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VIA ELECTRONIC FILING

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

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

Enclosed for filing please find an original and 5 copies of PacifiCorp's Closing 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

BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON

UE 173

In the Matter of PACIFICORP (d/b/a Pacific Power & Light Company) Application for Approval of Power Cost Adjustment Mechanism	**REPLY BRIEF OF PACIFICORP**

I. INTRODUCTION

In this Reply Brief, PacifiCorp (or the "Company") first provides comments regarding the recent Commission Order in UE 165/UM 1187. PacifiCorp then discusses what it believes to be the central issues presented in this proceeding. To the extent that the Opening Briefs of Staff and Intervenors repeated arguments that were made in their testimony, PacifiCorp relies on its responses to those arguments contained in its Opening Brief and will not seek to repeat them here.

A. Applicability of PGE Order

Administrative Law Judge Logan issued a memorandum on December 29, 2005 instructing the parties to address the Commission's Order No. 05-1261 in UE165/UM 1187 (the "PGE Order") which dealt with Portland General Electric Company's ("PGE") application for a hydro generation power cost adjustment mechanism.

PacifiCorp believes that much of the PGE Order is not applicable to these proceedings. Important differences include:

1. The PGE Order appears to deal with the issue of the expected variability of hydro electric generation from normalized levels and not with the issue of an asymmetrical distribution of actual net power costs which is presented in this case. PGE Order at 2.
2. The PGE Order deals only with fluctuations in net power costs arising from the level of available hydro electric generation. This fluctuation was found by

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the Commission to not be within PGE's control. PGE Order at 9. This case concerns all of PacifiCorp's net power costs, some of which can be arguably affected by the Company's decisions. Therefore, in this proceeding, the Commission will likely wish to consider appropriate incentives for prudent management of net power costs.

3. The PGE Order considered a short-term (two-year) arrangement which was proposed at a time of poor hydro electric conditions. PGE Order at 7. PacifiCorp is proposing a long-term mechanism which should ultimately capture a variety of hydro electric and power market conditions and reflect a better balance over time between shareholder and customer interests. PGE Order at 9, 10.

4. The PGE proposal gave rise to some unique mechanical issues that were of particular concern to the Citizens' Utility Board ("CUB"). Specifically, PGE proposed to model the increased or decreased costs that it would face, in the event of changed hydro electric conditions, on the assumption that PGE would correspondingly increase or decrease its purchases in short-term markets. PGE Order at 7. In contrast, PacifiCorp is proposing to compare predicted net power costs to actual net power costs, with no need to model the economic consequences of actual conditions.

Nonetheless, there is one area where the PGE Order would appear to signal Commission preferences that might have bearing on this case.[1] In the PGE Order, the

[1] As discussed at length below, PacifiCorp acknowledges that "deadbands" may be appropriate in the case of normal variability from predicted results, but does not believe they are justified if the variability in net power costs is asymmetric. Nonetheless, for purposes of this case, the Company would accept the application of the Commission's two-part test in lieu of being denied any relief. Even if the variability in hydro electric output is symmetrical, there remains the issue of regulatory lag. Absent a mechanism such as PacifiCorp's TAM, in an environment of constantly increasing fuel and purchased power costs, a deadband virtually assures that the Company will not have a fair opportunity to earn its allowed rate of return on an expected basis.

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Commission favors a "two-part" mechanism where there would be both: a) a determination of whether a utility's overall return was outside a reasonable range, and b) a determination of whether the earnings impact of actual net power costs falls outside a deadband bracketing the range of reasonable total returns. The Commission suggested that a range of reasonable overall equity return for PacifiCorp in its last rate case, where the issue was contested was 10.5 to 11 percent.[2] If the overall return test is satisfied, a deadband of 100 basis points would apply to PCAM charges and credits. PGE Order at 10. PacifiCorp understands that under this proposed two-part mechanism, PCAM charges would not accrue unless: a) the Company's actual return on equity is less than 9.75 percent and b) actual unrecovered net power costs exceed an amount equal to 100 basis points (about $60 million). Similarly, PCAM credits would not accrue unless: a) the Company's actual return on equity is above 10.25 percent; and b) actual overrecovered net power costs exceed an amount equal to 100 basis points.

In contrast, PacifiCorp's proposed PCAM is effectively a three-part mechanism. The Company suggested: a) an overall earnings test (tied to the Company's allowed rate of return on equity, (not a range); b) a $15 million threshold trigger; and c) a 70/30 sharing of the first $100 million of net power cost exceedances or shortfalls from estimated levels. PacifiCorp Brief at 2, 3.

B. Staff and Intervenors Do Not Acknowledge the Significance of Asymmetry in the Variability of Actual Net Power Costs.

At the risk of being macabre, consider a game of Russian roulette in which each player has a revolver with two live shells and four blanks.[3] Under these circumstances, a

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[2] In the Company's subsequent rate case, UE 170, a 10 percent allowed return on equity was adopted as a result of a stipulation among the parties. Therefore, an appropriate "part 1" range to apply to these proceedings would appear to be 9.75 to 10.25 percent.

[3] For a Company that has sustained $675 million of unrecovered net power costs over recent years, the analogy is not all that much of a stretch. PP&L/102, Omohundro 1. Astonishingly, ICNU argues that the Company has not demonstrated that it is "actually being harmed." ICNU Brief at 6.

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player will be shot one third of the times the trigger is pulled on an "expected basis," although there is a wide range of potential actual outcomes.[4] If a player proposed to use a different weapon that holds six blanks and two live shells, she could be reasonably accused of reducing her risk (for which other players should be somehow compensated). She should be particularly scolded if she proposed that other players in the game be required to continue to use the six-shooter. It is this view of the world that Staff and CUB bring to their critique of PacifiCorp's proposed PCAM when they advocate deadbands and "neutral cost recovery."

However, Staff and CUB fail to recognize that the foregoing scenario is in sharp contrast to one in which a player discovers that her weapon actually has three live shells and her chances of being shot are really 50 percent. In this case, when the player proposes to remove one of the live shells, so that the game is as advertised, she should not be asked to share some of her added risk, and she owes no compensation to the other players, even though their risk is increased by the change. Moreover, the other players should not be permitted to remove one live shell from their weapons so that the proposed change is "neutral." Any such misguided attempt at "neutrality" just preserves the underlying inequity. The player who has the odds stacked against her should not be expected to bear any of the risk to the extent it is more than she bargained for.

So it is here. Mr. Galbraith plainly states that the ratemaking process is supposed to afford a utility a fair opportunity to recover its costs on an expected basis. Yet, Staff still espouses the concept of "neutral cost recovery," which only makes sense if the variability in actual net power costs is normally (not asymmetrically) distributed in the first place.[5]

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[4] Similarly, according to Mr. Galbraith, PacifiCorp should expect to recover all of its prudently incurred net power costs on an expected basis, although some years it will sustain losses and some years it will experience gains over normalized levels. Staff/300, Galbraith 4.

[5] Parties regularly speak of the "normalization process" without apparently acknowledging that there is a reason the word "normal" is part of the phrase. Perhaps not surprisingly, the *Random House Unabridged Dictionary* defines "normalize" as "to make normal."

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Mr. Widmer has testified that PacifiCorp's actual net power costs have not been normally distributed around expected values and that in recent years, the Company's actual net power costs have consistently exceeded the amount estimated in its rate cases. He expects this situation to continue in the future. PP&L/200, Widmer 3. While at times Mr. Galbraith is noncommittal on the issue of whether PacifiCorp's net power cost risk is asymmetrical, he nonetheless asserts that in order to preserve the principle of neutral cost recovery, because actual net power costs are asymmetrically distributed, deadbands need to be asymmetric as well. Staff/100, Galbraith 10. While Mr. Galbraith's arithmetic may be correct, his position virtually guarantees that PacifiCorp would not have a fair opportunity to recover its costs on an expected basis. Therefore, under the circumstances presented in this case, Staff is wrong in its assertion that "neutral cost recovery" is necessary to avoid an "economic windfall" to the Company. Staff at 1, 6.

Similarly, CUB's Opening Brief repeatedly makes reference to the "fluctuation" or "variation" of net power costs and makes arguments that are appropriate to a situation where there is a normal distribution of such fluctuation.[6] Only when it comes to establishing deadbands does CUB acknowledge that the distribution of actual net power cost outcomes is asymmetrical, thereby requiring asymmetric deadbands. CUB/100, Jenks 27.

C. PacifiCorp is Not Being Presently Compensated for Its Net Power Cost Risk.

The Opening Briefs of Staff and Intervenors are replete with suggestions that PacifiCorp does not need or deserve a PCAM because it is already being compensated for the risk of net power cost variability through its allowed rate of return. Staff Brief at 5; CUB Brief at 6; ICNU Brief at 16. The record demonstrates that this is not the case. Unquestionably, the Company has traditionally faced some measure of variability in net

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[6] CUB's Opening Brief accurately observes that there is a difference in the theoretical basis of its PCAM proposal and that of the Company. CUB Brief at 2. CUB's premise that the Commission is faced only with an issue of fluctuation of net power costs around a predicted value may well be the reason for the difference in theoretical approach.

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power costs and the risk of that historic variability may well be reflected in its allowed rate of return. In the past, the Company has not advocated a PCAM and has stood ready to assume what CUB describes as the "non-normalized cost fluctuations that the utility absorbs between rate cases." CUB at Brief at 6. PacifiCorp believes that its proposed 70/30 sharing mechanism provides more than adequate incentives for it to do its best to manage such "normal" fluctuations and exposes the Company to the potential for many millions of dollars of losses.[7] Contrary to ICNU's claim, PacifiCorp is not seeking a guarantee that it will achieve its allowed rate of return. ICNU Brief at 5. It seeks only a fair opportunity to do so.

The Company made this filing because, for the past five years, the amount of variability in the Company's net power costs has been hugely increased and that variability has been highly asymmetric. These circumstances have continued long after the 2000/2001 "Energy Crisis" referenced by CUB. CUB Brief at 5. No party has provided any evidence that this unprecedented level of risk has been reflected in rate of return allowances. To the contrary, Ms. Omohundro demonstrates that PacifiCorp's allowed rate of return has been derived from the results of "comparable" companies who are protected from these risks by various power cost adjustment mechanisms. PP&L/103, Omohundro 4.

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D. Staff and Intervenors Continue to Unfairly Characterize PacifiCorp's Proposed PCAM as Unreasonable.

Staff's Opening Brief suggests that PacifiCorp's proposed PCAM would "shift nearly all NVPC risk to customers." Staff Brief at 6. CUB claims the Company's proposal is "rife with inequities" and "so flawed as to be unworkable. CUB Brief at 1, 11. ICNU contends that PacifiCorp's proposal would "ensure" that it earned its allowed rate of return. ICNU Brief at 5. It appears that Staff and Intervenors reach these dramatic conclusions because

[7] The Company proposes that if the Commission elects to apply it proposed "two-part" deadband described in the PGE Order, a 90/10 sharing ration would be more reasonable. *See infra* at 2, 3.

they hold as a matter of faith the notion that any PCAM that does not include deadbands is outrageously generous to shareholders. Ideology aside, the only objective basis for determining the reasonableness of the parties' various proposals is to consider the numeric results they produce. PacifiCorp's Opening Brief does just that (at 12-17). There, it is demonstrated that PacifiCorp's proposal exposes its shareholders to the potential for substantial unrecovered costs, while the results of the CUB and Staff proposals are punitive and quixotic and at times counter-productive.

E. PacifiCorp Does Not Disagree With a Number of Staff's Recommendations.

Staff's Opening Brief makes a number of recommendations starting at page 8 of its Opening Brief.

PacifiCorp agrees that, in an ideal world, base rates would be set using stochastic modeling that provides a more realistic simulation of PacifiCorp's operations and captures the asymmetry of the variability in net power costs. However, the tools to do that have not yet been developed. PP&L/205, Widmer 2.

PacifiCorp agrees that if the parties are successful in setting base rates using stochastic modeling that captures asymmetrical outcomes, a deadband that excludes a reasonable range of normal variation is appropriate and both the deadband and the base level of net power costs should be updated annually.

PacifiCorp agrees that a PCAM should maintain the loss of load risk for the Company. PP&L/205, Widmer 3.

PacifiCorp always intended that natural gas sales for resale should be reflected in its PCAM. PP&L/205, Widmer 3.

PacifiCorp agrees that its PCAM should only be applicable to cost-of- service customers. PP&L/102, Omohundro 3.

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II. 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 CUB PCAM proposals neither afford adequate relief to the Company nor do they provide sensible and predictable results and incentives.

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CERTIFICATE OF SERVICE

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

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