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January 17, 2006

Via Electronic and US Mail

Public Utility Commission of Oregon
Attn: Filing Center
550 Capitol St. NE #215
P.O. Box 2148
Salem OR 97308-2148

Re: In the Matter of PACIFIC POWER & LIGHT Application for Power Cost
Adjustment Mechanism
Docket No. UE 173

Dear Filing Center:

Enclosed please find an original and six copies of the Reply Brief on behalf of the Industrial Customers of Northwest Utilities in the above-captioned proceeding.

Please return one file-stamped copy of the document in the self-addressed, stamped envelope provided. Thank you for your assistance.

Sincerely,

/s/ Ruth A. Miller
Ruth A. Miller

Enclosures

cc: Service List

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I have served the foregoing Reply Brief on behalf of the Industrial Customers of Northwest Utilities upon the parties, on the service list shown below, by causing the same to be mailed, postage-prepaid, through the U.S. Mail, as well as an electronic version via email.

Dated at Portland, Oregon, this 17th day of January, 2006.

/s/ Ruth A. Miller
Ruth A. Miller

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**BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON**

UE 173

In the Matter of)	
)	
PACIFICORP)	REPLY BRIEF OF THE INDUSTRIAL
)	CUSTOMERS OF NORTHWEST
Application for Approval of Power Cost)	UTILITIES
Adjustment Mechanism.)	
)	
_____)	

The Industrial Customers of Northwest Utilities (“ICNU”) submits this Reply Brief in response to the Opening Brief of PacifiCorp (or the “Company”) in this Docket. PacifiCorp’s Opening Brief and its testimony provide very little support for its proposal to shift the risk of power cost variations from the Company to ratepayers through a comprehensive power cost adjustment mechanism (“PCAM”). Rather, PacifiCorp appears to assume, without any legal or policy justification, that it is entitled to a PCAM.

Because the Opening Brief of the Oregon Public Utility Commission (“OPUC” or “Commission”) Staff merely summarizes Staff witness Maury Galbraith’s direct testimony in this case, ICNU’s Opening Brief has already responded to the issues raised therein. Although it was a significant issue in this proceeding, Staff’s Opening Brief does not address the issue of the interstate allocation of costs included in a PCAM.

Pursuant to Administrative Law Judge Logan's Memorandum Ruling dated December 29, 2005, ICNU also addresses the impact on this case of Order No. 05-1261 in OPUC Docket Nos. UE 165/UM 1187.

I. RESPONSE TO PACIFICORP'S BRIEF

1. **PacifiCorp Should Not Be Permitted to Eliminate Its Power Cost Risk and Incentives For Efficiency**

PacifiCorp's arguments regarding power cost risk are contradictory.

PacifiCorp characterizes as "misleading" Staff's and intervenors' arguments that PacifiCorp's proposal would eliminate virtually all of the power cost risk that the Company has traditionally borne. PacifiCorp Opening Brief at 10. Yet at the same time, the Company argues that utilities should no longer bear the risk of cost changes between rate cases, and that the ratemaking process needs to be "significantly altered." *Id.* at 6, 7.

PacifiCorp's proposal would not guarantee that the Company would recover *all* of its net power costs, but it would guarantee that the Company would recover *the vast majority* of those costs. As a result, PacifiCorp would be relieved of many of the power supply risks to which it has traditionally been exposed. ICNU's position is not that the Company should not be allowed the opportunity to earn its authorized rate of return, but that PacifiCorp should not be guaranteed recovery of nearly all of its net variable power costs. Such a guarantee would dramatically alter the balance of risk between PacifiCorp and its customers. Importantly, the Company proposes to include costs in the PCAM that are not beyond the Company's control. ICNU/100, Falkenberg/13, 29-30. This would remove the Company's incentive to effectively and

efficiently manage its power costs. Therefore, the PCAM proposal would shift risk and reduce incentives, all to the detriment of ratepayers.

PacifiCorp has made clear that with or without a new owner, the Company will be filing annual rate cases in an effort to increase rates approximately 4% per year.^{1/} In addition, PacifiCorp's recently approved transition adjustment mechanism ("TAM"), will allow the Company to reset its power costs on an annual basis. Re PacifiCorp, OPUC Docket No. UE 170, Order No. 05-1050 (Sept. 28, 2005). The combination of annual rate cases plus the TAM will allow very frequent rate adjustments that will dramatically reduce the risk that PacifiCorp will not recover its power costs. Given the Company's strategy to reset its power costs on more than an annual basis, it would be absurd to award PacifiCorp a PCAM.

2. **PacifiCorp's Return on Equity Should Be Reduced If the Commission Adopts a PCAM**

PacifiCorp makes a misguided argument that if its PCAM is denied, then the Commission should increase the Company's return on equity ("ROE") because some of the "comparable" companies used to derive PacifiCorp's ROE had some sort of PCAM and/or ROEs in excess of PacifiCorp's allowed ROE. PacifiCorp Opening Brief at 22. The problem with PacifiCorp's argument is that PacifiCorp's ROE was set based on the premise that it did not have a PCAM. ICNU/300, Gorman/5. If the Commission does not allow a PCAM, that premise will not change, and no adjustment to ROE will be necessary or appropriate. On the other hand, if the Commission allows a PCAM, then

^{1/} PacifiCorp has announced its intention to file a new rate case in Oregon around the end of January 2006.

risk will be shifted from the Company to customers, and it would be appropriate for the Commission to make the ROE adjustment or reduction described in ICNU's Opening Brief. ICNU Opening Brief at 16-17. Finally, as noted in the Standard & Poor's report attached to PacifiCorp witness Christy Omohundro's direct testimony, the rating agencies consider Portland General Electric Company's ("PGE") RVM mechanism to be a quasi-PCA. PPL/101, Omohundro/2. The TAM will likely be viewed in a similar manner.

**II. ALL OF THE PCAMS PROPOSED IN THIS DOCKET ARE
INCONSISTENT WITH ORDER NO. 05-1261**

In Order No. 05-1261, the Commission rejected a stipulation between PGE and the OPUC Staff that would have created a hydro-related PCAM and applied it retroactively to January 1, 2005. Re PGE, OPUC Docket Nos. UE 165/UM 1187, Order No. 05-1261 (Dec. 21, 2005). In doing so, the Commission set out four primary design criteria that must be included in future hydro-related PCAM proposals: 1) the PCAM should be limited to unusual events; 2) no adjustments should occur if overall earnings are reasonable; 3) the PCAM must be revenue neutral; and 4) the PCAM must be designed for long-term operation. Id.

1. The Commission Should Adopt a Stronger Standard for Comprehensive PCAMs

ICNU supports the criteria established by the Commission in Order No. 05-1261 for hydro-only PCAMs. Nevertheless, the UE 165 standards are not directly applicable to the PCAMs proposed in this proceeding, which are comprehensive, rather than hydro-only, PCAMs. Because comprehensive PCAMs apply to costs that are within the utility's control, the Commission should adopt additional standards for

comprehensive PCAMs. Most importantly, a comprehensive PCAM should only result in a cost deferral under extraordinary circumstances.

In UE 165, the Commission explained that it would apply the less-stringent “unusual event” standard to hydro-related PCAMs, as compared to the “extraordinary event” standard that it applied to deferred accounting in Docket No. UM 1071, for two reasons: 1) a PCAM should stay in effect for many years, so that it compensates for the effects of both good and bad hydro conditions over time; and 2) “hydro availability is largely beyond the company’s control.” Id. at 9. The Commission determined that limiting a PCAM to unusual events could be achieved by including a deadband around expected power costs. Id.

In addition to the power cost deadband, the Commission stated in UE 165 that a deadband around a utility’s ROE is necessary in a hydro-related PCAM to ensure that the mechanism does not result in rate adjustments if the utility’s overall earnings are reasonable. Order No. 05-1261 at 9. Although the Commission recognized that it has adopted 250-basis-point ROE deadbands in authorizing deferrals or approving amortization of deferred accounts in several cases, it suggested that a 100-basis-point ROE deadband may be appropriate for a hydro-only PCAM that incorporates both a power cost deadband and an ROE deadband. Id. at 9-10.

ICNU believes that a double-deadband approach is appropriate for comprehensive PCAMs. Comprehensive PCAMs should, however, be limited to “extraordinary,” rather than “unusual” events, because unlike hydro costs, the power costs that the Company proposes to include in a comprehensive PCAM are largely within

the Company's control. ICNU/100, Falkenberg/29-30. For this reason, the power cost deadband in a comprehensive PCAM should be larger than in a hydro-only PCAM. A larger power cost deadband will help to limit PCAM operation to extraordinary events. Larger deadbands are also appropriate for comprehensive PCAMs because a small power cost deadband combined with a 100-basis-point ROE deadband could effectively guarantee earnings within the 100-basis-point band, thereby virtually eliminating risk to the utility.

The Commission did note in its UE 165 order that its double-deadband approach, combined with its "unusual events" standard, "may well shift risks to customers that they have not borne under the sporadic use of deferrals and PCAs in the past." Order No. 05-1261 at 10. If that is the case, the Commission stated that it "will consider the reduced risk for the company in setting ROE in future rate cases." Id. Likewise, the Commission must consider whether to reduce ROE prior to implementing a comprehensive PCAM. This factor takes on even greater significance in the context of a comprehensive PCAM, because a comprehensive PCAM shifts risks related to all power costs, not only those that are hydro-related, to customers.

The Commission also indicated that a hydro-related PCAM must be revenue neutral, and that this requires an asymmetric power cost deadband because the cost of replacement power in poor hydro years is greater than the benefits to customers in above-normal hydro years. Id. However, a party proposing a PCAM must provide evidence that the mechanism will be revenue-neutral even if an asymmetric power cost deadband is included. Id. at 12. Finally, because a hydro-related PCAM should

permanently allocate the risks and benefits of hydro variability, the Commission explained that hydro-related PCAMs should be long term. Id. at 10. ICNU believes that the Commission's determinations regarding revenue neutrality and longevity should apply equally to comprehensive PCAMs.

2. The PCAMs Proposed in This Docket Utterly Fail Based on the Standards in Order No. 05-1261

The Commission's analysis and proposed approach to hydro-related PCAMs in Order No. 05-1261 were reasonable. Nevertheless, each of the PCAMs proposed by PacifiCorp, Staff, and CUB fail to satisfy the standards that the Commission articulated in that order. None meet the double-deadband requirement, none are supported by evidence of revenue neutrality, and none satisfy the longevity test.

Moreover, as noted above, if the Commission allows PacifiCorp to implement a comprehensive PCAM, it should set the criteria for comprehensive PCAMs at a higher threshold than it has set for hydro-only PCAMs. PacifiCorp's proposed PCAM does not include a deadband; as a result, it would not meet even the "unusual" event standard, much less the more stringent "extraordinary" event standard.

The Commission has recognized that the additional risk that a PCAM shifts to customers warrants a corresponding reduction in the utility's ROE. Order No. 05-1261 at 10. As ICNU has explained in its Opening Brief and above, an adjustment to PacifiCorp's ROE should be made if the Commission adopts a PCAM.

Finally, the proposed PCAMs have not been shown to be revenue neutral or long-term. No party has presented evidence that its proposed PCAM will be revenue

neutral over a range of conditions, as required by Order No. 05-1261. Moreover, neither PacifiCorp's nor Staff's proposed PCAMs account for the asymmetric risk identified by the Commission in UE 165. The proposed PCAMs are also not long-term because they do not prevent PacifiCorp from withdrawing its PCAM in the future. In addition, Staff's proposed interim PCAM is designed as a stopgap proposal to be used until a long-term PCAM is adopted.

3. **The Commission's Decision on Retroactive Ratemaking in Order No. 05-1261 Does Not Apply to Staff's Proposed Interim PCAM**

In Order No. 05-1261, the Commission stated that even though the PGE/Staff SD-PCAM Stipulation would have allowed PGE to defer hydro costs beyond those included in PGE's original deferral request in UM 1187, the Stipulation would not result in retroactive ratemaking. The Commission reasoned that because PGE's UM 1187 filing asked the Commission "to implement the terms of tariff Schedule 128 *or such other allocation of the costs and benefits* of the variance in hydro generation that the commission adopts in UE 165," the language in UM 1187 was broad enough to enable the Commission to consider the request for deferral of hydro costs without being bound to PGE's original request or the SD-PCAM. Id. at 13.

The Commission's reasoning in Order No. 05-1261 does not apply to Staff's proposed interim PCAM in this Docket. PacifiCorp's UM 1193 application only requested deferral of hydro-related costs, while Staff has proposed to allow PacifiCorp to include *other* costs in the interim PCAM, retroactive to February 2005. Re PacifiCorp, OPUC Docket No. UM 1193, Application at 1 (Feb. 1, 2005); Staff Opening Brief at 13-

14. In UE 165/UM1187, there was no proposal to extend the scope of allowable costs beyond those included in the original application. Although PacifiCorp's UM 1193 application stated that PacifiCorp sought to defer the hydro costs for later incorporation in rates, the application did not contain language extending the scope of the application beyond hydro costs. Essentially, adopting Staff's proposal would allow PacifiCorp to defer types of costs that were not included in PacifiCorp's original UM 1193 Application. As a result, and as explained in ICNU's Opening Brief, Staff's proposal would result in illegal retroactive ratemaking. ICNU Opening Brief at 12-14.

III. CONCLUSION

The record in this proceeding does not justify adopting a PCAM for PacifiCorp. The Commission's decision in Order No. 05-1261 strengthens the conclusion that the PCAMs proposed by PacifiCorp, Staff, and CUB in this Docket should be rejected. None of the proposed PCAMs meet the standards for hydro-related PCAMs, and the standards for comprehensive PCAMs should be higher. Order No. 05-1261 also supports the conclusion that Staff's proposed interim PCAM would result in retroactive ratemaking. Finally, if the Commission decides to adopt a PCAM for PacifiCorp, an ROE adjustment is warranted. Far from being "unhinged" by PacifiCorp's proposal, ICNU's witness has demonstrated that an ROE reduction is the only equitable approach to partially compensate ratepayers for the shift in risk.

PacifiCorp may well decide to propose a new PCAM that applies the criteria from Order No. 05-1261 when it files its general rate case later this month. ICNU remains willing to work with PacifiCorp to design a balanced and reasonable PCAM.

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Notably, Avista's and Puget Sound Energy's ("PSE") power cost recovery mechanisms were developed through a collaborative process.^{2/} Such an approach would be appropriate to develop a PCAM for PacifiCorp.

Dated this 17th day of January, 2006.

Respectfully submitted,

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Of Attorneys for Industrial Customers
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^{2/} PSE's and Avista's "negotiated" PCAMs contain deadbands, \$20 million for PSE and \$9 million for Avista. The Washington Utilities and Transportation Commission ("WUTC") recently rejected Avista's attempt to reduce its deadband to \$3 million. WUTC v. Avista, Docket Nos. UE-050482 and UG-050483, Order No. 05 at ¶ 71 (Dec. 21, 2005).