825 N.E. Multnomah
Portland, Oregon 97232
(503) 813-5000

September 9, 2005

VIA ELECTRONIC FILING

Oregon Public Utility Commission
550 Capitol Street NE, Suite 215
Salem, OR 97301-2551

Attn: Vikie Bailey-Goggins Administrator
Regulatory and Technical Support

RE: Case No. UE-173

PacifiCorp (dba Pacific Power & Light Company) submits for filing an original and twenty conformed copies of PacifiCorp's Rebuttal Testimony in Docket No. UE-173. Copies of this filing have been served on the UE-173 Service List.

It is respectfully requested that all formal correspondence and staff requests regarding this matter be addressed to:

By E-mail (preferred): datarequest@pacificorp.com.

By Fax: (503) 813-6060

By regular mail: Data Request Response Center
PacifiCorp
825 NE Multnomah, Suite 800
Portland, OR 97232

With copies to: Katherine A. McDowell
Stoel Rives LLP
900 S.W. Fifth Ave., Suite 2600
Portland, OR 97204
Telephone Nos. (503) 294-9602
Fax No. (503) 220-2480
Email: kamcdowell@stoel.com

Informal inquiries may also be made to Laura Beane at (503) 813-5542.

Very truly yours,

D. Douglas Larson
Vice President, Regulation

Enclosure

CERTIFICATE OF SERVICE

I hereby certify that I served the foregoing Rebuttal Testimony in Docket No. UE-173 on the following named person(s) on the date indicated below by:

_X_ Mailing with postage prepaid
_X_ Email
__ Facsimile transmission
__ Overnight delivery

LOWREY R BROWN CITIZENS' UTILITY BOARD OF OREGON 610 SW BROADWAY, SUITE 308 PORTLAND OR 97205 lowrey@oregoncub.org	DATA REQUEST RESPONSE CENTER PACIFICORP 825 NE MULTNOMAH, SUITE 800 PORTLAND OR 97232 datarequest@pacificorp.com
MELINDA J DAVISON DAVISON VAN CLEVE PC 333 SW TAYLOR, STE. 400 PORTLAND OR 97204 mail@dvclaw.com	JASON EISDORFER CITIZENS' UTILITY BOARD OF OREGON 610 SW BROADWAY STE 308 PORTLAND OR 97205 jason@oregoncub.org
RANDALL J FALKENBERG RFI CONSULTING INC PMB 362 8351 ROSWELL RD ATLANTA GA 30350 consultrfi@aol.com	MAURY GALBRAITH PUBLIC UTILITY COMMISSION PO BOX 2148 SALEM OR 97308-2148 maury.galbraith@state.or.us
DAVID HATTON DEPARTMENT OF JUSTICE REGULATED UTILITY & BUSINESS SECTION 1162 COURT ST NE SALEM OR 97301-4096 david.hatton@state.or.us	D DOUGLAS LARSON PACIFICORP ONE UTAH CENTER 201 SOUTH MAIN STREET, SUITE 2300 SALT LAKE CITY UT 84111 doug.larson@pacificorp.com
KATHERINE A MCDOWELL STOEL RIVES LLP 900 SW FIFTH AVE STE 1600 PORTLAND OR 97204-1268 kamcdowell@stoel.com	

DATED: September 9, 2005

Peggy Ryan
Regulatory Operations Coordinator

Case UE-173
PPL Exhibit 102
Witness: Christy A. Omohundro

BEFORE THE PUBLIC UTILITY COMMISSION

OF THE STATE OF OREGON

PACIFICORP

Rebuttal Testimony of Christy A. Omohundro

Policy

September 2005

1 **Q. Please state your name.**

2 A. My name is Christy A. Omohundro.

3 **Q. Did you previously offer testimony in this proceeding?**

4 A. Yes, I filed testimony in the Company's direct case.

5 **Purpose and Summary of Testimony**

6 **Q. Please summarize your testimony.**

7 A. The Company has experienced net losses of over $675 million related to power
8 costs from 2000 through 2004. In light of these significant losses, it is astonishing
9 that parties in this docket would suggest this is not a problem. Had the situation
10 been reversed, and the Company had over collected $600 plus million dollars, I
11 am certain Staff and the parties would have found the situation unacceptable and
12 would have immediately sought to address the problem.

13 My rebuttal testimony will address the policy related arguments raised by
14 Staff witness Maury Galbraith and Industrial Customers of the Northwest Utilities
15 (ICNU) witness Randall J. Falkenberg against the proposed structure of
16 PacifiCorp's Power Cost Adjustment Mechanism (PCAM). I will also explain
17 why the alternative PCAMs proposed by Mr. Galbraith and Citizens Utility Board
18 (CUB) witness Bob Jenks are inadequate.

19 **Q. Please summarize the arguments made by Mr. Galbraith and Mr.**
20 **Falkenberg against the structure of the Company's proposed PCAM.**

21 A. Mr. Galbraith argues that the PCAM sharing bands proposed by PacifiCorp shift
22 "nearly all" of the risk related to net variable power costs (NVPC) to
23 customers. Mr. Galbraith also argues that PCAM surcharges or surcredits

1 should be applied only to customers that were charged cost-of-service rates
2 during the PCAM year.
3 Mr. Falkenberg argues that the Company has not made the proper
4 showing of the need for a PCAM, for various reasons, and characterizes the
5 mechanism as "cost-plus" ratemaking. He argues that the mechanism creates
6 perverse incentives for the Company in acquiring power supply resources to
7 meet loads.
8 **Q. Staff witness Mr. Galbraith asserts that the PCAM proposed by PacifiCorp**
9 **shifts "nearly all" of the risk related to net variable power costs (NVPC) to**
10 **customers. Do you agree?**
11 A. No. Mr. Galbraith has provided no explanation as to why he believes the
12 proposed sharing bands do not provide appropriate incentives to the Company, or
13 how the proposed structure shifts "nearly all" of the NVPC related risk to
14 customers. In fact, under the proposed structure, the Company retains a large
15 measure of the risk related to power costs, as demonstrated by Mr. Widmer in
16 PPL Exhibit 204. Additionally, in his rebuttal testimony, Mr. Widmer shows that
17 the costs addressed by the PCAM are a very small proportion of the Company's
18 total revenue requirement. The proposed PCAM was designed not to shift all risk
19 to customers, but to produce a risk allocation between customers and shareholders
20 that is more in line with historic levels.

1 **Q. Please respond to the recommendation made by Mr. Galbraith that PCAM**
2 **surcharges or surcredits should be applied only to customers that were**
3 **charged cost-of-service rates during the PCAM year.**
4 A. I agree. The application of surcharges or surcredits related to the PCAM would
5 be inconsistent with the intent of direct access, and therefore these should not
6 apply to customers on direct access schedules.
7 **Q. Please respond to Mr. Falkenberg's argument that PacifiCorp has not**
8 **demonstrated that a PCAM is needed.**
9 A. The Company has provided ample justification and has clearly demonstrated in its
10 direct case that the variability of net power costs is a serious problem. Mr.
11 Widmer has presented evidence showing that the Company's net power cost
12 exposure has increase by over 1200 percent from the 1990s to today, and that the
13 exposure has become very asymmetric toward losses. With these market
14 conditions, the Company does not have a fair or reasonable opportunity to earn its
15 authorized rate of return over the long term.
16 Mr. Falkenberg argues that the Company has failed to address many
17 problems inherent in the PCAM concept and that there is no justification provided
18 to warrant implementation of such a "major change" in regulatory policy. Mr.
19 Falkenberg seems to suggest that a PCAM is a radical, untested ratemaking
20 concept that should be approached with caution. On the contrary, PCAM
21 mechanisms are common ratemaking tools that have been utilized by the majority
22 of the states across the country for many years. In the West, seven out of eleven
23 of the largest investor owned utilities have fuel and purchased power adjustment

1 mechanisms, as shown in PPL Exhibit 101. Further, the assessment of Standard
2 and Poor's in PPL Exhibit 101 indicates that PacifiCorp's lack of a fuel and
3 purchased power adjustment mechanism is a serious credit concern and could
4 contribute to a credit downgrade.

5 **Q. Mr. Falkenberg argues that the Company should provide a cost-benefit**
6 **analysis related to a potential improvement in the Company's credit rating.**
7 **Do you agree?**

8 A. No. The Company is entitled to a reasonable opportunity to earn its allowed rate
9 of return, and should not be required to provide a cost-benefit analysis to justify a
10 PCAM.

11 **Q. Mr. Falkenberg argues that the RVM proposed by the Company and Staff in**
12 **UE 170, if approved by the Commission, would afford PacifiCorp protection**
13 **between rate cases unless the Company plans to file rate cases more often**
14 **than its annual RVM updates. Do you agree?**

15 A. Absolutely not. The RVM, designed to facilitate direct access for eligible
16 customers, will ensure that the current forecast for power costs is properly
17 reflected in customer rates on an annual basis. The Company could accomplish
18 the same power cost update by filing annual general rate cases, an approach which
19 ICNU has consistently opposed. Mr. Falkenberg argues that even if PacifiCorp
20 filed a general rate case every year, the power cost estimates reflected in rates
21 could be a year out of date by the time rates went into effect. This argument
22 suggests a troubling lack of familiarity with the general rate case process in
23 Oregon. In fact, many costs, including power costs, are routinely updated to

1 reflect current data at different points in the rate case process. While the RVM
2 will reduce lag related to the recovery of power costs, it does nothing to address
3 the volatility of power costs between annual updates. The purpose of the PCAM
4 is to address the risk related to power cost exposure between rate cases.

5 **Q. Please respond to Mr. Falkenberg's characterization of the Company's**
6 **proposal as "cost-plus" ratemaking.**

7 A. Mr. Falkenberg's characterization is totally unreasonable and inaccurate. Mr.
8 Falkenberg characterizes the Company's proposal as an "exact cost recovery"
9 rider, which somehow translates to "cost-plus" ratemaking. It is neither. As we
10 have demonstrated numerous times in direct and rebuttal testimony, the sharing
11 bands proposed by the Company leave a substantial portion of the exposure to
12 variations in net power costs with the Company. Contrary to Mr. Falkenberg's
13 assertion, in PPL Exhibit 204, Mr. Widmer demonstrates that PacifiCorp would
14 have recovered only 76 percent of excess net power costs incurred to serve
15 customers had the Company's proposed PCAM been in place in 2004.

16 **Q. Does the mechanism proposed by PacifiCorp create perverse incentives with**
17 **respect to the Company's approach to the acquisition of power supply**
18 **resources, as Mr. Falkenberg suggests?**

19 A. No. The sharing bands discussed above ensure that customer and shareholder
20 interests are aligned. Because of the remaining exposure to power supply
21 variations, along with a regular prudence review, the Company has every
22 incentive to minimize net power costs between rate cases.

1 **Q. In response to the Company's filing, both Staff and CUB have proposed**
2 **alternative PCAMs in this proceeding. What is the Company's response to**
3 **these proposals?**
4 A. Given the large deadbands proposed by Staff and CUB, these alternative PCAM
5 proposals can fairly be characterized as "catastrophic insurance" mechanisms
6 designed to give the Company the same sort of relief it received during the
7 energy crisis. Unfortunately, neither proposal would effectively address the two
8 principal issues that the Company seeks to have addressed in this proceeding: 1)
9 the need for a fair opportunity to earn our authorized return on equity over the
10 long term, given the extreme asymmetry of the Company's net power cost
11 exposure, and 2) the need for a meaningful fuel and purchased power
12 adjustment mechanism to avoid the imputation of debt related to long-term
13 power purchase agreements by the major credit rating agencies. Therefore,
14 without significant modifications, neither proposal would be acceptable to
15 PacifiCorp.
16 **Q. Does this conclude your rebuttal testimony?**
17 A. Yes.

Case UE-173
PPL Exhibit 205
Witness: Mark T. Widmer

BEFORE THE PUBLIC UTILITY COMMISSION

OF THE STATE OF OREGON

PACIFICORP

Rebuttal Testimony of Mark T. Widmer

Net Power Costs

September 2005

1 **Q. Are you the same Mark T. Widmer that filed direct testimony with the**
2 **Company's original filing?**
3 A. Yes.
4 **Q. What is the purpose of your rebuttal testimony?**
5 A. The purpose of my testimony is to address various issues raised by staff Witness
6 Mr. Galbraith, ICNU witness Mr. Falkenberg and CUB witness Mr. Jenks.
7 **Q. Do you agree with Mr. Galbraith that if the Company's proposed PCAM**
8 **were adopted that it would become the primary form of ratemaking?**
9 A. No. It is not reasonable to assume that the Company's PCAM would become the
10 primary form of regulation because net power costs are approximately 25 percent
11 of our overall Oregon revenue requirement, the PCAM would only apply to net
12 power cost variations from the level in rates, and 30 percent of those variances up
13 to $100 million total Company and 10 percent of variances above $100 million
14 total Company, would be borne by the Company. For example, 2004 net power
15 costs in rates were approximately $598 million and actual net power costs were
16 $745 million total Company. The proposed PCAM would have affected only the
17 $147 million variance, which amounts to 15 percent of actual net power costs
18 after application of the sharing mechanisms. Since net power costs are roughly 25
19 percent of the overall revenue requirement, the PCAM would only affect 3.75
20 percent of the Company's overall revenue requirement and would not become the
21 primary form of regulation for the Company.

1 **Q. Do you agree with Mr. Galbraith that the appropriate goal is to set rates to**
2 **allow recovery of net power costs on an expected cost basis?**
3 A. Yes. However, that is not happening. As demonstrated in Exhibit PPL 201,
4 recovery of net power costs through the general rate case process is not
5 symmetrical. If anything, recovery has become very asymmetric starting in
6 calendar year 2000. Mitigation of this lack of symmetry does not constitute a
7 "windfall" to the Company unless recovering a higher percentage of prudently
8 incurred costs is considered a windfall. As long as the Company is subject to
9 recovery asymmetry, it is not likely that it will be able to earn its authorized rate
10 of return over the long run. The Company's proposed PCAM would only fix the
11 asymmetry problem, not produce a windfall.
12 **Q. Should the Commission adopt the stochastic modeling approach proposed by**
13 **Mr. Galbraith in the next rate case?**
14 A. Not at this time. It is too premature to adopt stochastic modeling for the next rate
15 case because it has not been evaluated for ratemaking. It is not a sure thing that
16 this can be reasonably accomplished for general rate cases. However, as part of
17 the settlement in Docket UE 170, the Company agreed to evaluate stochastic
18 modeling with the Staff and other parties as a ratemaking methodology in the year
19 following the issuance of the order in that docket. Since the hearings for this case
20 occur during October 2005 and the stochastic evaluation will not be completed
21 until roughly September 2006, it is too early to make decisions on the
22 appropriateness of stochastic modeling for the next general rate case.

1 **Q. If the evaluation determines that the stochastic approach can be reasonably**
2 **accomplished, is the Company opposed to adopting it for future rate cases?**
3 A. No. I also believe that deadbands set at a particular band of risk and an annual
4 update of the deadbands as proposed by Staff would be appropriate if recovery
5 asymmetry is eliminated.
6 **Q. Both Mr. Galbraith and Mr. Falkenberg have suggested that natural gas**
7 **sales should be included in the PCAM. Does the Company agree?**
8 A. Yes. Page nine of my direct filed testimony includes natural gas sales in the
9 definition of which costs and revenues would be included in the calculation of the
10 PCAM.
11 **Q. Do you have any comments on Mr. Galbraith's and Mr. Jenks' suggestions**
12 **that Qualifying Facility (QF) cost variation should be treated on par with the**
13 **cost variation associated with other resources?**
14 A. Yes. There are several reasons QF costs should not be treated on par with other
15 resources. Besides the fact that QF costs are not discretionary, the Company has
16 no control over the output of QFs. In other words, the QF has the option of
17 putting these resources to the Company whenever they desire. This option places
18 additional risk on the Company in comparison to other purchase power contracts.
19 Furthermore, new QFs or QFs that sign new contracts after expiration of existing
20 contracts now have the option of indexing the rate they receive for selling power
21 to the Company to volatile natural gas prices. This increases the recovery risk
22 between rates cases above the level previously experienced by the Company.

1 **Q. Does the Company support Staff's PCAM prudence review proposal to**
2 **model it after the one conducted in Docket UM 1039 for Portland General**
3 **Electric Company?**
4 A. Not in total. I think it is reasonable for the other parties to develop advisory issue
5 lists, subject to my following testimony, so the Company could respond to
6 appropriate issues in direct testimony. On the other hand, I don't agree that all
7 contracts and resources should be subject to a blanket prudence review. Many of
8 the long-term contracts and resources that will be in effect during the period of the
9 PCAM have already been reviewed from a prudence perspective in Docket UM
10 995 and should not be subject to another review of the contract terms or resource
11 costs. Prudence is determined based on the information that is available at the
12 time of the decision to enter a transaction. Since there is no new information for
13 the contracts executed and resources acquired by the conclusion of UM 995, there
14 is no point to reviewing the terms of contracts or generation resource acquisition
15 costs again.
16 I do agree that the operation, dispatch and fueling of these resources
17 should be subject to a prudence review with the exception of long-term firm
18 wholesale sales contracts. Long-term firm sales contracts should also be exempt
19 from an operational prudence review because they are dispatched by the counter
20 party, not the Company. Prudence review of contract terms and acquisition of
21 generating resources that have already been reviewed should not occur over and
22 over as Staff's recommendation in this case would allow because it is unnecessary
23 and wasteful, since there is no additional information from the time the decision

1 was made to enter the contract or acquire the resource and from the prior
2 prudence review. Further, new information was not available at the time of the
3 decision and is not useable as evidence in a prudence review.

4 Q. **Do your comments on Staff's prudence review also apply to Mr. Jenks'**
5 **comments on prudence reviews?**

6 A. Yes.

7 Q. **Has the Staff previously taken the same position the Company has taken**
8 **regarding a need for more than one prudence review?**

9 A. Yes. In Docket UE 170, Staff witness Mr. Wordley testified in surrebuttal
10 testimony in relation to a question of whether certain resources provided benefits
11 to customers:

12 The acquisition process, cost and impact on customers of the West Valley
13 CTs were analyzed in UI 196 and UE 134. The Commission concluded
14 that the West Valley lease agreement is fair, reasonable and not contrary
15 to the public interest in Order 02-361 in UI 196. Staff analysis in UE 134
16 concluded the company was prudent in entering into the West Valley lease
17 agreement (UE 134, Staff/200).
18
19 This testimony demonstrates that Staff has previously taken the position that
20 prudence reviews are not necessary if they have already occurred.

21 Q. **Mr. Falkenberg suggests that the Company has not clearly indicated how it**
22 **would coordinate settlements such as the one in Docket UE 170 so that costs**
23 **disallowed in a rate case would not be recovered through a PCAM. Can you**
24 **provide additional detail?**

25 A. Yes. The Company agrees that costs specifically disallowed via a settlement or a
26 Commission order should not be recoverable through a PCAM. This is consistent
27 with the Company's proposal to include the SMUD revenue imputation

1 adjustment in actual results so that Commission adjustments that disallow costs
2 are not reversed through a PCAM. On the other hand, settlements related to
3 modeling adjustments such as hydro normalization, thermal plant normalization,
4 contract normalization etc. should be disregarded because modeling adjustments
5 only address how the Company's system should be modeled to be consistent with
6 actual operations. Since the modeling is intended to be consistent with actual
7 operations or exclude normalized costs that the parties don't think should be
8 included in rates, there is not an issue of recovering costs disallowed in a
9 settlement. For example, if a party proposes to impute additional margin for a gas
10 resource because they don't believe the benefits of optionality are being captured
11 in normalized rate making and benefits were imputed in the settlement, a PCAM
12 would not reverse those benefits because the actual benefits of the gas resources
13 optionality are included in actual results. If anything, the PCAM would provide a
14 better matching of costs and benefits because customers would receive the actual
15 benefits, not an estimate of the benefits.

16 Q. **Did the UE 170 net power cost settlements include adjustments that would**
17 **result in a reversal of disallowed costs that would be recovered through the**
18 **PCAM?**

19 A. No. The proposed PCAM would not result in the reversal of a material amount of
20 disallowed costs in relation to the UE 170 settlement. So, the potential problem
21 suggested by Mr. Falkenberg is not an issue for UE 170.

22 Q. **Does Mr. Falkenberg's UE 147 example have any relevance to this case?**

23 A. No. New net power costs from UE 170 will be in effect before the hearing in this

1 docket is even held; therefore, the UE 147 settlement is irrelevant. Mr.
2 Falkenberg is correct in that future black box settlements may require additional
3 documentation to ensure disallowed costs are not subsequently recovered through
4 the PCAM. Nonetheless, I expect that the existence of a PCAM would be taken
5 into consideration in future settlements so that the potential problems identified
6 by Mr. Falkenberg are not an issue.

7 **Q. Do you have any comments on Mr. Falkenberg's criticism of your statement**
8 **that net power costs will never fall below zero?**

9 A. Yes. Mr. Falkenberg has mischaracterized my testimony. When I stated that net
10 power costs will not fall below zero I was referring to annual net power costs, not
11 net power costs over a short period of time. The Company's net power costs have
12 never been negative, or even close to negative, on an annual basis. The absurdity
13 of Mr. Falkenberg's suggestion that net power costs could fall below zero, which
14 is based on a subset of 2001 information, is demonstrated by actual 2001 net
15 power costs which totaled $1.2 billion.

16 **Q. Do you agree with Mr. Falkenberg's suggestion that the Aquila hydro hedge**
17 **protects the Company from hydro volatility and therefore a PCAM is not**
18 **justified?**

19 A. No. Mr. Falkenberg overstated the volatility risk protection provided by the
20 hydro hedge. The hedge only protects the Company from a small portion of its
21 total hydro volatility risk.

22 **Q. Are hydro hedges readily available from the market?**

23 A. No. The market is not liquid. In fact, the Aquila hedge was off loaded to Swiss

1 Re because Aquila exited the business as did a number of other companies. For
2 this reason, the Company does not believe it will be able to enter another hydro
3 hedge that provides equivalent benefits when the Aquila hedge expires in 2006.

4 **Q. Mr. Falkenberg states that the RVM would provide protection between rate**
5 **cases unless the Company plans to file rate cases more often than its annual**
6 **RVM updates. Is this an accurate statement?**

7 A. No. The RVM process, if adopted, would not protect the Company from hydro
8 volatility risk between rate cases. The Commission should question Mr.
9 Falkenberg's statements given his recommendation in this case. If the RVM
10 produces all the protection suggested by Mr. Falkenberg, it would seem that a
11 PCAM would provide little if any additional benefits to the Company and begs
12 the question of why he is objecting to a PCAM.

13 **Q. Mr. Falkenberg states a PCAM might shield the Company to such an extent,**
14 **that it would not develop long-term solutions to dependence on the wholesale**
15 **market. Is dependence on the wholesale market unique to the Company and**
16 **grounds for precluding approval of a PCAM?**

17 A. No. It is common practice for generating utilities to depend on the wholesale
18 market to balance their systems when long, and or, short. Mr. Falkenberg's
19 argument does not provide a reasonable basis for denying the Company's
20 application because the majority of investor owned utilities in the WECC have a
21 PCAM, and all have a dependence on the wholesale market.

1 **Q. Does the Company rely too heavily on the wholesale market as Mr.**
2 **Falkenberg suggests?**
3 A. No. For calendar year 2004 the Company's net short-term firm transactions
4 totaled a mere .2 million MWh out of a total resource requirement of 80.9 million
5 MWh. Despite this low reliance on the wholesale market, the Company under
6 recovered $147 million on a total Company basis based on Oregon authorized net
7 power costs.
8 **Q. Do you agree with Mr. Falkenberg's contention that a pass through account**
9 **discourages efficiency?**
10 A. No. Generating unit efficiency and generating unit availability are closely linked.
11 PacifiCorp emphasizes maintaining high availability because market prices are
12 generally higher than PacifiCorp's production cost. PacifiCorp also emphasizes
13 maximizing thermal efficiency given unit load and equipment condition. In
14 general, good thermal efficiency contributes to high availability. Optimizing
15 thermal efficiency is integral to maintaining high availability and would not be
16 discouraged by a pass through account.
17 **Q. Does the excerpt from the heat rate initiative used in Exhibit ICNU/102**
18 **provide evidence that a pass through account discourages efficiency?**
19 A. No. The heat rate initiative described in Exhibit ICNU/102 was initiated in the
20 middle of 1999 by PacifiCorp personnel to determine a standard software package
21 for real time monitoring of thermal unit performance. At that time, we had two
22 competing software packages installed at two of our plants; and personnel
23 identified the need to adopt a common standard software package for all plants.

1 The three slides in this exhibit simply state the conditions and objectives that
2 existed as the heat rate initiative was implemented. PacifiCorp does emphasize
3 maximizing availability. PacifiCorp then expects plant personnel to operate each
4 unit in a manner that produces the best heat rate given the required load and
5 equipment condition. The objective is to first minimize the purchase of high cost
6 outside resources and second minimize fuel costs which ultimately results in low
7 net power costs. The technical paper in Exhibit ICNU/102 is evidence of
8 PacifiCorp's attention to thermal efficiency at the same time an emphasis is
9 maintained on maximizing generation output.

10 **Q. Is Mr. Falkenberg correct when he states that there is no proof that high or**
11 **volatile market prices harm the Company in a substantial way?**

12 A. No. His statement is not accurate. As shown on PPL Exhibit 201, high market
13 prices have caused significant financial harm post 1999. Of course some of that
14 harm was due to poor hydro conditions and the Hunter 1 outage, but had market
15 prices not been so high the harm would not have been nearly as great.

16 **Q. Do you agree with Mr. Falkenberg's reference to the Company's net power**
17 **cost recovery risk as a stochastic risk?**

18 A. No. For the Company's recovery risk to be stochastic it would have to be
19 expected to average out over time and that is not the case. In fact, the Company's
20 risk is asymmetric as demonstrated by PPL Exhibit 201 and discussed by Staff
21 witness Galbraith. The Commission has also recognized that risks need to
22 average out over time for them to be stochastic. In Order No. 04-108, page 9, the
23 Commission stated:

1 The financial threshold for deferred accounting is lower for scenario or
2 paradigm risk because the effect of that type of risk is not likely to
3 fluctuate as stochastic risks do. Hydro variability causes costs to swing
4 above and below the average included in rates, so the effect should
5 average out.

6 **Q. Is the Company's definition of net power costs too nebulous for a permanent**
7 **PCAM as Mr. Falkenberg states?**

8 A. No. As discussed on page nine of my direct filed testimony, the Company is
9 using its standard rate case definition of net power costs. This includes fuel costs,
10 purchase power costs, wheeling costs, and wholesale sales of gas and electricity.

11 **Q. Do you agree with Mr. Falkenberg's suggestion to limit eligible costs to only**
12 **those costs that are volatile, significant and beyond the Company's control?**

13 A. No. If the Company did not include a PCAM that reflected all elements of net
14 power costs, I believe we would have been widely criticized. As is discussed in
15 my direct testimony, all net power costs are interrelated and should be included in
16 the calculation to avoid the potential problem of a mismatch of costs. For
17 example, if thermal generation was less because a unit had an extended major
18 outage, the Company would likely incur additional purchase power expense and
19 less coal fuel expense. Based on Mr. Falkenberg's recommendation to include
20 only some net power costs in a PCAM, the Company would recover more costs
21 than it was incurring because it would continue to recover its normal level of fuel
22 expense, even though it was actually incurring less, and recover the higher level
23 of power purchase expense due to lower coal generation. Of course, an
24 adjustment could be made to reduce the fuel expense, but many adjustments could
25 be required and this would only add unnecessary complexity to the mechanism.

1 In the end, the simplest and best method of ensuring a proper matching of costs is
2 to include all net power costs.

3 **Q. Is the Company opposed to the retail load and revenue adjustment suggested**
4 **by Mr. Falkenberg?**

5 A. No. If such an adjustment is adopted it should be part of the PCAM deferral
6 calculation and should be calculated by multiplying the change in Oregon retail
7 load by the unbundled generation and transmission rate currently in effect.

8 **Q. Mr. Jenks cites PCA mechanisms for Puget and Avista as evidence that a**
9 **case for a PCA as generous as that proposed by the Company has not been**
10 **made. Is there any information that contradicts Mr. Jenks contention?**

11 A. Yes. There is evidence for both Avista and Puget. Recently, Avista and some of
12 the parties in their current general rate case Docket No. UE-050482 signed a
13 settlement agreement that would increase their revenue requirement by $22
14 million. Part of that settlement addresses changes to their existing Energy
15 Recovery Mechanism (ERM). If approved by the Washington utilities and
16 Transportation Commission, the ERM would have 90%/10% sharing between
17 customers and shareholders for costs outside a plus or minus $3.0 million
18 deadband. The $3.0 million deadband is equivalent to approximately .98 percent
19 of retail revenue. For the Company, this would equate to a deadband of plus or
20 minus $7.9 million in Oregon, prior to rate changes for UE 170.

21 As far as the Puget mechanism is concerned, while the $20 million
22 deadband applies to a single year, there is also a four-year, $40 million cap. Once
23 the cap has been reached during the four year period, 99 percent of all variances

1 above the cap are recoverable by Puget. Therefore, on an average annual basis,
2 Puget's deadband is equal to only .6 percent of retail revenue. For the Company,
3 this would equate to a deadband of plus or minus $4.8 million in Oregon, prior to
4 rate changes for UE 170.

5 **Q. Is the Company's proposed mechanism more generous than either of the**
6 **Puget or Avista PCA mechanisms?**

7 A. No. On the contrary, the Company's proposed mechanism would provide results
8 similar to the Avista mechanism and significantly less generous than Puget's
9 mechanism. For example, if the annual variance was $100 million Total
10 Company and Oregon's allocated share was roughly 28 percent, the Company
11 would absorb approximately $8.4 million on an Oregon basis under its proposal,
12 while it would absorb $8.1 million under the Avista mechanism. If the annual
13 variance was $200 million total Company, the Company would absorb
14 approximately $10.7 million for Oregon under its proposal, while it would absorb
15 $10.9 million under the Avista mechanism. Using the prior examples with the
16 Puget mechanism and the average annual rate for the four-year period, the
17 Company would absorb only $5.0 million and $5.3 million, respectively. As
18 demonstrated, the Company's mechanism is clearly not as generous and regional
19 precedent supports the Company's proposed mechanism.

20 **Q. Does it appear that Avista was penalized on return on equity in the**
21 **settlement given the ERM?**

22 A. Not in comparison to the Company's recent experience. The Avista settlement
23 calls for a 10.4 percent return on equity compared to the 10.0 percent return on

1 equity included in the Company's UE 170 settlement.

2 **Q. Do you agree with Mr. Jenks that the PCAM could lead to monthly rate**
3 **changes?**

4 A. No. The PCAM accruals would be recorded monthly but it is not contemplated
5 that rates would be changed monthly. Pursuant to the Company's proposal, the
6 Company would be required to seek rate changes once the plus or minus $15
7 million Oregon trigger for the balancing account has been reached. Of course it is
8 theoretically possible that the balance could be reached each month, although it is
9 not very likely. Further, once the trigger has been reached, the Company would
10 need to prepare and make its filing and go through a prudence review and
11 possibly hearings. Therefore, it is extremely unlikely that the Company's
12 proposed mechanism would lead to monthly rate changes and the volatility
13 suggested by Mr. Jenks.

14 **Q. Why does the Company's proposal use a trigger instead of an annual**
15 **mechanism?**

16 A. A trigger threshold was proposed so that during periods of lower cost volatility
17 there would be fewer rate changes and during periods of higher cost volatility
18 there could be more cost changes so customers would receive proper price signals
19 for electricity use decisions. If the Commission is concerned with this approach,
20 the Company is not opposed to limiting the number of rate changes during a given
21 year.

1 **Q. Mr. Jenks also suggested that there could be problems with shifts between**
2 **sharing bands. Do you agree?**
3 A. No. Shifting between sharing bands is simple math and should not be a concern.
4 **Q. Do you have any comments on the PCA mechanism proposed by Mr. Jenks?**
5 A. Yes. CUB's proposed PCAM does nothing to solve the Company's risk recovery
6 asymmetry. In fact, the proposed mechanism would exacerbate the Company's
7 asymmetry because of the significantly asymmetrical deadbands proposed.
8 **Q. Does this conclude your rebuttal testimony?**
9 A. Yes.

Case UE-173
PPL Exhibit 301
Witness: Gregory N. Duvall

BEFORE THE PUBLIC UTILITY COMMISSION

OF THE STATE OF OREGON

PACIFICORP

Rebuttal Testimony of Gregory N. Duvall

Allocation Methodology

September 2005

1 **Q. Are you the same Gregory N. Duvall that submitted direct testimony in this**
2 **docket?**
3 A. Yes.
4 **Purpose and Summary of Rebuttal Testimony**
5 **Q. What is the purpose of your rebuttal testimony?**

6 - I concur with Mr. Jenks that the allocation of "non-normalized" or actual power
7 costs through a Power Cost Adjustment Mechanism (PCAM) is a new issue for
8 the Commission. I also concur with Mr. Jenks that the Revised Protocol deals
9 only with "normalized" power costs and does not prescribe any specific allocation
10 method for a PCAM.
11 - I show that assigning the risk of hydro volatility to the Northwest is consistent
12 with representations made by Oregon parties about the Revised Protocol.
13 - I rebut Mr. Jenks' claim that the Northwest did not receive a dedication of low-
14 cost hydro resources under the Revised Protocol. To the contrary, Oregon
15 receives the "lion's share" of benefits from the low-cost hydro resources under the
16 Revised Protocol and it is fair for Oregon to bear greater than proportional levels
17 of risk associated with hydro output.
18 - I demonstrate that MSP participants understood the difference between the costs
19 of hydro replacement and the costs of hydro variability and that the Company's
20 PCAM proposal, which addresses hydro variability, is reasonable.
21 - I show that Mr. Wordley's alternate proposal is not fair because it assigns the risk
22 of hydro variability equally to loads in all jurisdictions rather than to the
23 jurisdictions that receive the benefits of the low-cost hydro resources.

1 • Finally, I indicate that Mr. Jenks' proposal to use allocation factors that are based
2 on actual loads for the PCAM is reasonable and adopting this proposal will
3 prevent Oregon customers from being overcharged.

4 **Allocation under a PCAM is a New Issue for the Commission**

5 **Q. Does the Revised Protocol specify how to allocate actual costs when using a**
6 **PCAM?**

7 A. No. As Mr. Jenks states on page 2 of his testimony, the Revised Protocol does
8 not require Oregon to follow any allocation methodology for a PCAM. Both Mr.
9 Jenks and Mr. Wordley state that the Revised Protocol focused on allocating
10 "normalized" power costs and the modeling that was done in the Multi-State
11 Process (MSP) was done on "normalized" data. A PCAM allocates actual or
12 "non-normalized" power costs.

13 **Q. Mr. Wordley argues that assigning proportionally more of the costs due to**
14 **year-to-year operational hydro-related power cost variations to Oregon is a**
15 **different deal than was agreed to in the Revised Protocol. Do you agree?**

16 A. No. Mr. Wordley correctly points out that the Revised Protocol is based on
17 "normalized" power costs and does not address operational hydro-related power
18 cost variations. It is up to this Commission to determine what is fair and
19 consistent with the Revised Protocol in the context of allocating costs among
20 states under a PCAM.

1 **Determining a Methodology**

2 **Q. If the Revised Protocol does not specify how to allocate costs using a PCAM,**
3 **how should the Commission proceed?**

4 A. The Commission should adopt an allocation method for use with a PCAM that is
5 consistent with the Revised Protocol. This was the Company's original guiding
6 principle which appears to be supported by Mr. Wordley and Mr. Jenks.

7 **Q. How does this Commission determine what is consistent with the Revised**
8 **Protocol?**

9 A. The most direct way for the Commission to make this determination is to look at
10 the representations of the Oregon parties. For example, in Oral Arguments before
11 this Commission, the following representations were made in reference to the
12 Revised Protocol:

13 "-- in order to get the long-term advantage of the Company's own
14 hydro, we had to agree to pay the relicensing costs. Which I think is a
15 reasonable -- *if we're going to get the benefits, we should pay the costs*."
16 (emphasis added)
17 (Bob Jenks, UM-1050 Oral Arguments, page 31, lines 11-14)
18
19 "So the reason we have a hydro benefit isn't based on simply to
20 make the modeling work out, it's because Oregon customers deserve those
21 benefits, Northwest customers deserve those benefits, we pay the cost
22 historically, the non-economic costs and benefits of those facilities are in
23 the region, *we should put all the costs and benefits in the region*."
24 (emphasis added)
25 (Bob Jenks, UM-1050 Oral Arguments, page 34, lines 13-18)
26
27 "...I'm looking at what is our historical tie to the hydro resources.
28 And that Oregon has consistently said *whether it's for the better or for the*
29 *worse*, we identify with the hydro and we have an endowment with the
30 hydro..." (emphasis added_
31 (Marc Hellman, UM-1050 Oral Arguments, page 52, lines 13-17)
32
33 "...we haven't looked at the hydro as yes we want it because we
34 know it's going to be good for us. We do expect it to be good for us, but

1 *we're also taking into account the risk of what the hydro might provide*,
2 plus we are located around what are likely to be the environmental effects
3 of changing hydro operations and things of that nature.
4 On the policy decisions and activities, that should not affect another
5 state."
6 (Marc Hellman, UM-1050 Oral Arguments, page 52, line 21 through page
7 53, line 4)

8 It is clear from these representations that if Oregon is to receive the benefits of the
9 low cost hydro, it should also bear the costs.

10 **Q. Mr. Jenks claims that the Revised Protocol does not dedicate hydro resources**
11 **to the Northwest states. Do you agree?**

12 A. No. Under the Revised Protocol, the Northwest states receive the benefit of the
13 low-cost hydro. As Mr. Hellman stated in Docket UM 1050 during Oral
14 Argument before this Commission:

15 "On page four of my presentation I talk about the Hydro
16 Endowment. And the Revised Protocol essentially provides to Oregon
17 what we would say is its historical entitlement may be greater than our
18 historical entitlement to the benefits of the region's hydro. Because the
19 Company [owned] hydro is allocated among the Pacific divisional states.
20 Mid-C is allocated based on kind of a contract basis. However, that
21 contract basis provides Oregon the lion's share of the Mid-C benefits."
22 (Marc Hellman, UM-1050 Oral Arguments, page 51, line 24 through page
23 52, line 7)

24 **Q. Are there additional ways to determine if the allocation under a PCAM is**
25 **consistent with the Revised Protocol?**

26 A. Yes. It may be easiest to compare and contrast the Revised Protocol with a
27 rolled-in allocation method using hydro as an example. Under rolled-in, each
28 state pays a proportional share of all resource costs and receives a proportional
29 share of the benefits of the low cost hydro. If a PCAM were adopted under
30 rolled-in, it would be fair to allocate the power cost variances due to "non-
31 normal" hydro conditions proportionately among all states.

1 Under Revised Protocol, however, the benefits of the low-cost hydro are
2 allocated among the former Pacific Power states and it would therefore be fair to
3 allocate power cost variances due to "non-normalized" hydro conditions among
4 the former Pacific Power states. This is exactly what the Company's proposal
5 does.

6 Q. **Mr. Jenks and Mr. Wordley contend that the Revised Protocol allocates**
7 **hydro replacement costs across the system, and therefore the principle of**
8 **consistency would require any increased power costs associated with below**
9 **normal hydro to be allocated across the system. Do you agree?**

10 A. No. MSP participants clearly understood the difference between the cost of
11 hydro replacement and the cost of hydro variability. Hydro replacement refers to
12 replacing reductions in "normalized" levels of hydro output. Hydro variability
13 refers to differences between "normalized" and actual levels of hydro output. As
14 testified to by both Mr. Wordley and Mr. Jenks, the Revised Protocol only
15 addresses the allocation of costs based on "normalized" hydro, not actual hydro.
16 The system-allocated "lost hydro generation" referred to by the Oregon parties in
17 their assessment of the Revised Protocol was limited to reductions related to
18 expiration of the Mid-Columbia Contracts and reductions in hydro output due to
19 relicensing requirements on Company-owned facilities. Mr. Wordley
20 acknowledged the unique benefit to Oregon customers in his testimony where he
21 states:

22 "[T]he cost to replace lost hydro generation, arguably an additional cost
23 that should be assigned to Oregon, but is not in the PRP [Revised
24 Protocol], is $74 million. (UM 1050 - Staff/200, Wordley/16)

1 Both Staff and CUB understood that the $74 million of "lost hydro generation"
2 applied strictly to reductions in output due to relicensing and contract expiration,
3 and had no implications as to how to allocate changes in power cost resulting
4 from hydro variability. They also both understood Oregon customers were
5 receiving a benefit under the Revised Protocol by allocating the narrowly defined
6 "lost hydro generation" system-wide. Oregon parties did not suggest that any
7 additional hydro-related costs should be shared system-wide. On the contrary,
8 there was an express recognition by the Oregon parties that departing from a
9 rolled-in method and allocating a greater share of hydro resources to Oregon
10 customers could increase the cost and price volatility to Oregon customers.
11 Representatives of CUB and the Oregon Staff regularly assured other MSP
12 participants that this was a risk they were willing to take in order to obtain a hydro
13 endowment.

14 **Q. Is Staff's recommendation to allocate power cost variances on the load-based**
15 **dynamic SG factor reasonable?**

16 A. No. Staff's proposal represents a mismatch between the allocation of the benefits
17 of the low-cost hydro and the associated operational risk, and is in direct conflict
18 with their express policy of taking the hydro "for better or for worse". Staff's
19 proposal allows Oregon to reap the lion's share of the benefits of the low-cost
20 hydro, while the total system bears the risk of changes in power costs associated
21 with varying water conditions. Staff's proposal is not fair.

22 **Q. From a mechanical perspective, is Staff's proposal consistent with the**
23 **Revised Protocol?**

1 A. No. Staff's proposal does not update the Embedded Cost Differential (ECD)
2 calculations with actual data. The ECD is an integral part of the Revised Protocol
3 and is the mechanism that provides Oregon with its hydro endowment. If actual
4 power costs are to be mechanically flowed through the Revised Protocol, this
5 requires updating the ECD calculations with actual data.

6 **Q. Mr. Jenks claims that the Company's proposal is seriously flawed because it**
7 **asks Oregon customers to subsidize power costs that will be incurred to serve**
8 **Utah load, while at the same time asking Oregon customers to pick up a**
9 **disproportionate share of hydro-related costs. Please comment.**

10 A. As stated already in this testimony, the Company strongly believes that the
11 allocation method it has proposed properly matches hydro related costs and
12 benefits. Mr. Jenks' contention that Oregon customers are picking up a
13 disproportionate share of hydro-related costs is based on two faulty premises.
14 First, he believes that the Northwest states do not receive a dedication of hydro
15 under the Revised Protocol. Second, he believes that the treatment of replacement
16 cost for "lost hydro generation" under the Revised Protocol should be the basis of
17 the treatment of variability of costs under a PCAM. I have already shown that
18 both of these assumptions are wrong.

19 The Company does not oppose Mr. Jenks' suggestion to base allocation factors on
20 actual loads for allocating variations in power costs under the PCAM.
21 Incorporating this change should alleviate concern that Oregon would be
22 subsidizing power costs that will be incurred to serve Utah because it matches
23 actual power costs with actual loads.

1 **Q. Does this conclude your rebuttal testimony?**

2 A. Yes.