BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UE 173

In the Matter of

PACIFICORP,

Application for Approval of A Power Cost Adjustment Mechanism.

OPENING BRIEF

OF THE

CITIZENS' UTILITY BOARD OF OREGON

December 22, 2005

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I. Introduction

Here we go again. We are faced with yet another utility proposal for a power cost adjustment that doesn't make the grade. The theoretical underpinning of PacifiCorp's petition is faulty, and the specifics of its proposed mechanism are worse. The Company's argument that its credit rating is at risk is groundless, its analysis of its risk over the past half decade is utterly skewed, and the specifics of its PCA proposal are not acceptable. We propose instead a far less radical shift in Oregon regulatory policy, a far simpler mechanism which is not rife with inequities, and a mechanism that will provide the Company protection when it is appropriate while leaving the utility to manage power costs as it should. CUB's proposed mechanism should reduce the string of deferral and PCA filings we have seen recently, and give PacifiCorp, as well as the credit rating agencies, some comfort with Oregon's backstop measures.

II. Argument

A. Theoretical Arguments

Before addressing the nuts and bolts of PacifiCorp's proposed power cost adjustment mechanism (PCA), we again distinguish the theoretical basis we used to design our recommended PCA from the theoretical basis the Company appears to have used to design its PCA. This theoretical basis is fundamental in prescribing the particulars of an appropriate mechanism.

i. An Appropriate Approach To An Oregon Power Cost Adjustment

In a rate case, the shareholder is compensated through an authorized return on equity (ROE) to accept certain financial risks, including those that accompany normalized utility ratemaking. Deferrals and PCAs are mechanisms that allow recovery for the shareholder when certain costs reach a level not anticipated in normal ratemaking. However, before customers pay additional money to the shareholders to cover those extreme costs, we need to make sure that the shareholders have absorbed the normal financial risk that customers pay for in rates through the rate of return. Otherwise, the deferral or PCA is simply a way to achieve a ROE that is higher than that authorized by the Commission, the upshot of which would be overcompensating shareholders for the risks we assume they are taking. The deadband is the way that we account for the expected financial risk that must be absorbed by the shareholder before customers pay more in rates. The Commission recognizes this as a matter of course, stating recently in UM 1071:

> The magnitude of the financial effect on the utility is also a factor in our consideration under the discretionary stage of the decision process. For a stochastic risk to justify deferred accounting, the financial impact must be

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

Order No. 04-108, UM 1071, March 2, 2004, p.9, footnote omitted.

PacifiCorp would like a PCA because costs fluctuate and the mechanism would "allow changes in net power costs to be reflected between general rate cases." PPL/100/Omohundro/2. Virtually all costs assumed in a general rate case will fluctuate and will deviate from the normalized assumptions in the test year. Just because costs fluctuate does not justify recovery of those costs through a PCA. On the contrary, a PCA should be used to allow the utility to recover only those costs incurred that are significantly beyond those that were contemplated and normalized in a general rate case.

ii. PacifiCorp's Need For A Power Cost Adjustment

Other than trying to reinvent the purpose of a power cost adjustment mechanism, as addressed above, the primary justification PacifiCorp provides for its proposed PCA is protecting its credit rating. PPL/100/Omohundro/3. The design of the Company's proposed mechanism suggests that any power cost variation, no matter how small, is a burden and a credit risk for the utility. The centerpiece of PacifiCorp's argument that it needs a power cost adjustment mechanism is a 2004 research article by Standard & Poor's exploring such mechanisms as they relate to western utilities' credit quality following the Energy Crisis. PPL/101/Omohundro. First, we note that the Western Energy Crisis is exactly the type of event CUB's proposed mechanism would address. Second, the details of the article undermine PacifiCorp's argument that it needs such a mechanism to bolster its credit rating.

The data in the article demonstrates that, in 2004, PacifiCorp's rating was the highest in the peer group, and was rivaled only by Idaho Power's which was on negative credit watch. PPL/101/Omohundro/2. In addition, a significant concern expressed in the S&P article is utilities' exposure when they have sizeable gas-fired generation or rely on power purchases that are indexed to market prices. In this context, PacifiCorp is in a good position; the utility has significant owned coal and hydro resources, as well as a good load-resource balance. CUB/100/Jenks/4-5.

Finally, the article holds PGE's resource valuation mechanism (RVM) with the ability to file for a deferral to be a quasi-PCA, and though we have serious concerns about the general applicability of this direct-access mechanism, PacifiCorp, in UE 170, was granted an annual transition adjustment mechanism (TAM). Combined with the ability to file for cost deferral, the Company now has a quasi power-cost mechanism of its own. Order No. 05-1050, September 28, 2005; reconsideration granted on other issues, Order No. 05-1254, December 19, 2005. While we do not necessarily believe the Company's premise that this combination is necessary for maintaining a credit rating – indeed the article itself notes that PCAs are "not a substitute for supportive regulation," and "supportive regulation" does not specify particular mechanisms – PacifiCorp's credit rating and its own quasi-PCA render the Company's argument based on this article moot. PPL/101/Omohundro/5.

PacifiCorp has not consistently had a PCA mechanism in the past, and its credit rating historically does not appear to have suffered as a consequence. PacifiCorp does attempt to argue that market conditions have changed and, therefore, this necessarily implies more volatile costs, thus supporting the Company's need for a PCA.

PPL/102/Oomohundro; PPL/201/Widmer. The Company's argument on this, however, is based on a faulty analysis.

To begin with, the analysis showing the Company's risk is based on a review of recent past years that include the Energy Crisis. CUB/200/Jenks/12. Added to this, PacifiCorp includes in its analysis the Hunter outage, which was not only a significant resource loss, but also happened during the middle of the Energy Crisis, thereby magnifying the supposed "risk exposure" identified in the analysis. Ibid. Compounding the problem, was PacifiCorp's own load miscalculation during the Energy Crisis, an error which further exacerbates the problems of this risk analysis. CUB/200/Jenks/12-13. Finally, the analysis includes costs the Company stipulated were imprudent. Ibid.

In closing, PacifiCorp did not prove that its market risk has changed significantly (as opposed to costs increasing, which, if they are, can be dealt with in a rate case), and it is worth remembering that managing power cost variation is one of the key reasons utilities are paid a rate of return. Providing power and managing power costs are what utilities do, and should not be the basis for overcompensation.

Neither PacifiCorp's philosophical approach, nor the Company's rationale for a PCA, are sound. If customers are to bear the risk of power cost variation, then why do we need shareholders? PacifiCorp's proposed customer allocation of 70¢ of the first dollar of increased power costs turns Oregon's regulatory risk balance on its head. If PacifiCorp needs a PCA for its credit rating then why was its credit rating not lower compared to its peers that did have such mechanisms in the article? The Company's suggestion that a lack of a PCA threatens its credit stability is simply a masquerade.

B. Practical Arguments

While PacifiCorp's theoretical justifications for implementing a PCA are weak, the Company's blueprint for the actual mechanism is not reasonable.

i. The Omitted Deadband

PacifiCorp's proposed PCA has no deadband. If PacifiCorp's powers of theoretical reasoning are weak, then their powers of observation are flatly non-existent.

Theoretically, PacifiCorp should understand that the deadband exists to represent the regular non-normalized cost fluctuations that the utility absorbs between rate cases. The utility is in the best (or only) position to manage these costs as they deviate from the normalized, forecast costs. Of course, the utility is compensated for taking this risk between rate cases in its return on equity. So the deadband represents the normal risk, given the return on equity, that the utility bears until an extreme cost justifies collection under the PCA. CUB/100/Jenks/17.

Even if PacifiCorp doesn't get this, it should at least be paying attention to the policy and tradition that exist in this state. Deadbands have been a regular feature of deferrals for the reasons outlined above. Further, in a recent pronouncement on deferrals, this Commission declared that deadbands are an assumed part of deferrals and, by extension, PCAs. To again quote, the Commission stated:

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

Order No. 04-108, UM 1071, March 2, 2004, p.9, footnote omitted.

We think that PacifiCorp should pay better attention to this State's policy and practice on the matter. The Company should understand that a PCA without a deadband is a non-starter.

ii. Treatment of Non-Normalized Hydro

PacifiCorp's treatment of hydro in its proposed mechanism both violates the Multi-State Process (MSP), and, in so doing, creates a patent inequity when compared with the mechanism's treatment of the costs of non-normalized load excursions in Utah.

The MSP was a long, hotly-contested proceeding, through which everyone made enormous concessions while attempting to reach settlement. The Revised Protocol does not allocate ALL of the benefits of the Northwest hydro system to the Northwest states, which is what CUB initially advocated for in the Multi-State Process. The Hydro Endowment established in the Protocol was a compromise in the first place, but even to get that, Oregon had to concede to pay the cost of historic qualifying facilities. Nowhere in the balance of these negotiations or the calculation of the costs and benefits of the Revised Protocol was there a mention of allocating hydro-replacement costs to the Hydro Endowment states.

The Company is now proposing to change the delicate balance of the Revised Protocol by allocating all costs associated with hydro-replacement power to the Hydro Endowment states, but not providing any additional hydro system benefits to those states. All of the parties who filed testimony in this case, other than PacifiCorp, agree that allocating all hydro-replacement costs to the Hydro Endowment states is inconsistent with the deal that was struck during the MSP negotiations which led to the Revised

Protocol. CUB/100/Jenks/6-14, CUB/200/Jenks/4-7, Staff/200/Wordley/1-5, Staff/400/Wordley/1-4, ICNU/100/Falkenberg/22-26.

At the same time as treating non-normalized hydro as a Northwest cost, PacifiCorp's proposed mechanism also treats the cost of non-normalized load excursions in Utah as a system cost. We acknowledge that hydro variability is a significant risk associated with non-normalized weather conditions in the Northwest. However, the risk of summer heat waves in the Company's southwestern territory is also a significant non-normalized weather risk. While the Company argues that the cost of non-normalized hydro conditions is problem that Northwest states should financially underwrite, PacifiCorp's mechanism considers the costs of non-normalized summer weather in the Southwest to be a system cost so that all states financially underwrite them. This is not consistent or fair and would result in Oregon paying a disproportionate share of system costs. CUB/100/Jenks/7&13-14, CUB/200/Jenks/6-7.

iii. Qualifying Facilities

PacifiCorp proposes to exempt Qualifying Facilities (QFs) from the sharing bands so that any variation in the cost of QF contracts from what was set in a rate case flows through to customers without any sharing. PPL/200/Widmer/7. Customers would take 100% of the cost of QF variation between rate cases, "because the purchases are required by PURPA." Ibid.

This PCA proposes to dump a set of costs on customers with no justification at all. First, there is no reason to believe that PacifiCorp will be able to perfectly contract QFs to minimize cost variation between rate cases; and second, there is no theoretical reason to place 100% of that variation on customers between rate cases. It is the utility that negotiates the QF contract, but now this utility wants to place all the risk of that contract on the customer. CUB/100/Jenks/24-25. The utility receives a return on equity in compensation for the risk of these contracts (among other things). The Company's proposed mechanism would shift this cost risk to customers without a speck of reasoning.

iv. Crippled Prudence Review

PacifiCorp's attempt, through its power cost adjustment mechanism, to deny CUB and other parties the opportunity to address the Company's prudence is untoward. PPL/200/Widmer/10. CUB will not agree to be silenced in its duty to present evidence and argument to the Commission.

The Company argues that contracts and resources that have been in proceedings before this Commission before should not be subject to a prudence review. Under such a framework, Staff, CUB, and other intervenors would have to analyze every new variable in excruciating detail, as we would never have another chance to question that variable. The implications of a particular contract may not be visible in the test year associated with a full rate case, much less the abbreviated schedule associated with an annual TAM or RVM. CUB/100/Jenks/26. Also, contracts may have escalator clauses that have future implications, and some contracts are added as updates after the Commission has rendered its decision in the case. This is absurd; no one can reasonably be expected to review or comprehend the future importance of every single contract or utility decision involved in a filing.

Simply because we do not make an imprudence argument about a contract in a docket, does not mean, by default, that we have come to the conclusion that it is prudent. PacifiCorp's attempt to hamstring the parties' ability to provide the Commission with prudence evidence and argument is not appropriate. CUB/100/Jenks/25-26, CUB/200/Jenks/10.

III. CUB's Proposal

Below is the table from CUB's opening testimony which lays out the framework of our proposed power cost adjustment mechanism. As described above, CUB's approach to a PCA in Oregon is one of protecting the Company from extreme events and wide swings in power costs. It leaves power costs to fluctuate within a reasonable range, and the Company is paid a rate of return to manage this risk. It also eliminates the need for what has recently felt like an endless string of deferral applications, and provides the Company, as well as the rating agencies, with some surety of reasonable recovery when the Company's incurred power costs are considerably above those that were forecast. In exchange for this protection, customers are also protected when power costs drop significantly below those that were forecast.

CUB Proposal

Baseline	Result of most recent rate case or most recent TAM
Deadband	125 basis points below baseline & 250 basis points above baseline
50/50 Sharing	Between 125 and 200 basis points below baseline & Between 250 and 400 basis points above baseline
75/25 Sharing	Below 200 basis points below baseline & Above 400 basis points above baseline
Allocation	Based on Oregon's actual share of monthly load
Amortization Period	Determined by the Commission

IV. Conclusion

PacifiCorp's rationale for a PCA is unfounded, and the Company's proposed mechanism is so flawed as to be unworkable. We urge the Commission to adopt CUB's proposed mechanism which is simple, fair, and unlikely to have unexpected outcomes. At worst CUB's proposal would do nothing. More likely, however, it will protect the Company from wide swings in power costs, it will give both the Company and the rating agencies some assurance of power cost recovery when circumstances deviate significantly from those that were forecast, and it will establish a framework to eliminate the regulatory burden of seemingly-annual deferral filings.

Respectfully Submitted,
December 22, 2005,

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CERTIFICATE OF SERVICE

I hereby certify that on this 22nd day of December, 2005, I served the foregoing Opening Brief of the Citizens' Utility Board in docket UE 173 upon each party listed below, by email and U.S. mail, postage prepaid, and upon the Commission by email and by sending 6 copies by U.S. mail, postage prepaid, to the Commission's Salem offices.

Respectfully submitted,

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