

Davison Van Cleve PC

Attorneys at Law

TEL (503) 241-7242 • FAX (503) 241-8160 • mail@dvclaw.com
Suite 400
333 SW Taylor
Portland, OR 97204

August 12, 2013

Via Electronic Mail and Federal Express

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

Re: In the Matter of PACIFICORP 2014 Transition Adjustment Mechanism
Docket No. UE 264

Dear Filing Center:

Enclosed for filing in the above-referenced docket, please find the original and five (5) copies of the redacted version of the Industrial Customers of Northwest Utilities' Confidential Prehearing Memorandum. Also enclosed are the original and five (5) copies of the confidential pages of same, which are sealed pursuant to the General Protective Order in this docket.

Thank you for your assistance, and please do not hesitate to call our office with any questions.

Sincerely,

/s/ Jesse Gorsuch
Jesse Gorsuch

Enclosures

cc: Service List

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I have this day served the foregoing documents upon all parties in this proceeding by causing the same to be sent via electronic mail to each individual's last-known email address, as shown below, and by causing the confidential pages of same to be sent via First Class U.S. Mail, postage prepaid, to all parties who have signed the General Protective Order in this docket.

Dated at Portland, Oregon, this 12th day of August, 2013.

/s/ Jesse Gorsuch
Jesse Gorsuch

(W) CITIZENS' UTILITY BOARD OF OREGON OPUC DOCKETS ROBERT JENKS (C) G. CATRIONA MCCrackEN (C) 610 SW BROADWAY, STE 400 PORTLAND OR 97205 dockets@oregoncub.org bob@oregoncub.org catriona@oregon.org	(W) PUBLIC UTILITY COMMISSION OF OREGON JOHN CRIDER (C) PO BOX 2148 SALEM OR 97308-2148 john.crider@state.or.us
(W) PACIFIC POWER SARAH WALLACE (C) SENIOR COUNSEL 825 NE MULTNOMAH STE 1800 PORTLAND OR 97232 sarah.wallace@pacificorp.com	(W) MCDOWELL RACKNER & GIBSON PC KATHERINE MCDOWELL (C) 419 SW 11TH AVE., SUITE 400 PORTLAND OR 97205 katherine@mcd-law.com

<p>(W) REGULATORY & COGENERATION SERVICES INC DONALD W SCHOENBECK 900 WASHINGTON ST STE 780 VANCOUVER WA 98660-3455 dws@r-c-s-inc.com</p>	<p>(W) ENERGY STRATEGIES LLC KEVIN HIGGINS (C) 215 STATE ST - STE 200 SALT LAKE CITY UT 84111-2322 khiggins@energystrat.com</p>
<p>(W) SAFEWAY INC. LISSA MALDONADO GEORGE WAIDELICH 5918 STONERIDGE MALL ROAD PLEASANTON OR 94588-3229 lissa.maldonado@safeway.com george.waidelich@safeway.com</p>	<p>(W) NOBLE AMERICAS ENERGY SOLUTIONS, LLC GREG BASS 401 WEST A ST., STE. 500 SAN DIEGO CA 92101 gbass@noblesolutions.com</p>
<p>(W) PUC STAFF – DEPARTMENT OF JUSTICE MICHAEL WEIRICH (C) BUSINESS ACTIVITIES SECTION 1162 COURT ST NE SALEM OR 97301-4096 michael.weirich@state.or.us</p>	<p>(W) RICHARDSON ADAMS, PLLC GREGORY M. ADAMS (C) PO BOX 7218 BOISE ID 83702 greg@richardsonadams.com</p>
<p>(W) PORTLAND GENERAL ELECTRIC SERVICES INC JAY TINKER 121 SW SALMON 1WTC13 PORTLAND OR 97204 pge.opuc.filings@pgn.com</p>	<p>(W) PORTLAND GENERAL ELECTRIC DOUGLAS C. TINGEY 121 SW SALMON 1WTC-0702 PORTLAND, OR 97204 doug.tingey@pgn.com</p>

**(W) HUTCHINSON COX COONS ORR
& SHERLOCK**

SAMUEL L. ROBERTS (C)
777 HIGH ST., STE 200
P.O. BOX 10886
EUGENE OR 97440
sroberts@eugenelaw.com

**(W) PACIFICORP, DBA PACIFIC
POWER**

OREGON DOCKETS
825 NE MULTNOMAH., STE 2000
PORTLAND OR 97232
oregon.dockets@pacificorp.com

(W) WAL-MART STORES, INC.

STEVE W. CHRISS (C)

2001 SE 10TH ST.
BENTONVILLE, AR 72716-0550
stephen.chriss@wal-mart.com

**BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON**

UE 264

In the Matter of)	
)	
PACIFICORP)	INDUSTRIAL CUSTOMERS OF
)	NORTHWEST UTILITIES’
2014 Transition Adjustment Mechanism)	CONFIDENTIAL PREHEARING
)	MEMORANDUM
)	
)	

I. INTRODUCTION

The Industrial Customers of Northwest Utilities (“ICNU”) submits this prehearing memorandum summarizing ICNU’s positions in this Transition Adjustment Mechanism (“TAM”) proceeding that will set net power cost rates and transition adjustment credits for the 2014 calendar year. Despite record low gas prices, PacifiCorp has proposed to essentially keep its power costs unchanged and is requesting a small \$48,371 TAM-related rate decrease. The final Oregon rate change number will change as PacifiCorp updates its net variable power costs at least one more time in November 2013. ICNU recommends that the Oregon Public Utility Commission (“OPUC” or the “Commission”) further reduce PacifiCorp’s proposed Oregon net variable power costs by \$8.7 million to ensure that consumers pay the lower of cost or market for coal fuel expense, to reflect increased generation capacity at the Jim Bridger Unit 2, and to remove PacifiCorp’s proposal to reshape the hourly output of wind resources in GRID based on one year of historical data. ICNU’s adjustments are summarized below:

ICNU Power Supply Adjustments (\$ in Millions)		
Issue	PacifiCorp NPC ^{1/}	OR NPC Allocation
Coal Costs	\$27.4	\$6.8
Jim Bridger Heat Rate Improvement	\$3.3	\$0.8
Wind Energy Shaping	\$4.6	\$1.1
Total:	\$35.3	\$8.7

While ICNU did not raise issues related to the design of the net power cost updates in this proceeding, ICNU remains strongly opposed to the one-sided and arbitrary nature of the annual TAM update, and urges the Commission to open an investigation into the design of the annual power cost update proceedings. ICNU raised a number of concerns and recommended revisions to the TAM design in Docket No. UE 227 (the TAM two years ago). The Commission declined to make any adjustments, and did not correct the problem of PacifiCorp having incentives to withhold key information from parties, to potentially manipulate the update process, and to submit inaccurate load growth estimates in stand-alone TAM proceedings. Re PacifiCorp, Docket No. UE 227, Order No. 11-435 at 6 (Nov. 4, 2011). The Commission explained that fundamental changes to the TAM design “are to be appropriately addressed in a general rate revision docket or other proceeding, not part of a stand-alone TAM proceeding.” Id.

Accordingly, ICNU and the Citizens’ Utility Board (“CUB”) followed the Commission’s guidance, and proposed changes to the TAM in PacifiCorp’s next general rate

^{1/} NPC is Net Power Costs. Column one is a system wide number and column two reflects these adjustments on an Oregon basis.

case proceeding, Docket No. UE 246. ICNU and CUB did not propose to eliminate the TAM, but instead proposed revisions to reduce its harmful impact on ratepayers and minimize the opportunity for manipulation and abuse. Although the TAM was originally adopted in a PacifiCorp general rate case, the Commission declined to make any changes to the TAM in the general rate case, stating that it will “address any issues related to transition adjustment mechanisms globally, such as through a generic docket applicable to both Pacific Power and PGE.” Re PacifiCorp, Docket No. UE 246, Order No. 12-493 at 16 (Dec. 20, 2012).

The problems with the TAM design have not diminished, and may become worse as PacifiCorp is likely to file a stand-alone TAM next year—which provides greater opportunities to potentially manipulate the process to inflate its rates. ICNU urges the Commission to quickly open a generic investigation into its annual power cost rate proceedings so that any changes to produce a more balanced and transparent process can be incorporated into next year’s TAM.

ICNU also recommends that the Commission adopt revisions on how transition adjustment mechanism credits and charges are calculated for direct access customers, as proposed by Noble Americas Energy Solutions (“Noble Solutions,” formerly known as Sempra Energy Solutions). The original purpose of subjecting ratepayers to an annual power cost adjustment proceeding was to calculate transition credits and charges for direct access customers, but the PacifiCorp direct access program has been hindered by poor program design and implementation. The Commission should abandon the current approach and try a new methodology that might finally provide PacifiCorp’s retail customers with access to reasonably priced market alternatives.

II. BACKGROUND

A proper understanding of the Commission's market price rule will be critical in this proceeding, as will an appreciation for the history of the treatment of that standard, and specifically within the context of affiliate coal pricing. The rule governing affiliate supply sales to parent utilities provides that "sales shall be recorded in the energy utility's accounts at the affiliate's cost or the market rate, whichever is lower." OAR § 860-027-0048(4)(e). While this "lower of cost or market" standard ("LCM") went into effect as an officially adopted OPUC rule in 2003, the enactment of the rule changed nothing—the Commission has always followed the LCM standard when approving affiliate coal pricing.

In fact, PacifiCorp witness Cindy Crane cites orders dating back over thirty years which establish that the Commission has approved the Company's Bridger Coal Company ("BCC") costs when priced below market. PAC/600, Crane/8 (citing Re Pacific Power, Docket No. UF 3508, Order No. 79-754 (Oct. 29, 1979), and Pacific Power, Docket No. UF 3779, Order No. 82-606 at 7 (Aug. 18, 1982)). Likewise, in the most recent order on the Company's BCC supply agreement, the Commission expressly incorporated and adopted a Staff recommendation which included an assertion "that the appropriate standard the Commission has used and continues to use for ratemaking is its affiliate interest transfer-pricing requirements, namely that the price is the lower of cost or fair market rate." Re PacifiCorp, Docket No. UI 189, Order No. 01-472 at Appendix A, p. 2 (June 12, 2001) (emphasis added).

Each of these decisions was issued before 2003, when the present, governing affiliate LCM rule went into effect (and the three, specifically referenced orders above are by no means an exhaustive list). Indeed, Staff has stated on record in a prior TAM proceeding that, far

from ushering in some bold new era of LCM analysis for affiliate transactions, OAR § 860-027-0048 simply “affirms the Commission’s Transfer Pricing Policy.” Re PacifiCorp, Docket No. UE 207, Staff/200, Dougherty/7; Staff/400, Dougherty/17. Moreover, a review of testimony in recent TAM proceedings establishes that both Staff and PacifiCorp have analyzed BCC and similar affiliate coal pricing in explicit regard to the LCM standard. E.g., Docket No. UE 227, Staff/200, Bahr/2, PPL/105, Duvall/33; Docket No. UE 216, Staff/200, Dougherty/2; Docket No. UE 207, Staff/200, Dougherty/8, 21.

In the full light of the Commission’s unchanging LCM policy on affiliate transactions and its specific treatment on BCC pricing, PacifiCorp filed this 2014 TAM on March 1, 2013, proposing net variable power costs of approximately \$1.457 billion on a Company-wide basis for 2014, with an Oregon allocation of \$363.1 million. The Company’s last TAM filing included system net power costs of \$1.473 billion and an Oregon allocation of \$362.7 million. Factoring in Oregon’s change in load from the last proceeding, this change represented an approximate \$1 million decrease to Oregon rates. ICNU/100, Deen/2. This is consistent with how ICNU recommends load changes should be accounted for in both stand-alone TAMs and TAMs filed concurrent with a general rate case.

PacifiCorp’s initial filing included testimony from three witnesses: Greg Duvall, Cindy Crane, and Judith Ridenour. Although PacifiCorp addressed coal cost issues in its initial testimony, PacifiCorp decided only to address the Commission’s coal transfer pricing policy in rebuttal testimony, even though the issue of the Commission’s market transfer pricing rule for coal costs has been controversial in numerous past TAMs, and the Company knew it would be an issue again, as PacifiCorp’s coal costs have exceeded market. PacifiCorp withheld this

information, fully aware that, unlike in past TAM proceedings that included five rounds of testimony and provided Staff and intervenors an opportunity to respond to Company arguments raised in rebuttal, this proceeding only includes three rounds of testimony and no opportunity for parties to respond to PacifiCorp's new arguments raised for the first time in rebuttal.

Staff and intervenors filed responsive testimony on June 4, 2013, and PacifiCorp filed rebuttal testimony on July 15, 2013. PacifiCorp's rebuttal testimony essentially ambushed parties by providing substantive support for the coal costs and wind shaping costs for the first time after Staff and intervenors filed their testimony. In addition to responding to the revenue requirement adjustments proposed by Staff and intervenors, PacifiCorp increased its net power cost estimate from a \$1 million Oregon rate decrease to an approximate \$48,371 rate decrease. PAC/500, Duvall/2. The Company now estimates that its system wide net power costs are about \$1.461 billion, which is an increase of about \$3.5 million from its initial filing, and its Oregon allocated net power costs are approximately \$364.1 million, or \$0.9 million higher than its initial filing. PacifiCorp will likely further increase its net power costs in its next round of updates—with each update providing less opportunity for review and no scheduled opportunity to submit responsive testimony.

III. LEGAL STANDARD

PacifiCorp has the burden of proof to establish that its proposed rate increase is just and reasonable. ORS § 757.210(1); Pac. Nw. Bell Tel. Co. v. Sabin, 21 Or. App. 200, 213-14 (1975). The Commission also has the independent responsibility to ensure that PacifiCorp's customers are only charged just and reasonable rates. ORS § 756.040(1); Pac. Nw. Bell Tel. Co., 21 Or. App. at 213. The burden of proof and persuasion is borne by the Company throughout the

proceeding and does not shift to any other party. Re PGE, Docket No. UE 228, Order No. 11-432 at 3 (Nov. 2, 2011). PacifiCorp also has the responsibility to provide the parties and the Commission with sufficient evidence to meet its burdens, and it is inappropriate for the Company to wait to provide both evidence and arguments until late in proceedings to prevent other parties from having a sufficient opportunity to respond. See Docket No. UE 228, Order No. 11-432 at 8, 15-17.

IV. ARGUMENT

A. PacifiCorp's Coal Expense Should Be Based on the Lesser of Cost or Market

Oregon law and policy requires that consumers receive the benefit of “lesser of” cost or market pricing for transactions with utility affiliate suppliers. Moving the price of the Jim Bridger plant coal supply to a market price reduces the Oregon allocated NPC by approximately \$6.8 million.

Specifically, the governing rule subsection in this case provides: “If services or supplies (except for generation) are not sold to an energy utility by an affiliate Sales shall be recorded in the energy utility’s accounts at the affiliate’s cost or the market rate, whichever is lower.” OAR § 860-027-0048(4)(e). A simple application of this subsection would mean that PacifiCorp must record all of its BCC purchases at the market rate, if BCC pricing exceeds the market rate.

Support for this straightforward application of the rule is found in the 2010 TAM proceedings. There, Staff found it “important to note that OAR 860-027-0048 addresses lower of cost or market pricing. It does not address a company’s penetration or participation in the market.” Docket No. UE 207, Staff/400, Dougherty/20 (emphasis added). In other words, the

rule only directs the Commission to determine if a market rate exists which is lower than the affiliate's cost and, if so, the Commission applies the market rate to the affiliate supply—and that is the entire and only effect.

Staff took this position in response to PacifiCorp comments alleging limited availability of market supply. Id. In this regard, Staff explained that “[t]he fact that nonaffiliated Black Butte coal supplies approximately one-third of Bridger clearly demonstrates that a nonaffiliated supply is available.” Id. at 18 (emphasis added). This precisely mirrors the factual situation in these proceedings, in which two-thirds of the Bridger plant's coal will be supplied by BCC, with the other one-third coming from Black Butte. PAC/600, Crane/9. Likewise, in these proceedings PacifiCorp cites to Order No. 79-754 as authority for Commission approval of BCC pricing. Id. at 8. In the 2010 TAM, Staff quoted this very order to demonstrate that PacifiCorp itself acknowledged, as far back as 1979, that “an alternate market exists for coal sold to PP&L.” Docket No. UE 207, Staff/400, Dougherty/18. PacifiCorp's present citation to this order should be well taken, then, to the extent it establishes the long-standing availability of market coal.

Staff's interpretation of OAR § 860-027-0048 appears reasonable and applicable to these proceedings, “since there is a market and pricing available (comparable and available coal).” Id. at 19. In the current TAM, the Company has identified Black Butte coal as “comparable” to BCC coal, PAC /200, Crane 15, while the provision of Bridger coal by Black Butte establishes its availability. As ICNU witness Michael Deen testifies, Black Butte coal provides more energy per unit than BCC coal. ICNU/100, Deen/8. Accounting for this superior heat content, Mr. Deen determined that the cost of Black Butte coal was only \$ [REDACTED] per MMBtu, compared with a cost of approximately \$ [REDACTED] per MMBtu for BCC coal. Id.

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Applying the LCM mandate means that BCC purchases should be recorded at the market rate of \$ [REDACTED] per MMBtu, as it is lower than the BCC cost. Using this market rate in these proceedings should lower PacifiCorp's Oregon allocated NPC by about \$6.8 million. Id. at 10.

Alternatively, if the Commission elects not to apply the market rate to all BCC purchases, ICNU requests that the market rate be applied, at a minimum, to the available excess capacity at the Black Butte mine and the full storage capacity at the Bridger plant. According to Ms. Crane, the total excess production capacity estimated for the Black Butte mine in 2014 is [REDACTED] million tons. PAC/600, Crane/11. Also, the 2013 PacifiCorp Coal Inventory Policies and Procedures state that the Bridger plant's inventory capacity is [REDACTED] million tons. PacifiCorp Response to OPUC Data Request 9, Attachment OPUC 9-2 at 13. The Commission should expect the Company to have minimized costs by filling Bridger capacity with the lowest price coal available. Hence, under the Commission's rule the market rate of \$ [REDACTED] per MMBtu must be applied at a minimum to [REDACTED] million tons of BCC coal purchases. This is the sum of excess Black Butte coal which should have been purchased using the Bridger plant capacity. Applying the market rate to this quantity lowers PacifiCorp's Oregon net power costs by about \$3.4 million.

The Company, however, opposes any application of the LCM standard. PacifiCorp appears to be presenting a false dichotomy regarding the Commission's treatment of affiliate supply pricing generally, and BCC pricing, particularly: "For several decades, the Commission has applied a cost-based approach instead of OAR § 860-027-0048 in approving the transfer price." PAC/600, Crane/9. In short, the Company would have the OPUC believe that

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two mutually exclusive standards governing affiliate transactions exist, with the latter applying to BCC pricing, i.e.: 1) the LCM policy articulated in OAR § 860-027-0048; and 2) an alternate, “cost-based” standard which relies only upon fairness and reasonableness considerations. In reality, the Commission has never separated its review of BCC transactions into such distinct and incompatible categories. Rather, the Company’s legal strategy seems focused on artificially pulling certain findings, relating to “cost-based” and “reasonable” terminology, out of the larger context in which such terms were considered by the Commission—context which, when taken in its entirety, expressly incorporated LCM policy along with the approval of fair, reasonable, and cost-based transactions. If the standard is as the Company suggests, then the protections from the affiliate rule evaporate.

In all events, even if the Commission were simply to operate under PacifiCorp’s interpretation of the standard, the Company fails to establish that the prices are objectively reasonable and that it has prudently investigated all other low cost options for coal. Ms. Crane testifies that, dating back to “the 1970s, the Commission has allowed PacifiCorp to purchase coal from BCC at the actual, prudent costs of production.” Id. at 8 (emphasis added). Thus, PacifiCorp itself acknowledges that the Commission only allows “prudent” BCC purchases. PacifiCorp has failed to provide affirmative evidence that it was prudent in foregoing opportunities to search out and secure available, low cost coal in lieu of more expensive BCC supply, with the unutilized capacity at the Black Butte mine and the underutilized reserve capacity at the Bridger plant being two primary examples.

B. The Commission Should Account for the Jim Bridger Heat Rate Improvement

PacifiCorp has made a significant capital investment to upgrade to its Jim Bridger Unit 2 and has charged Oregon customers all costs associated with the upgrade, but has not accounted for all the net power cost benefits that are expected to accrue to ratepayers. The Commission should require PacifiCorp to reflect the increased efficiency and generation capacity that results from this upgrade, which would reduce Oregon net power costs by approximately \$0.8 million.^{2/}

There is no factual dispute that PacifiCorp has made significant capital investment in its Jim Bridger 2 facility that is designed to increase generating capacity with no additional fuel requirement to maintain maximum output. PacifiCorp included \$31 million related to this efficiency upgrade in its concurrently filed general rate case, and the Company supports the prudence of the investment on the grounds that it will result in a large efficiency improvement. ICNU/100, Deen/3; Docket No. UE 263, PAC/400, Testimony of Dana Ralston. PacifiCorp has proposed to charge Oregon customers the full costs of the efficiency upgrade, but to exclude the net power cost benefits of the efficiency improvements. ICNU/100, Deen/3-4. PacifiCorp witness Dana Ralston and ICNU witness Michael Deen's testimony explain the specific efficiency improvements, how they will lower net power costs, and why they are likely to occur during the period in which the TAM rates will be in effect. Id. at Deen/3-6; Docket No. UE 263, PAC/400, Testimony of Dana Ralston.

^{2/} In its initial filing, the Company inadvertently excluded some months from the heat rate calculation of all its coal units. PAC/500, Duvall/4-5, 11-12. As the Company incorporated this change in its rebuttal filing, the Oregon allocated NPC impact of ICNU's heat rate adjustment is now \$0.8 million rather than \$1.2 million. Id.

PacifiCorp filed rebuttal testimony by Greg Duvall on the Jim Bridger heat rate adjustment that does not dispute that the efficiency upgrade will occur or that it is expected to lower the Company's net power costs. Instead of addressing the merits of Mr. Deen's adjustment, PacifiCorp argues that accounting for the efficiency improvements would be inconsistent with the prior recommendation of ICNU witness Randall Falkenberg in Docket Nos. UM 1355 and UE 216, and the terms of the TAM stipulation in Docket No. UE 216. PAC/500, Duvall/21-24. The Commission should treat as highly suspect PacifiCorp's arguments on this issue, in which there is no factual dispute that there will be net power cost savings, and which instead rely entirely upon distorted and one-sided interpretations of the testimony of a retired ICNU witness who is not testifying in this case. The facts in the current case do not support allowing PacifiCorp's lopsided approach of charging customers for the upgrades and keeping the benefits of the upgrades for itself based on testimony from 2010.

A review of Mr. Falkenberg's actual testimony and the terms of the UE 216 Stipulation from 2010 contradict PacifiCorp's procedural arguments and support accounting for the Jim Bridger 2 efficiency upgrades in this proceeding. Mr. Falkenberg's testimony in the general forced outage rate investigation (Docket No. UM 1355) addressed an entirely different issue (i.e., whether forced outage rates should include a ramping adjustment). Mr. Falkenberg recommended that rolling outage rates should generally be used, but that it would be appropriate to reflect increased efficiencies when customers are charged the specific costs and there is an objective manner to measure efficiency improvements. Mr. Falkenberg made the same points in his testimony in 2011 TAM (Docket No. UE 216), in which he recommended against a PacifiCorp proposed adjustment in its heat rates because they were "speculative," only looked at

one side of the issue, and failed to consider all the realistic impacts of the capital changes.

Docket No. UE 216, Testimony of Randall Falkenberg at 52-55. The net power cost benefits of the Jim Bridger 2 upgrades are different and should be accounted for since they are undisputed, not speculative, and consider all relevant factors.

The UE 216 Stipulation provided that PacifiCorp would not propose one-sided heat rate adjustments in TAM proceedings, absent a change in facts or circumstances identified by the Company. Docket No. UE 216, Order No. 10-363, Appendix A at 3 (Sept. 16, 2010). Thus, the UE 216 Stipulation was not an absolute bar on the Company proposing changes to its heat rates, if they were appropriately supported. More importantly, the limitations on proposing heat rate adjustments only applied to the Company. Id. In order to prevent the Company from making the exact argument it is making in this case, the parties specifically inserted language in the UE 216 Stipulation that stated the limitations “apply to the Company. Staff and intervenors reserve the right to review, challenge and propose alternatives” Id. The Commission should reject PacifiCorp’s creative efforts to apply the limitation on ICNU, when the plain meaning of the stipulation allows and encourages ICNU to propose different methodologies.

C. The Commission Should Reject PacifiCorp’s Novel Wind Energy Shaping Charge

ICNU, Staff and CUB all recommend that the Commission reject PacifiCorp’s proposal to reshape the hourly output of wind resources in GRID based on one year of historical data. Removing this change reduces the Oregon allocated NPC \$1.1 million. PacifiCorp included this new wind energy shaping charge in its TAM filing, but failed to identify or explain the basis for the change, and only provided a substantive justification for the change in its last round of rebuttal testimony that parties do not have an opportunity to respond to. The

Commission should reject this approach of justifying changes by ambush, and conclude that PacifiCorp has failed to meet its burden of proof to justify this type of change.

PacifiCorp's wind energy shaping charge should also be rejected as it will over estimate the Company's wind related net power costs. Historically, PacifiCorp has forecast wind energy in its GRID model using median energy, which has an equal probability of over or under forecasting in any given year. PacifiCorp then used the forecast to include in the GRID model expected wind generation divided into four-hour blocks. The Company has used a similar wind energy forecast in the past, but this year has used only energy output from a single year (2011) to create an hourly generation profile.

The Commission should not utilize a single year of wind energy output to set rates absent overwhelming evidence that an isolated, single year of data can accurately predict costs in the future. Wind energy resources typically have a high degree of inter-annual variability in output, which has not been proven to be predicted by one year of data. Typically, modeling of these types of variable resources should rely upon ten or more years of operational data.

ICNU/100, Deen/10-11. While PacifiCorp uses complex mathematical equations to claim that a single year of wind data is sufficient, the Company did not provide this information with its initial filing and it has not been reviewed or vetted, and has not been shown to accurately predict its wind energy output. PAC/500, Duvall/12-20. PacifiCorp's single year of wind data approach should also be rejected because it has not shown that its current GRID modeling approach to wind generation and wind integration costs does not already fully account for the full costs of variable wind generation. ICNU/100, Deen/11. Accepting PacifiCorp's change will have the practical result of allowing PacifiCorp to overestimate its wind generation costs in the TAM.

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V. CONCLUSION

ICNU urges the Commission to reduce PacifiCorp's Oregon net power costs by about \$8.7 million to ensure that Oregon ratepayers pay the lower of cost or market coal costs, obtain the benefits of the capital improvements at Jim Bridger 2, and not overpay the costs of wind generation. The Commission should also adopt Noble Solution's revisions to the calculation of the direct access transition adjustment mechanism and initiate an investigation into the procedural rules for updating PacifiCorp's and PGE's net power costs.

Dated this 12th day of August, 2013.

Respectfully submitted,

DAVISON VAN CLEVE, P.C.

/s/ Irion A. Sanger

Irion A. Sanger

333 S.W. Taylor, Suite 400

Portland, Oregon 97204

(503) 241-7242 telephone

(503) 241-8160 facsimile

ias@dvclaw.com

Of Attorneys for the Industrial Customers of Northwest
Utilities