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December 22, 2005

VIA ELECTRONIC FILING

PUC Filing Center
Public Utility Commission of Oregon
PO Box 2148
Salem, OR 97308-2148

**Re: Opening Brief of PacifiCorp
Docket UE 173**

Enclosed for filing please find an original and 5 copies of PacifiCorp's Opening Brief in the above-referenced docket. A copy of this filing has been served on all parties to this proceeding as indicated on the attached certificate of service.

Very truly yours,

Katherine A. McDowell

KAM:knp
Enclosure
cc: Service List

Oregon
Washington
California
Utah
Idaho

1 BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON

2

UE 173

3

4 In the Matter of PACIFICORP (dba Pacific Power & Light Company) Application for 5 Approval of Power Cost Adjustment Mechanism	**OPENING BRIEF OF PACIFICORP**

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1 ## I. PROCEDURAL BACKGROUND

2 On April 15, 2005, PacifiCorp (or, the "Company") filed an Application, pursuant to
3 ORS 757.210(1), to establish a power cost adjustment mechanism ("PCAM"). The
4 Company's Application was supported by the prefiled direct testimony of Christy A.
5 Omohundro, Mark T. Widmer and Gregory N. Duvall. The Application was assigned docket
6 number UE 173.

7 On April 20, 2005, the Company moved to consolidate the UE 173 proceedings with
8 those in UM 1193 (a previously filed Application to defer expected higher costs associated
9 with poor hydro-electric conditions).[1]

10 The Citizens' Utility Board of Oregon ("CUB") filed a Notice of Intervention in
11 UE 173 on April 27, 2005 and the Industrial Customers of Northwest Utilities ("ICNU")
12 filed a "Response" to the Company's Application on May 12, 2005. A prehearing
13 conference was held on May 25, 2005 which was attended by representatives of the
14 Company, CUB, ICNU and Commission Staff. That prehearing conference gave rise to a
15 Prehearing Conference Report dated May 26, 2005 which established a procedural schedule.

16 CUB, ICNU and Commission Staff filed testimony in response to the Company's
17 filing and subsequently filed Supplemental Testimony. All three Company witnesses
18 submitted rebuttal testimony and sur-surrebuttal testimony.

19 All parties ultimately agreed to waive cross-examination. Accordingly, the hearing
20 set for November 16, 2005 was cancelled. Instead, a procedural conference was held on
21 November 16, 2005, at which time the prefiled testimony and exhibits of the parties were

22

23 [1] Based upon the recommendation of the parties, assigned Administrative Law Judge Logan has not ruled on the Company's Motion to Consolidate. However, in an Order dated
24 May 26, 2005, Judge Logan suspended further proceedings in UM 1193 on the basis that the parties' attention would be best focused on the Company's PCAM Application. In its
25 UE 173 Application, the Company stated that if the proposed PCAM is adopted by the Commission, it would incorporate the costs proposed to be deferred in UM 1193 and replace
26 the deferral of such costs on a going forward basis.

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admitted into evidence along with certain of the Company's responses to ICNU data requests. A briefing schedule was also set at that time.

II. THE COMPANY'S PROPOSAL

In its Application, the Company proposed an incentive-based mechanism that would share variations between "baseline forecast net power costs" and "adjusted actual net power costs," with one exception.[2] The one proposed exception is that 100 percent of cost variances related to Qualifying Facilities would be exempted from sharing bands. All other variations between actual and forecasted net power costs would be subject to symmetrical sharing bands which straddle baseline net power costs in rates. When actual adjusted net power costs are within $100 million, plus or minus of forecasted levels, total Company, the increment would be allocated 70 percent to customers and 30 percent to the Company. When the variance exceeds $100 million, the increment over $100 million would be allocated 90 percent to customers and 10 percent to the Company, so as to provide catastrophic protection.

Under the proposed PCAM, Oregon-allocated net power costs will be calculated on a monthly basis and posted to a balancing account. An entry into the accrual account will occur in every month unless actual adjusted net power costs are equal to baseline net power costs. A positive balance in the account represents money owed to the Company from customers. A negative balance represents money owed by the Company to customers. The balance will accrue interest at the Company's authorized rate of return.

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[2] "Net power costs" include all fuel, wheeling and purchase power expense, offset by revenues from wholesale electricity and natural gas sales. For purposes of the proposed PCAM, "baseline net power costs" are defined as net power costs adopted from the Company's annual Transition Adjustment Mechanism ("TAM") established in Docket UE 170. "Actual adjusted net power costs" are defined as actual net power costs incurred during the accrual period adjusted to remove prior-period adjustments recorded during the accrual period and to reflect Commission-adopted adjustments from the most recent rate case.

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1 The Company further proposes that a plus or minus $15 million accrued balance be
2 established as a trigger. Once the trigger point is reached, the Company will be required to
3 return a negative balance to customers or recover a positive balance from customers. The
4 amortization period would be over a one-year period, or such longer period as is required to
5 comply with ORS 757.259.
6 Surcharges and surcredits arising from the PCAM will be spread to all customers,
7 except direct access customers, on a uniform cents-per-kilowatt-hour basis. Because
8 differences in delivery voltage result in different line losses and power requirements, the
9 Company proposes to vary the surcharge and surcredit amounts by delivery voltage based
10 upon applicable line loss factors.
11 Finally, the Company proposes to make the PCAM subject to an earnings test. If the
12 Company's actual rate of return shown in its most recent semi-annual report was above
13 authorized levels, positive balances accrued under the PCAM during that period would not be
14 recoverable. Similarly, if earned rates of return are deficient, negative accrued PCAM
15 balances would not be returned to customers.

16 **III. REASON FOR COMPANY PROPOSAL**

17 Ms. Omohundro's Direct Testimony (PPL/100) explains why the Company is
18 proposing a PCAM at this time. Most fundamentally, the Company has found in recent years
19 that the traditional ratemaking process has caused the Company to incur in excess of
20 $675 million of net power costs for which it was not compensated by customers.
21 PP&L/102,Omohundro 1. These deviations from authorized net power costs were primarily
22 related to factors beyond the Company's control. PPL/200,Widmer 3. This experience has
23 caused the Company to conclude that there is a greatly increased variability in net power
24 costs from the level projected in general rate cases and that this variability is not
25
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symmetrical.[3] Absent a PCAM, PacifiCorp does not have a reasonable opportunity to earn its allowed rate of return. PPL/100, Omohundro 3.

The proposed PCAM will ensure that, in the future, PacifiCorp's prices more accurately capture the Company's actual prudently incurred costs of providing service to its customers. Without a PCAM, the magnitude of harm that PacifiCorp faces would require it to seek other regulatory relief, which would increase the frequency of fluctuations in rate levels. Conversely, the PCAM will lead to greater rate stability.

Moreover, as explained by Ms. Omohundro, the proposed PCAM should improve the Company's credit standing and lower the level of debt imputation associated with purchased power contracts, thereby making such contracts more attractive to the Company and its customers.

IV. COMMISSION POLICY

In its Order in UM 1071, the Commission acknowledged that "climate changes and other factors, such as hydro availability" may impact the ability of a utility to recover its hydro losses using current normalization techniques. *In re Portland General Electric,* Order No. 04-108 at 10 (2004). For this reason, the Commission encouraged the parties to the proceeding to investigate alternatives such as a PCAM to deal with hydro variability.

V. POSITIONS OF OTHER PARTIES IN THIS PROCEEDING

The Company's proposed PCAM has not yet enjoyed broad support from the Staff and intervenors.

Commission Staff at times seems to acknowledge that the Company has a legitimate concern about its inability to earn its allowed rate of return, but does not believe that a PCAM is an appropriate remedy, except for extraordinary circumstances. Staff also takes exception to the Company's proposal to allocate PCAM surcharges and surcredits among

[3] Ms. Omohundro observes that since 2000-2001, wholesale electricity market prices have fluctuated by five to ten times the amount previously observed. PPL/100,Omohundro 2.

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PacifiCorp's jurisdictions in the same manner as normalized power costs are allocated in general rate proceedings.

CUB questions whether a "problem" really exists, seems to support the concept of a PCAM compared to other mechanisms for dealing with net power cost variability, but takes strong exception to the form of the PCAM proposed by the Company. CUB raises the same interjurisdictional cost allocation issues as the Commission Staff.

ICNU denies there is a problem, contends that a PCAM is not an appropriate response to any problem that might exist, disputes many of the elements of the form of PCAM proposed by the Company and argues that PacifiCorp's allowed rate of return should be reduced if it is permitted a PCAM.

While the Company continues to believe that its proposed PCAM is reasonable and appropriate, in its rebuttal and sur-surrebuttal testimony and in responses to data requests, the Company has agreed with some of the points made by the other parties to the proceeding. Specifically:

1. The Company agrees with Staff that ideally, the ratemaking process should afford the Company a fair opportunity to recover its costs on an expected basis and to earn its authorized rate of return on equity over the long term without relying heavily on supplemental ratemaking to achieve those goals. Staff/300, Galbraith 4; PPL/205, Widmer 2.
2. The Company agrees with Staff, CUB and ICNU that a PCAM should be designed to provide incentives for the Company to effectively manage its net power costs.
3. The Company agrees with Staff, CUB and ICNU that the PacifiCorp Revised Interjurisdictional Allocation Protocol ("Revised Protocol") did not resolve how non-normalized costs should be allocated.

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4. The Company agrees with CUB that any allocation of PCAM surcharges and surcredits should be based upon updated interjurisdictional allocation factors. PPL/301, Duvall 7.

5. The Company agrees with CUB and ICNU that revenues from gas sales should be included in net power costs for purposes of calculating the PCAM (and always intended that outcome). PPL/205, Widmer 3.

6. The Company is agreeable to a retail load and revenue adjustment as suggested by Messrs. Jenks and Falkenberg. PPL/205, Widmer 12.

7. The Company agrees with Staff and ICNU that PCAM surcharges and surcredits should not be paid by direct access customers. PPL/102, Omohundro 3.

VI. ARGUMENTS

A. The Company Faces a Major Problem.

Mr. Jenks' testimony harkens back to happier and simpler days when utilities took the risk of cost changes between rate cases. In those days, "some costs go up, some costs go down, and the utilities bear the risk and reap the reward for those changes." CUB/100, Jenks 3. This is another way of expressing Mr. Galbraith's more technical description of "stochastic" ratemaking, meaning that if costs are properly estimated in rate cases, over time, the good will balance the bad for the Company and its customers on an expected value basis. In Mr. Galbraith's view, it is inappropriate for the Company to game the system by seeking special relief when the "bad" things happen, while pocketing the benefits of the "good" things. Assuming the system works as Mr. Galbraith suggests it should, the Company would agree.

As pointed out by Mr. Falkenberg, the Company long eschewed power cost adjustments and believed that general rate cases should be the principal means of establishing net power costs. ICNU/200, Falkenberg 22, 23. But, as emphasized in the direct testimony

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1 of Ms. Omohundro and Mr. Widmer, this filing represents a change in Company policy
2 driven by a recognition that the good old days alluded to by Mr. Jenks are gone and the
3 idealized ratemaking goals of Mr. Galbraith are not being accomplished. Since the Western
4 power crisis of 2000, from the Company's perspective, the "good" has been swamped by the
5 "bad" and the Company has not had a fair opportunity to recover its net power costs on an
6 expected basis. The Company believes that the fundamentals of the power market have
7 changed in a way that it can expect hundreds of millions of dollars of future losses if the
8 ratemaking process is not significantly altered. PPL/200, Widmer 3.

9 Staff and CUB appear to vaguely acknowledge that the world has probably changed
10 and at least hint that they suspect that the Company faces asymmetric risk. Nonetheless, they
11 propose PCAM mechanisms that fall far short of affording the Company a fair opportunity to
12 recover its net power costs on an expected basis. ICNU acknowledges nothing and proposes
13 nothing except further study and rulemaking proceedings.

14 Staff and intervenors contend that they oppose the Company's PCAM proposal
15 because the Company has not really demonstrated that a problem exists that requires a
16 remedy in this docket. Specifically:

17 1. It is suggested that the Company's recent multi-year experience of losing
18 hundreds of millions of dollars may be aberrational. CUB/200, Jenks 13.
19 Staff suggests that it may all have been just a "run of bad luck." Staff/300,
20 Galbraith 7.

21 2. It is suggested that the Company has not conclusively proven that it faces a
22 substantially asymmetric power cost environment. CUB/200, Jenks11, 13;
23 Staff/300, Galbraith 2.[4]

24

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[4] This is suggested notwithstanding Mr. Widmer's testimony that from 2000-2004,
26 PacifiCorp averaged $135.5 million of excess net power costs. PPL/200, Widmer 3.

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3. It is suggested that the Company's recently-approved Transition Adjustment Mechanism ("TAM") will resolve much, if not all, of any problem that might exist. CUB/200, Jenks 2; ICNU/100, Falkenberg 10; ICNU/200, Falkenberg 24.

4. It is suggested that the Company is not materially exposed to market risks. CUB/100, Jenks 4; CUB/200, Jenks 5.

5. It is suggested that if there is a problem, it should be resolved at some time in the future, either through introducing stochastic power cost modeling in general rate cases (Mr. Galbraith) or further study and rulemaking (Mr. Falkenberg).[5]

However, as observed by Ms. Omohundo, other positions taken by the parties in this proceeding suggest that their dismissal of the "problem" should be viewed with substantial skepticism. PPL/103, Omohundro1, 2. To put it bluntly, it appears other parties know the Company is losing a lot of money and wish to avoid shifting those costs to customers for as long as possible. Otherwise, one must ask:

1. Why would Mr. Jenks dismiss the severity of the Company's problem, but then characterize the Company's PCAM proposal as a "lottery jackpot for shareholders" and express grave concern that customers might have to pick up 70 percent of net power costs that are not otherwise being recovered? CUB/200, Jenks 4.

2. Why would Mr. Galbraith state that there is "considerable uncertainty" as to whether the Company faces an asymmetric recovery problem, but then

[5] Mr. Falkenberg proposes an additional "multi-step" process. ICNU/200, Falkenberg 6. CUB finds this all "déjà vu" and apparently would not relish more process. CUB/200, Jenks 1

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express considerable certainty that the proposed PCAM will result in a "large risk shift to customers?" Staff/300, Galbraith 6, 12.

3. Why would Mr. Falkenberg insist that the Company has provided "scarcely any justification for a PCAM," while the other ICNU witness, Mr. Gorman, testifies that the proposed PCAM will "significantly" increase the Company's ability to earn its authorized rate of return on equity? ICNU/200, Falkenberg 3; ICNU/300, Gorman 2.

4. Why would both Mr. Jenks and Mr. Galbraith suggest that asymmetric "sharing bands" are appropriate because the Company's cost risk is asymmetric? CUB/100, Jenks 27; Staff/100, Galbraith 2.

5. Why would the parties express such great concern about how the PCAM surcharges and surcredits are going to be allocated among PacifiCorp's jurisdictions if they really believed the Company's net power cost risk was symmetrical?

6. If the Company can be reasonably expected to recover the bulk of its net power costs through general rate cases and the TAM, is a symmetrically designed PCAM going to cause harm appropriate to the level of outrage expressed by the parties? PPL/205, Widmer 8.

B. PacifiCorp's Proposal for Sharing Net Power Cost Risk Between Customers and Shareholders is Reasonable.

PacifiCorp has proposed that there be a 70/30 percent sharing of the first $100 million of net power cost variances between customers and shareholders and a 90/10 sharing of any variance above $100 million.

Other parties to this proceeding have reacted poorly to this proposal. At times, their enthusiasm has caused them to suggest that the Company will somehow profit from this sharing mechanism, even to the point of enjoying a "lottery jackpot for shareholders."

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1 CUB/100 at 5. Mr. Falkenberg for some reason describes it as "cost-plus ratemaking."
2 ICNU/100 at 11. More restrained, but just as misleading, are suggestions from Staff, CUB
3 and ICNU that the Company is proposing to assume virtually no net power cost risk.
4 Mr. Galbraith suggests that the proposed mechanism removes "nearly all of PacifiCorp's
5 earnings risk related to net power costs." Mr. Jenks alludes to a "customer-bear-all risk
6 approach" by utilities. CUB/200, Jenks 2. Mr. Falkenberg uses terms such as "exact-cost
7 recovery rider" and "pass-through." ICNU/100, Falkenberg 11, 13. They offer this
8 testimony notwithstanding Mr. Widmer's demonstration that had the proposed PCAM been
9 in place for calendar 2004, the Company would have still borne $34.8 million of unrecovered
10 net power costs. PPL/200, Widmer 9.

11 In their response to PacifiCorp's sharing proposal, the parties seem to have lost track
12 of the first principles of ratemaking as enunciated by Mr. Galbraith. To wit: The Company
13 is to be afforded "a fair opportunity to recover its costs on an expected basis." Staff/300,
14 Galbraith 4. To the contrary, Staff and intervenors seem to be suggesting that any proposal
15 that creates even a possibility of the Company recovering all of its prudently incurred net
16 power costs is somehow unfair or undesirable. It is noteworthy that ICNU was so unhinged
17 by a proposal that would increase (but not guarantee) the chances that the Company would
18 earn its allowed rate of return, that it proposed to reduce PacifiCorp's allowed rate of return.
19 ICNU/300, Gorman 5

20 Parties purport to be shocked that the Company has not proposed deadbands that
21 would virtually guarantee that the Company will not have a fair opportunity to recover its
22 costs on an expected basis. Most of the Oregon precedent cited for such deadbands arises
23 from deferred cost recovery decisions. CUB/100, Jenks 16; ICNU/100, Falkenberg 27, 28.
24 Staff and intervenors do not appear to recognize an important distinction between a deferred
25 accounting decision and a PCAM mechanism. As discussed by Messrs. Jenks and
26 Falkenberg, there is a potential lack of symmetry in a deferred cost application associated

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1 with net power costs. CUB/100, Jenks 5; ICNU/200, Falkenberg 14. Such applications tend
2 to get filed in the "bad" years and may not reflect circumstances when a utility has recovered
3 more than its estimated net power costs in good years. In the context of deferred cost
4 applications, deadbands can be a reasonable means of restoring symmetry to the ratemaking
5 process.
6 But, as indicated by Mr. Jenks, a PCAM establishes the "rules of the game" ahead of
7 time and can assure symmetry between the Company and its customers. In this context a
8 "deadband" is not necessary to assure fairness. This is not to say that PacifiCorp proposes a
9 direct pass through of all net power cost variations. PPL/100, Omohundro 4. As observed
10 by all parties to this proceeding, an assurance of full cost recovery would not provide
11 PacifiCorp with appropriate incentives to effectively manage its net power costs. However,
12 in the context of a PCAM, any deadband or sharing mechanism should be evaluated on the
13 basis of whether it provides sufficient and appropriate incentives, while permitting the
14 Company a fair opportunity to recover all its prudently-incurred costs.
15 Without much explanation, Messrs. Jenks and Galbraith suggest that if the
16 Company's risk of net power cost variability is asymmetrical, the deadbands also need to be
17 asymmetrical. CUB/100, Jenks 27; Staff/100, Galbraith 10. They seem to be contending that
18 a necessary attribute of a properly constructed PCAM is to have payments to the Company
19 and shareholders equal out over time. This is wrong-headed. Remembering Mr. Galbraith's
20 admonition that the Company should be afforded a fair opportunity to recover all its
21 prudently-incurred costs on an expected basis, it follows that if net power costs exceed rate
22 case estimates by a greater frequency and/or magnitude than they fall under rate case
23 estimates, PCAM surcharges will necessarily and appropriately exceed PCAM surcredits.
24 Moreover, it appears that deadbands, and particularly Mr. Jenks' asymmetric
25 deadbands, give rise to unjustifiable results and screwy incentives for the Company.
26

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Following are seven hypothetical cases showing net power cost variances over a ten-year period. In the first column are shown the amounts by which actual net power costs exceed estimated net power costs in the year. The second, third and fourth columns show the effect on the Company if CUB's proposal, Staff's interim PCAM proposal and the Company's proposal had been in effect. As indicated, in these columns, a negative number indicates that the Company has under-recovered its actual net power costs, notwithstanding the proposed PCAM, and a positive number indicates that the Company has over-recovered its net power costs, notwithstanding the PCAM:[6]

CASE 1	**Net Power Cost Variability from Projected Amount**	**Rev/Cost Delta CUB Proposal**	**Rev/Cost Delta Staff Proposal**	**Rev/Cost Delta Company Proposal**
Year				
1	200	-175	-155	-40
2	-100	87.5	100	30
3	200	-175	-155	-40
4	-100	87.5	100	30
5	200	-175	-155	-40
6	-100	87.5	100	30
7	200	-175	-155	-40
8	-100	87.5	100	30
9	200	-175	-155	-40
10	-100	87.5	100	30
Total	**500**	**-437.5**	**-275**	**-50**

[6] CUB proposes a 125 basis point return on equity deadband for actual net power costs below estimates and a 250 basis point deadband for net power costs above deadbands. CUB proposes to share shortfalls 50/50 between 125 and 200 basis points and 75/25 over 200 basis points. Further, under the CUB proposal, exceedances would be shared 50/50 between 250 and 400 basis points and 75/25 above 400 basis points. CUB/100 at 29. Staff proposes an interim PCAM with a 90/10 sharing for any shortfalls or exceedances above 250 basis points. Staff/100 at 21. Per Mr. Falkenberg, it is assumed that 100 basis points is equivalent to $60 million. ICNU/200, Falkenberg 17. All numbers are in millions of dollars.

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CASE 2	**Net Power Cost Variability from Projected Amount**	**Rev/Cost Delta CUB Proposal**	**Rev/Cost Delta Staff Proposal**	**Rev/Cost Delta Company Proposal**
Year				
1	200	-175	-155	-40
2	-150	105	150	35
3	200	-175	-155	-40
4	-150	105	150	35
5	200	-175	-155	-40
6	-150	105	150	35
7	200	-175	-155	-40
8	-150	105	150	35
9	200	-175	-155	-40
10	-150	105	150	35
Total	**250**	**-350**	**-25**	**-25**

CASE 3	**Net Power Cost Variability from Projected Amount**	**Rev/Cost Delta CUB Proposal**	**Rev/Cost Delta Staff Proposal**	**Rev/Cost Delta Company Proposal**
Year				
1	250	-197.5	-160	-45
2	-100	87.5	100	30
3	250	-197.5	-160	-45
4	-100	87.5	100	30
5	250	-197.5	-160	-45
6	-100	87.5	100	30
7	250	-197.5	-160	-45
8	-100	87.5	100	30
9	250	-197.5	-160	-45
10	-100	87.5	100	30
Total	**750**	**-550**	**-300**	**-75**

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CASE 4	Net Power Cost Variability from Projected Amount	Rev/Cost Delta CUB Proposal	Rev/Cost Delta Staff Proposal	Rev/Cost Delta Company Proposal
Year				
1	400	-235.0	-175	-60
2	-100	87.5	100	30
3	400	-235.0	-175	-60
4	-100	87.5	100	30
5	400	-235.0	-175	-60
6	-100	87.5	100	30
7	400	-235.0	-175	-60
8	-100	87.5	100	30
9	400	-235.0	-175	-60
10	-100	87.5	100	30
Total	**1500**	**-737.5**	**-375**	**-150**

CASE 5	Net Power Cost Variability from Projected Amount	Rev/Cost Delta CUB Proposal	Rev/Cost Delta Staff Proposal	Rev/Cost Delta Company Proposal
Year				
1	400	-235	-175	-60
2	-400	167.5	175	60
3	400	-235	-175	-60
4	-400	167.5	175	60
5	400	-235	-175	-60
6	-400	167.5	175	60
7	400	-235	-175	-60
8	-400	167.5	175	60
9	400	-235	-175	-60
10	-400	167.5	175	60
Total	**0**	**-337.5**	**0**	**0**

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CASE 6	Net Power Cost Variability from Projected Amount	Rev/Cost Delta CUB Proposal	Rev/Cost Delta Staff Proposal	Rev/Cost Delta Company Proposal
Year				
1	-400	167.5	175	60
2	300	-210	-165	-50
3	-400	167.5	175	60
4	300	-210	-165	-50
5	-400	167.5	175	60
6	300	-210	-165	-50
7	-400	167.5	175	60
8	300	-210	-165	-50
9	-400	167.5	175	60
10	300	-210	-165	-50
Total	**-500**	**-212.5**	**50**	**50**

Year	Net Power Cost Variability from Projected Amount	Rev/Cost Delta CUB Proposal	Rev/Cost Delta Staff Proposal	Rev/Cost Delta Company Proposal
CASE 7				
1	100	-100	-100	-30
2	-50	50	50	15
3	100	-100	-100	-30
4	-50	50	50	15
5	100	-100	-100	-30
6	-50	50	50	15
7	100	-100	-100	-30
8	-50	50	50	15
9	100	-100	-100	-30
10	-50	50	50	15
Total	**250**	**-250**	**-250**	**-75**

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These hypothetical cases demonstrate that: (i) neither the CUB nor Staff proposals afford the Company anything close to a fair opportunity to recover its costs on an expected basis, (ii) rating agencies could take little comfort from what is being offered, and (iii) the CUB and Staff deadbands, particularly CUB's asymmetric deadbands, give rise to bizarre results and poorly aligned incentives depending upon what numbers are chosen. For example:

1. In a fairly extreme case (Case 4), the Company would be able to recover only 51 percent of $1.5 billion of net exceedances under the CUB proposal and only 75 percent of such exceedances under the Staff proposal. Under a relatively "stable" case, (Case 7) the Company recovers none of its $250 million of net exceedances.
2. In Case 1 under the CUB proposal, the Company recovers only $62.5 million from $500 million of net exceedances from customers, but under Case 6, returns $212.5 million to customers from net savings of $500 million.
3. In Case 2 under the CUB proposal, the Company is $100 million worse off than it would be without a PCAM because it is required to return that amount to customers, even though it experienced net exceedances of $500 million.
4. In Case 5 under the CUB proposal, the Company breaks even over the study period, but nonetheless is required to return an additional $337.5 million to customers. This result is substantially more beneficial to customers than Case 6 where the Company has net *savings* of $500 million.
5. Under the CUB proposal, if the Company has net exceedances of $250 million (Case 2) it loses $350 million, whereas under Case 1, where it has $500 million of net exceedances, it loses $437.5 Million. Equally bizarre are the outcomes under the Staff proposal under Cases 1 and 2. Notwithstanding the professed effect of the Staff deadbands, if the Company has net

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1 exceedances of $250 million, it loses $25 million, but if it has net exceedances
2 of $500 million it loses $275 million.
3 6. Contrary to Staff's suggestion that its proposed deadbands are intended to
4 provide appropriate incentives for the Company to minimize net power costs,
5 under Case 3, where the Company has net exceedances of $750 million, it
6 loses $300 million, whereas under Case 4, where it has net exceedances of
7 $1.5 billion, it loses $375 million.
8 In sharp contrast, the results under the Company's sharing proposal seem far more
9 predictable and rational. While the issue of what amount of losses the Company needs to
10 face in order to have appropriate incentives is somewhat subjective, the Company proposal
11 seems to give rise to results that are reasonably predictable and directionally correct. If net
12 exceedances double, the Company's losses double (Cases 3 and 4). Where the Company's
13 actual costs equal its predicted costs, the Company is neither benefited nor penalized
14 (Case 5). When the Company has substantial savings for customers, it benefits at a level
15 comparable to the losses it suffers when it has increased costs (Cases 1 and 6), but does not
16 retain a majority of the savings as would result from the CUB proposal. If Mr. Jenks had
17 reviewed numbers such as these, could he still in good faith characterize the Company's
18 proposal as "ridiculously generous" and "overshoots absurd"? CUB/200, Jenks 14.
19 CUB suggests that the sharing bands proposed by the Company are generous
20 compared to PCAMs that have been put in place for other Northwest utilities. CUB/100,
21 Jenks 5, 16. The Company's rebuttal testimony demonstrates that this is not the case. In a
22 recent settlement, revisions to Avista's "Energy Recovery Mechanism" provide for a 90/10
23 sharing between customers and shareholders outside a $3 million deadband. This equates to
24 a $7.9 million deadband in Oregon for PacifiCorp. In the case of Puget Sound Energy, while
25 there is a $20 million deadband for a single year, there is also a four-year, $40 million cap.
26 Once the cap has been reached during a four-year period, 99 percent of variances are

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1 recoverable by the Company. On an average annual basis, this would equate to a $4.8 million
2 deadband for PacifiCorp. PPL/205, Widmer 12, 13.

3 Finally, Mr. Jenks maintains that deadbands are necessary because a PCAM does not
4 reflect the increased retail revenue that the Company enjoys when increased net power costs
5 are caused by higher loads and the loss of retail revenues the Company suffers if net power
6 cost savings are associated with decreased loads. CUB/100, Jenks 17. The deadbands
7 proposed by Mr. Jenks seems grossly disproportionate to any such load/revenue phenomenon
8 that may exist. Additionally, Mr. Widmer has testified that PacifiCorp is prepared to
9 incorporate a load/revenue adjustment in its proposed PCAM. PPL/205, Widmer 12.

10 **C. A PCAM is the Best Means Now Available for Addressing the Volatility in the**
11 **Company's Net Power Costs**

12 Staff is opposed to the Company's proposal because it believes that the bulk of
13 volatility in net power costs should be captured through stochastic net power cost modeling
14 in the context of a general rate case. Staff/100, Galbraith 12. As indicated by Mr. Widmer,
15 the Company is not opposed in principle to Mr. Galbraith's approach at such time as it can be
16 implemented. However, the tools for stochastic modeling of net power costs have not yet
17 been fully developed. PPL/205, Widmer 2, 3. The work will be complex and potentially
18 controversial. The absence of an agreed-upon methodology should not be an excuse for
19 continuing to deny the Company a fair opportunity to recover its costs when a well-accepted
20 alternate method (the PCAM) is available. Had the Company over-recovered in excess of
21 $675 million from 2000-2004, Staff and intervenors would be doubtless expressing a greater
22 sense of urgency to find a solution. PPL/102, Omohundro 1. Moreover, if Mr. Galbraith's
23 "wait and see" approach were adopted, parties representing customer interests would have
24 little or no incentive to agree on a stochastic approach to modeling net power costs.

25 Both CUB and ICNU describe the infirmities of using cost deferral as a means of
26 dealing with net power cost volatility. Deferred cost applications have proven to be complex

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1 and controversial for all concerned. These were doubtless the same sorts of concerns that
2 caused the Commission to encourage the parties to explore alternatives to deferred
3 accounting in its UM 1071 Order.

4 As indicated above, if a PCAM is approved in this docket, PacifiCorp will
5 incorporate the costs proposed to be deferred in UM 1193 in the PCAM and replace the
6 deferral of such costs on a going-forward basis. PPL/100, Omohundro 4.

7 **D. The Implementation Issues Raised by the Parties are Resolvable**

8 CUB and ICNU raise a number of concerns about the details of how the Company's
9 proposed PCAM will be implemented and suggest that it could not be effectively
10 administered. Mr. Falkenberg would have the Commission believe that a PCAM is a radical
11 and untested concept, even though it has been utilized by the majority of state commissions
12 for many years. PPL/102, Omohundro 3. The Company's rebuttal testimony demonstrates
13 that these concerns are overstated. For example:

14 1. Mr. Jenks suggests that PacifiCorp's PCAM proposal could lead to monthly
15 rate changes. CUB/100, Jenks 21. Mr. Widmer explains that while the
16 PCAM accruals would be recorded monthly, it is not contemplated that rates
17 would be changed monthly. PPL/205, Widmer 14.

18 2. Mr. Jenks suggests that costs under the PCAM are being over-allocated to
19 Oregon. CUB/100, Jenks 19. In part, he bases this conclusion on the fact that
20 in the Company's fiscal 2004 analysis, Oregon's share of PCAM costs
21 appears to be greater than Oregon share of total system load and its average
22 costs are higher than other jurisdictions. All manner of circumstances
23 (including Oregon's monthly and annual load factor) could explain these sorts
24 of differences and they are not a reasonable basis for concluding the
25 Company's PCAM methodology is somehow flawed. Furthermore, as
26 explained by Mr. Duvall, Mr. Jenks appears to confuse the concept of

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replacing permanently lost hydroelectric generation under the Revised Protocol for such things as relicensing conditions (whose cost is allocated on a system basis) with the issue of who should pay the cost of replacement power if hydroelectric generation is reduced in real time by poor water conditions. PPL/301, Duvall 5. However, the Company does not oppose Mr. Jenks' contention that PCAM interjurisdictional allocation factors should be based upon actual loads. This should alleviate concerns that Oregon is somehow subsidizing power costs that are incurred to serve Utah customers because it matches actual power costs with actual loads. PPL/301, Duvall 7.

3. Mr. Falkenberg contends that there will be great difficulty implementing general rate case settlements in the PCAM. ICNU/100, Falkenberg 14, 15. Mr. Widmer explains why this is likely not to be the case. The Company certainly recognizes that any category of cost that has been disallowed in a general rate case should not be recoverable through a PCAM. Furthermore, most general rate case issues involving net power costs are modeling issues that relate to how net power costs should be predicted for purposes of the general rate case. These modeling issues are irrelevant to how actual net power costs are calculated for purposes of the PCAM. PPL/205, Widmer 5, 6.

4. Mr. Falkenberg for some reason believes that there will be great difficulty in determining what costs should be included in net power costs for purposes of the PCAM. He goes so far as to propose a rulemaking proceeding to grapple with this issue. ICNU/100, Falkenberg 21. The Company has proposed that for purposes of the PCAM, the same costs be included as are included in its TAM. PPL/200, Widmer 7. It would appear that if it is possible to figure out what costs should be included in the TAM, the PCAM would not give rise to the mystery that Mr. Falkenberg would suggest. Furthermore, PacifiCorp

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does not concur with Mr. Falkenberg's suggestion that only some elements of net power cost should be reflected in a PCAM. All net power costs are interrelated and picking and choosing among them could lead to a mismatch. PPL/205, Widmer 11.

E. It Makes Most Sense to Allocate PCAM Surcharges and Surcredits Among PacifiCorp Jurisdictions on the Same Basis as Net Power Costs are Allocated in General Rate Cases.

As indicated above, PacifiCorp agrees with those parties who have argued that the Revised Protocol did not resolve the issue of how non-normalized costs should be allocated among its jurisdictions. Nonetheless, the Company believes that is most sensible to use the same methods for allocating normalized power costs, for purposes of the PCAM, that are used to allocate PCAM surcharges and surcredits.[7] Much of the disagreement seems to be related to parties' misunderstanding regarding the hydro-electric replacement issue discussed above. *Infra* at 19.

F. The Company is Not Being Currently Compensated for its Current Net Power Cost Recovery Risk

Mr. Jenks asserts that whatever "asymmetry problem" the Company faces is something that PacifiCorp is "paid a rate of return to manage." CUB/200, Jenks 10. Mr. Gorman not only argues that the Company's current allowed rate of return is compensatory for the risk being taken, but that if the Company's chances of recovering all of its costs are improved, the Company's allowed rate of return should be correspondingly reduced. ICNU/300, Gorman 5, 6.

[7] It appears that Staff and CUB agree that there should be consistency with the Revised Protocol, but do not believe that the Company's proposal has achieved that consistency. PPL/301, Duvall 3. If, it is believed that there should not be consistency, this is probably an issue that should be addressed by the Standing Committee provided for in the Revised Protocol.

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Ms. Omohundro's sur-surrebuttal testimony demonstrates why these positions are misplaced. Ms. Omohundro explains that PacifiCorp's allowed rate of return is derived from the financial performance of various "comparable" utilities whose stock is publicly traded. Exhibit PPL/104 is a listing of these sixteen companies. Of the sixteen, fourteen have some means available to them for recovering power cost variability and all of them have an allowed rate of return in excess of the 10 percent established for PacifiCorp in UE 170 as referenced by Mr. Gorman. If anything, this data would suggest that if PacifiCorp is denied a PCAM, its allowed return on equity should be increased by the amount of Mr. Gorman's proposed adjustment. PPL/103, Omohundro 4.

G. It is reasonable to reflect all variability in QF costs in PCAM Accruals

The Company proposed that 100 percent of the variance in its Qualifying Facility ("QF") costs be reflected in the PCAM. PPL/200, Widmer 7. Both Staff and CUB take exception to this approach. Staff/300, Galbraith 15; CUB/100, Jenks 25. Mr. Widmer's rebuttal testimony explains the justification for the proposed unique treatment of QF costs. All parties seem to agree that the purpose of the "sharing bands" is to provide the Company with appropriate incentives to manage its costs. Mr. Widmer explains that the Company does not have discretion as to whether to enter into QF contracts and has no control over the output of QFs. Furthermore, future QF contracts may be indexed to natural gas prices which will further increase the Company's exposure to recovery risk between rate cases for reasons totally out of its control. PPL/205, Widmer 3.

VII. CONCLUSION

There can be little doubt that PacifiCorp is not being afforded a fair opportunity to recover its prudently incurred net power costs. The Company has lost hundreds of millions of dollars since 2000 fulfilling its obligation to provide safe, adequate and reliable service to its Oregon customers. The Company's proposed PCAM is a reasonable means of redressing the problem until other agreed-upon ratemaking methods are put in place. The Staff and

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1 CUB PCAM proposals neither afford adequate relief to the Company nor do they provide

2 sensible and predictable results and incentives.

3 DATED: December 22, 2005.

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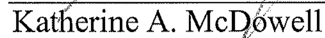

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1 **CERTIFICATE OF SERVICE**

2 I hereby certify that I served a true and correct copy of the foregoing document in
3 Docket UE 173 on the following named person(s) on the date indicated below by email and
4 first-class mail, addressed to said person(s) at his or her last-known address(es) indicated
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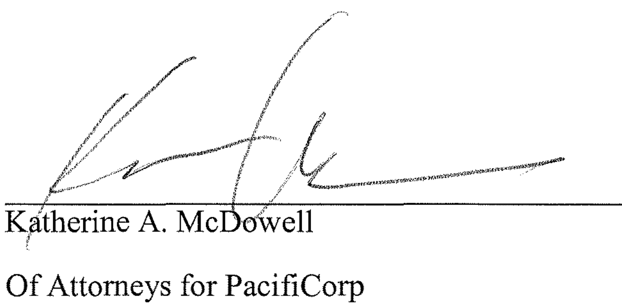

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