BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UE 173

In the Matter of	)
PACIFICORP,	)
Application for Approval of A Power Cost Adjustment Mechanism.	)

REPLY BRIEF

OF THE

CITIZENS' UTILITY BOARD OF OREGON

January 17, 2006

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I. Introduction

The applicability of the Commission's Order in UE 165 to this docket is not clear to us. While the Commission clearly laid out a number of principles specifically applicable to a hydropower cost adjustment mechanism in its UE 165 Order, that Order does not address criteria for a comprehensive power cost adjustment mechanism, such as those proposed by the parties in this docket, and so the question of applicability to this docket remains.

If the Commission would like a hydropower cost adjustment mechanism, then all of the proposals in this docket should be rejected, as they are not hydropower cost adjustment mechanisms. If the Commission would like a comprehensive mechanism with the UE 165 design criteria, it should instruct the parties to design an appropriate mechanism.

We believe the Commission should not attempt to apply its UE 165 Order to a comprehensive power cost adjustment mechanism, because such a mechanism was not before the Commission in UE 165, and we think the design criteria for a hydropower, as opposed to a comprehensive, mechanism should be different.

We continue to recommend CUB's comprehensive power cost adjustment mechanism as one that is clear, simple, does not require annual tinkering, is easily understood by customers and rating agencies alike, and stands the best chance of long-term operation without unintended consequences.

II. Application Of The UE 165 Order To UE 173

The first hurdle we encountered when assessing the applicability of the Commission's Order in UE 165 to PacifiCorp's Application for a power cost adjustment mechanism was uncertainty as to whether the Commission intended the criteria laid out in its Order to apply only to hydro-specific mechanisms, as were discussed in the Order, or whether the criteria were also meant to apply to broader, comprehensive mechanisms.

A. Do Criteria Of 165 Order Apply Beyond Hydropower Mechanisms?

The following table lays out the general guidelines the Commission provided in its UE 165 Order, and compares them to the mechanisms proposed in this docket.

Criteria	UE 165 Order	UE 173 Proposed Mechanisms			
		PacifiCorp	Staff - Ongoing	Staff - Interim	CUB
Mechanism Scope	hydropower	all power costs	all power costs	all power costs	all power costs
Tenure	ongoing	ongoing	ongoing	interim	ongoing
Event Frequency	unusual	common	extraordinary	extraordinary	extraordinary
Revenue Neutral	yes	no	yes	no	yes
Power Cost Deadband	asymmetric[1]	none	asymmetric[2]	symmetric	asymmetric
Sharing	yes	yes	yes	yes	yes
Earnings Test	yes	yes	no	no	no[3]
ROE Deadband	yes	no	no	no	no

1. The Commission did not specifically prescribe an asymmetric deadband, but in describing revenue neutrality, acknowledged CUB's assertion that this requires an asymmetric deadband. Order No. 05-1261, page 10.
2. Though Staff's percentiles were symmetric, we, and we believe Staff, presume that this would result in asymmetric power cost values.
3. Though CUB did not propose an earnings test, it is something we feel is important, and the omission was an oversight, not a policy position.

Clearly, the scope of the mechanisms proposed in this docket goes well beyond hydro variation, and we simply don't know if the UE 165 Order tells us anything about comprehensive power cost adjustment mechanisms.

B. Tenure

The parties appear to be in alignment with the Commission that an ongoing mechanism makes the most sense, as a mechanism must be in place for a number of years in order for the revenue variations to balance out. It is our preference to have a relatively simple mechanism that does not need constant tweaking and updating. Though Staff, for its proposed long-term mechanism, may envision a simple annual update of certain variables, we are skeptical that such an update could be simple, and we remain skeptical about the long-term feasibility of a mechanism that requires annual tinkering.

In regard to the Commission's, as well as the parties', desire for an ongoing mechanism, we point again to CUB's proposed mechanism. It is simple, it is based on relatively few variables, and it has a deadband and sharing bands that we believe are appropriate for a comprehensive mechanism. We think CUB's proposal offers the

Company protection from wide swings in power costs, avoids the contention and unexpected outcomes that are inherent in more-complex mechanisms, and offers the best option for a smooth mechanism that can be in operation over a long time period without updates. It is difficult to assess the revenue neutrality of a mechanism that changes every year, even if only for variable updates.

C. Event Frequency

The Commission used a 1 in 4.5-year hydro event to express “unusual”, as opposed to “extraordinary.” UE 165, Order No. 05-1261, page 9. However, what comprehensive circumstances would be comparable to a 1 in 4.5-year hydro event? The $15 million figure provided by the Commission comes from a rough, $17.5 million estimate related to a 1 in 4.5-year hydro event, and therefore does not seem applicable to a comprehensive power cost adjustment mechanism. The measure of a power cost variation equivalent to 250 basis points of return on equity used by the Commission in the past was a measure of financial impact, not event frequency. It is unclear whether the Commission would like a comprehensive adjustment mechanism to be triggered by event frequency or financial impact, and we don’t know the magnitude that would define “unusual” when all net power cost variables are included in a comprehensive mechanism. Indeed, we are not sure how to measure comprehensive event frequency other than by financial impact.

D. Revenue Neutrality

Everyone agrees that the financial risk of power cost variations is asymmetric,[1] and so the deadband must be, too, if a mechanism is to be revenue neutral. Though Staff's long-term proposal and CUB's proposal are the only two proposals that aim to meet this criteria, there is no evidence that we have achieved it. Presumably, if Staff's vision of stochastic power cost modeling is achieved, then using balanced percentiles of power costs would produce a revenue neutral mechanism. CUB's proposal could be back-cast to test its revenue neutrality, and would, of course, be monitored for this over time.

E. Financial Impact & Power Cost Deadband

Parties in this proceeding propose the use of a deadband to represent the financial impact power cost variations might have on the utility, and CUB and Staff in particular use a deadband to encompass the utility's responsibility to manage power cost variations between rate cases. Again, the parties all proposed comprehensive mechanisms, but even so, had widely varying opinions as to the appropriate variation the utility should be responsible for. In its Order in UM 1071, the Commission clearly stated that the 250 basis point deadband it established in UM 995 – for all power costs – represented the normal variation a utility is expected to manage.

> In UM 995 … we established a deadband around PacifiCorp's baseline of 250 basis points of return on equity. We allowed no recovery of costs or refunds to customers within that deadband, reasoning that the band represented risks assumed, or rewards gained, in the course of the utility business.

UM 1071, Oregon PUC Order No. 04-108, page 9.

[1] See Note 2 of the Table as regards Staff's proposal.

In its Order in UE 165, the Commission found that a power cost deadband for a hydropower cost adjustment mechanism could be lower, and that the hydropower cost variation resulting from a 1 in 4.5-year hydro event represented a reasonable deadband for an ongoing mechanism tracking hydropower costs only. Though Staff produced the $17.5 million estimate in UM 1071, Staff expressed considerable uncertainty about that number, and referred to it as a "rough estimate" and a "ballpark estimate." UM 1071, Staff Opening Comments, page 6. The Commission recommended a $15 million hydropower cost deadband to represent a 1 in 4.5-year hydro event.

However, we are not dealing with a hydropower mechanism in this docket; the parties all proposed comprehensive mechanisms. A comprehensive mechanism includes far more variables, and absorbs the balance of one-variable-up and one-variable-down movements that are expected, even presumed, when forecasting rates. This requires a larger deadband than a 1 in 4.5-year hydropower event cost variation to justify the encompassing scope of the mechanism, as well as the shift of risk from the Company to customers that comes with additional variables.

For example, according to PacifiCorp's testimony, since 1990, the Company's average annual variation of net power costs from those that were forecast is $67.5 million, or an Oregon allocation of just over $19 million average annual power cost variation. PPL/201/Widmer/1. Obviously, a $19 million average annual power cost variation is greater than the $15 million hydropower cost deadband suggested in the Commission's UE 165 Order. As this is the average variation, by definition, it is not unusual. Obviously a deadband designed to represent an unusual event, an event with a probability of occurring once every 4.5 years, would have to be greater than this annual average. How much greater is not known, because the record in this case is not sufficient to determine the financial effect of a 1-in-4.5-year net power cost variation.

The Company's proposal to eliminate the deadband, such that the Company would no longer bear the risk of any power cost variation at all, is a non-starter.

F. Sharing

In UE 165, the Commission chose to not place a high priority on providing incentives for prudent management in a hydropower mechanism, especially given that the amount charged to customers in the Company's proposed mechanism would be calculated by a model, and not related to the Company's actual behavior. That being said, all parties appear to agree with the Commission that sharing is appropriate for a power cost adjustment mechanism. Again, the parties in this docket proposed comprehensive mechanisms, while the Commission addressed hydropower mechanisms in its UE 165 Order, so it is unclear how the parties feel about cost-sharing in a hydro-specific mechanism and how the Commission feels about cost-sharing in a comprehensive mechanism.

Given past power cost adjustment mechanisms, and presuming that a comprehensive power cost adjustment would calculate charges based on the Company's management of power costs, we are under the impression that the Commission shares our belief that utilities ought to have some skin in the game. Not only does this shared financial risk provide an incentive for responsive and aggressive power cost management, but it also maintains a balance which recognizes that, in many ways, customers and the utility are in this together, despite their differing goals.

G. Earnings Test & ROE Deadband

Though we failed to propose an earnings test in our mechanism, we appreciate the Commission's assertion that, when the utility's earnings are within a reasonable range, there is no need for costs or benefits to be shifted. The Commission's proposed earnings test of +/- 100 basis points of return on equity seems appropriate to us.

III. Response To Opening Briefs In UE 173

The Company's brief, beyond its outlandish tone, fails to offer the Commission much help in analyzing the proposals from Staff, CUB, and the Company. The Company inflates the risk associated with power cost variation by including in its analysis the extraordinary costs associated with the Western Power Crisis and costs that PacifiCorp stipulated were subject to a prudence disallowance. The Company fails to explain why customers should bear 70¢ of the first dollar of power cost variation that occurs between rate cases, or why, if that variation is due to QFs, customers should bear the entire cost variation.

What is new in the Company's Opening Brief, however, are the pages of hypothetical examples which seem to show that, under nearly all scenarios, CUB and Staff's proposed mechanisms would result in much greater cost under-recovery than the Company's proposal. PacifiCorp Opening Brief, pages 12-15.

These scenarios should be ignored, and the related arguments should be rejected outright. First, they are rebuttal testimony, and do not belong in a brief. Adding insult to injury, the scenarios are testimony without sufficient supporting evidence, as PacifiCorp provided no work papers to support the scenarios.

Second, these scenarios are designed to mislead the Commission. Instead of showing what is likely to happen under the Company's, Staff's, and CUB's proposals, the scenarios show what would happen in circumstances that simply will not exist. A comparison of the scenarios to the actual variability the Company has experienced since 1990, shows that the scenarios represent an extreme far worse than what the Company experienced even during the Western Power Crisis. PPL/201/Widmer/1.

In the scenarios presented in PacifiCorp's Opening Brief, 93% of the years have power costs that vary by more than 16% from the Company's baseline power costs.[2] In actuality, since 1990, power costs have varied by more than 16% only 4 times, or 27% of those years. Of the years presented in the scenarios, 57% of the years contain power costs varying by more than 33% from baseline, when in reality this has happened only once since 1990 … during the Western Power Crisis. Of the years presented in the scenarios, 36% have power costs varying from forecast by more than 50%; this has not happened since 1990, not even during the Western Power Crisis. Finally, 29% of the years presented in scenarios have power costs varying by more than 67% of forecast; again, this has not happened. In contrast, only 7% of the years in the Company's scenarios contained power costs that varied less than 10% from the forecasted amount, though in reality, this is what normally (67% of the time) happens.

Third, PacifiCorp claims the scenarios show "the effect on the Company if CUB's proposal, Staff's interim PCAM and the Company's proposal had been in effect." PacifiCorp Opening Brief, page 10. At best they show one example of what the effect might be. For example, in Case 1, the Company claims that if net power costs were $200 million above those that were predicted in rates, the Company would under-recover

[2] Using the baseline from PPL/204/Widmer/2.

$40 million in its own proposal. But PacifiCorp's proposed mechanism treats changes in cost differently depending on whether the changes are related to hydro, fuel, load, or QFs. Under CUB's proposal, we would need to know whether the change in cost is associated with changes in states' loads. Claiming that a certain level of variability will lead to a certain level of under-recovery cannot be done without identifying the source of that variability. Without work papers, we do not know the source of the variability cited in the Company's examples.

Finally, the Company's scenarios exaggerate the impact of various proposals by applying the Oregon proposals, not to Oregon's net power costs, but to system net power costs. In the footnote on page 12 of the Company's Brief, PacifiCorp cites Mr. Falkenberg's assumption that 100 basis points is equivalent to $60 million. This would mean that CUB is proposing a deadband of $150 million, but CUB is proposing a deadband associated with the Company's Oregon revenue requirement. In Oregon, 250 basis points represents $40 million, not $150 million.[3] The proposals before the Commission apply only to Oregon revenue requirement. In 2004, Oregon was responsible for 28.63% of system generation under the Revised Protocol. PPL/204/Widmer/2. This means that, in each proposed scenario, the impacts on the Company of the various proposals are between ¼ and ⅓ of what the Company portrays.

IV. Conclusion

PacifiCorp's Opening Brief, in the process of inappropriately including new evidence, produces evidence that is faulty, exaggerated, and unsupported. Other than

[3] PacifiCorp's March 2005 Results of Operations (on file with the PUC) shows that 100 basis points of equity is $16 million.

this, it contains nothing of substance. In light of the Commission's Order in UE 165, we continue to recommend CUB's proposed comprehensive mechanism for its simplicity, its clarity, and its ability to protect the Company and customers from wide power swings, with little, if any, potential for unintended consequences.

A second option would be for the Commission to reject PacifiCorp's application for a power cost adjustment mechanism altogether, now that the Company has a Transition Adjustment Mechanism that will annually update rates. After this has been tested over a few years, the parties can revisit the idea of a power cost adjustment for PacifiCorp if circumstances warrant. Finally, if the Commission does not choose either of these options, we ask for direction as to whether the Commission would like the parties to design a hydropower cost adjustment mechanism with the criteria from the UE 165 Order, or a comprehensive mechanism using the same, or some other criteria.

Respectfully Submitted,
January 17, 2006

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CERTIFICATE OF SERVICE

I hereby certify that on this 17th day of January, 2006, I served the foregoing Reply Brief of the Citizens' Utility Board in docket UE 173 upon each party listed below, by email and U.S. mail, postage prepaid, and upon the Commission by email and by sending 6 copies by U.S. mail, postage prepaid, to the Commission's Salem offices.

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