adopt a rate spread and rate design that does not unnecessarily penalize large customers. Finally, the evidence will establish that the RVM is unnecessary and harmful, and that ICNU's transition adjustment is the only proposal that is consistent with Senate Bill 1149 and will allow customers a realistic opportunity to elect direct access.

Dated this 13th day of July, 2005.

Respectfully submitted,

DAVISON VAN CLEVE, P.C.

/s/ Irion Sanger

Melinda J. Davison

Irion Sanger

Davison Van Cleve, P.C.

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