BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UM 1081

In the Matter of the PUBLIC UTILITY COMMISSION OF OREGON STAFF's Investigation Into Direct Access Issues for Industrial and Commercial Customers under SB 1149.	**THE INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES' CLOSING BRIEF**

Pursuant to OAR §§ 860-014-0090 and 860-013-0040, and the Administrative Law Judge's ("ALJ") June 29, 2004 Ruling, the Industrial Customers of Northwest Utilities ("ICNU") submits this Closing Brief responding to the Opening Briefs of PacifiCorp (or the "Company") and the Oregon Public Utility Commission ("Commission" or "OPUC") Staff.

I. INTRODUCTION

PacifiCorp attempts to minimize the dispute in this case, stating that "there is now more agreement than disagreement in the parties' positions." PacifiCorp Brief at 1. While the differences may seem minor, the underlying philosophical debate is fundamental. PacifiCorp's direct access program has been a complete failure, due in large part to its methods for planning for direct access load and calculating the transition adjustment ("Transition Adjustment"). PacifiCorp uses a load resource forecast that assumes zero direct access load. PacifiCorp also has a resource strategy of filling all

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open positions on a rolling 24-month basis. The net effect of these strategies is that departing direct access load always results in PacifiCorp selling off already purchased power in a low value transaction. PacifiCorp Brief at 4.

ICNU has demonstrated in this case that PacifiCorp's proposed interim Transition Adjustment calculation makes direct access uneconomic. Revised ICNU/107. If the Commission adopts the resource planning paradigm described above, then any requirement for PacifiCorp to continue to offer direct access will be both futile and a waste of resources. Similarly, PacifiCorp's suggested use of the GRID model also may offer no solution. As demonstrated by Mr. Widmer, the use of GRID could result in a Transition Adjustment that is even more uneconomic than PacifiCorp's interim proposal. Revised ICNU/107; PPL/103; PPL/300, Widmer/3; PPL/302.

This case presents a fundamental policy question: Is a transition mechanism that always renders direct access uneconomic a barrier to a competitive market that the Commission has a statutory obligation to remedy? ICNU submits that the answer is yes.

All parties to this case support a two-step remedy. First, the Commission should adopt an interim result that will apply to the November 2004 direct access election window. Second, the Commission should initiate a process to establish a long-term solution for calculating the Transition Adjustment. For the interim, the Commission should adopt ICNU's Four Hubs avoided purchase approach, because it is the most accurate reflection of the impact of direct access on PacifiCorp's system, and it is the only alternative that creates a realistic opportunity for direct access to succeed. For the

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longer term, the Commission should require PacifiCorp to pursue an avoided cost approach to calculating the Transition Adjustment, similar to Portland General Electric Company ("PGE"). Unlike PacifiCorp, PGE assumes that the departure of direct access load will allow it to avoid power purchases and associated wheeling and losses. Use of the GRID model in developing the Transition Adjustment may be appropriate if GRID can be used to value these avoided purchases.

II. ARGUMENT

A. The Transition Adjustment Must Measure the Value That PacifiCorp's Resources Provide to Direct Access Customers

PacifiCorp and Staff do not correctly identify the standard under which the Commission should evaluate the reasonableness of the Transition Adjustment. PacifiCorp states that the Commission should approve a fair and equitable Transition Adjustment that balances the Commission's mandates of removing barriers to competition with preventing unwarranted cost shifting. PacifiCorp Brief at 1-2. Staff argues that there are two purposes for the Transition Adjustment: 1) to accurately measure the direction of any cost shift; and 2) to indicate the level of transition credits that might reasonably balance the interests of consumers. Staff Brief at 2. Staff assumes that there will be cost shifts and that the first step in evaluating a Transition Adjustment is to calculate the amount of such cost shifts. Id. Thus, for PacifiCorp and Staff, the primary purpose of the Transition Adjustment is to measure and avoid cost shifts.

Staff and PacifiCorp skip an important statutorily required step in evaluating an appropriate Transition Adjustment by failing to acknowledge that the

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Commission's primary statutory obligation is to accurately ascertain the Company's economic utility investments. ORS § 757.607(2). Similarly, PacifiCorp and Staff do not recognize that economic utility investments refer to the full benefits of the utility's resources that are no longer available to consumers because they elected direct access. ORS § 757.600(10). As a result, the first step in this proceeding is to value the utility's resources from the perspective of the direct access customer, which will then allow the Commission to ascertain whether the Transition Adjustment is a barrier to direct access or results in any unwarranted cost shifts. ORS § 757.646(1), (2).

PacifiCorp and Staff also claim that the Transition Adjustment should not permit any unwarranted cost shifting, but they do not adequately explain the difference between warranted and unwarranted cost shifts. Staff also argues that shifting costs could somehow cause remaining customers' rates to no longer be just and reasonable. Staff Brief at 3. Contrary to Staff's assertions, Oregon law does not prohibit cost shifting, but only "unwarranted" cost shifts. Unwarranted is defined as "lacking adequate or official support: UNJUSTIFIED, UNAUTHORIZED." Webster's Third New Int'l Dictionary 2514 (1993). According to this definition, a cost shift would be warranted if it was justified or authorized by adequate or official support, such as fulfilling other statutory obligations. Thus, shifting costs is warranted to fulfill the Commission's directive to remove competitive barriers or to ensure that the benefits of economic utility investments are passed through to direct access customers.

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B. PacifiCorp and Staff's Proposal Does Not Reflect PacifiCorp's Response to Direct Access

PacifiCorp and Staff assert that their self-described "market even" Transition Adjustment is more reasonable than one based on avoided purchases. PacifiCorp Brief at 1, Staff Brief at 1-2. The Staff and PacifiCorp proposal is based "on the assumption that the impact of direct access on PacifiCorp's operations is an equal mix of increased sales and avoided purchases." Staff Brief at 1. As explained in ICNU's Opening Brief, while Staff and PacifiCorp's proposal is simple, it does not accurately reflect that both the amount and value of avoided purchases should exceed the amount and value of any increased sales in the short-term. ICNU Brief at 14-19. Mr. Apperson admitted that, as a practical matter, the Company would take a variety of actions to respond to direct access load loss, including avoided purchases. Hearing Transcript ("Tr.") at 62, lines 16-25. PacifiCorp and Staff's approach also is inconsistent with a functioning, long-term direct access program under which PacifiCorp should make few, if any, additional sales. ICNU Brief at 23-26.

Staff and PacifiCorp fail to recognize that the Company's failure to plan on load selecting direct access is the reason PacifiCorp does not avoid purchases for all of its direct access load. PacifiCorp plans on no participation in its direct access program and acquires resources to meet all of its load that is eligible for direct access. ICNU Brief at 16. PacifiCorp's customers that elect direct access will be charged additional costs because the Company has planned on no direct access load loss. This reduces the value of its freed-up resources and causes customers not to choose direct access. In contrast, if

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PacifiCorp planned on load selecting direct access, then PacifiCorp would avoid additional purchases and increase the value of the Transition Adjustment. Planning on direct access load loss could provide direct access an opportunity to succeed, while PacifiCorp and Staff's proposal unnecessarily undervalues the Company's freed-up resources and is a barrier to direct access.

C. ICNU's Avoided Purchase Transition Adjustment Does Not Shift Costs

PacifiCorp claims that an avoided purchase Transition Adjustment is a "results-driven argument" designed only to make direct access an economic option. PacifiCorp Brief at 9. Similarly, Staff suggests that ICNU and EPCOR may argue "that the Commission is statutorily required to determine transition credits as to make direct access attractive to customers . . . ." Staff Brief at 3. PacifiCorp and Staff also assert that the only way to make direct access economic is to shift costs to PacifiCorp or customers that remain on cost-of-service rates. Staff Brief at 4-5; PacifiCorp Brief at 7-9.

ICNU's position is not that the Commission must make direct access an economic option, but that the only way for direct access to be an economic option is for the Transition Adjustment to pass through the full value of PacifiCorp's economic utility investments. Staff appears to agree with the principle that passthrough of less than 100% of PacifiCorp's economic utility investment may be a barrier to competitive markets and inconsistent with Oregon law. Staff Brief at 2. However, Staff and PacifiCorp propose a Transition Adjustment that does not accurately calculate the value that PacifiCorp's resources have to direct access customers and that does not fully pass through the benefits of the Company's economic utility investments.

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The Transition Adjustment adopted in this proceeding should be consistent with the Commission's statutory obligation "to eliminate barriers to the development of competitive retail market structure." ORS § 757.646(1). While this permits the Commission to shift costs from direct access customers to the Company or remaining ratepayers to remove competitive barriers, ICNU has not urged the Commission to shift any costs in this proceeding. Instead, ICNU has argued that, if the Commission must decide between two competing proposals that do not perfectly capture the value of the Company's economic utility investment, then the Commission should approve the Transition Adjustment that is consistent with its obligation to remove barriers to competitive markets and moves toward a long-term direct access solution. ICNU Brief at 6-8, 29-30.

Staff and PacifiCorp argue that an avoided purchase based Transition Adjustment would result in large, unwarranted cost shifts. Staff Brief at 4-5; PacifiCorp Brief at 7-9. According to Staff, the alleged cost shifts would occur because PacifiCorp would absorb, or pass on to other customers, the "wheeling costs incurred when its operational response is to sell the power" freed-up due to direct access. Staff Brief at 5. PacifiCorp believes that cost shifts will occur because an avoided purchase Transition Adjustment will "shift the cost of ESS transmission away from either the ESS or the direct access customer to the utility's remaining customers." PacifiCorp Brief at 9. This description misrepresents ICNU's proposal. The transmission component of ICNU's proposed Transition Adjustment reflects the value of freed-up transmission, not a subsidy of transmission costs incurred by an ESS.

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An avoided purchase based Transition Adjustment is unlikely to actually shift any costs to PacifiCorp or its remaining cost-of-service customers. EPCOR Brief at 10-15; ICNU Brief at 14, 19. Failure to compensate direct access customers for the value of this freed-up transmission inappropriately reduces the value of the Transition Adjustment and allows PacifiCorp to retain these benefits. As EPCOR points out, in the short term, PacifiCorp may use freed-up transmission for other purposes, such as entering into buy-sell agreements. EPCOR Brief at 3, 7-15. In the long term, freed-up transmission will allow PacifiCorp to avoid additional transmission purchases. Id.

Staff asserts that the cost shifts associated with an avoided purchase Transition Adjustment could be significant and result in a "long-term subsidization of direct access by PacifiCorp's cost-of-service customers." Staff Brief at 4. There will not be any long-term cost shifts because this proceeding is only establishing an interim Transition Adjustment. More importantly, the cost shifts suggested by Staff are unlikely to occur because the Company will only make sales of freed-up power if modest amounts of load elect direct access. ICNU Brief at 18-19. The only way in which cost shifts could occur is if larger amounts of load elect direct access and PacifiCorp does not plan on any direct access load. Under these circumstances, PacifiCorp would make sales of freed-up resources and potentially incur transmission costs that are not recovered from direct access customers. This scenario seems unlikely given the lack of direct access participation to date.

The Commission could address any concerns regarding potential cost shifts caused by large amounts of load selecting direct access by capping overall

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participation in the Company's direct access program during the interim period. These potential cost-shifts can be avoided in the long-term if the Commission requires PacifiCorp to adjust its resource acquisition strategy to plan on load electing direct access. This solution is preferable to Staff and PacifiCorp's Transition Adjustment, which will: 1) charge direct access customers for transmission wheeling costs that PacifiCorp is unlikely to incur; and 2) fail to credit direct access customers for transmission wheeling savings that PacifiCorp will experience.

D. PacifiCorp and Staff Admit that It Is Inappropriate to Value PacifiCorp's Resources at Only the Mid-Columbia Market Hub

Staff and PacifiCorp support a long-term GRID based Transition Adjustment that would include "the market value of power at PacifiCorp's four primary hubs" and "ultimately capture the system value of the freed-up load in the manner advocated by ICNU . . . ." Staff Brief at 7; PacifiCorp Brief at 10. Despite supporting a long-term proposal to provide direct access customers with the value of PacifiCorp's ability to access the Four Hubs, PacifiCorp and Staff argue that the interim Transition Adjustment should value PacifiCorp's freed-up resources at only the lower value Mid-Columbia market hub. Id. Mr. Galbraith admitted that Staff's proposal was inconsistent with GRID. Tr. at 139, line 13.

ICNU's proposal is based on the fact that PacifiCorp operates its system on an integrated basis, a fact that was recently confirmed by the Federal Energy Regulatory Commission ("FERC") when it approved a Four Hub approach to pricing energy imbalances over the objection of EPCOR and Sempra. PacifiCorp, 108 FERC ¶

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61,068, mimeo at 3 (2004). Furthermore, PacifiCorp uses the Four Hubs to serve direct access eligible customers while they are on cost-of-service rates. As explained in ICNU's Opening Brief, customers eligible for direct access currently benefit from PacifiCorp's ability to access the Four Hubs. ICNU Brief at 26-29. Similarly, if load departed for direct access, PacifiCorp would make avoided purchases and increased sales at the Four Hubs, not just the Mid-Columbia market hub. Id.; Staff/102. Likewise, it is fundamentally inconsistent for PacifiCorp to charge customers for imbalance energy based on an average of market prices at the Four Hubs, while using the lower value Mid-Columbia price to calculate its Transition Adjustment. ICNU Brief at 26-29. Therefore, valuing the Transition Adjustment based on only the Mid-Columbia market hub does not pass through to direct access customers the full value of their economic utility investments but instead allows PacifiCorp to retain these benefits for itself.

While Staff does not explain its opposition to the use of the Four Hubs, PacifiCorp alleges that ICNU's proposal could create "a windfall for direct access customers at the expense of other customers." PacifiCorp Brief at 10. PacifiCorp's position, that direct access customers should receive zero value for the Company's ability to access the Four Hubs, is not based on an assertion that the Company does not access the Four Hubs to serve direct access eligible customers, but is based on a concern that ICNU's proposal may overvalue these resources. PacifiCorp's Brief also fails to address the fact that any overvaluation due to the use of the Four Hubs in the Transition Adjustment is at least partially offset by increased energy imbalance charges based on the value of PacifiCorp's resources at the Four Hubs.

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ICNU acknowledges that the Four Hubs approach approximates the changes in system operations suggested by GRID. Depending on the amount of direct access load, GRID model results suggest that PacifiCorp would access the Mid-Columbia for 27% to 56% of the avoided purchases and increased sales. Staff/102. The more direct access load loss, the larger the number of transactions at the Mid-Columbia market hub. Id.

If PacifiCorp and Staff were truly concerned about adopting an accurate interim Transition Adjustment, then they would propose a methodology that they believe reflects the actual value of PacifiCorp's ability to access other market hubs. This would be consistent with PacifiCorp's and Staff's position that a long-term Transition Adjustment should pass through the value of the Four Hubs to direct access customers. Staff Brief at 6-7; PacifiCorp Brief at 10. However, instead of proposing to adjust the interim Transition Adjustment so that it would capture some of the value of PacifiCorp's ability to access other market hubs, PacifiCorp and Staff simply propose that direct access customers receive none of this value.

If the Commission is concerned about potential accuracy of the Transition Adjustment due to use of the Four Hubs, the Commission could adopt a compromise between equal use of all four hubs and only the Mid-Columbia market hub. For example, the Commission could value PacifiCorp's freed-up power based on 50% at the Mid-Columbia and 50% at the remaining market hubs. Any compromise should err on the side of direct access customers because they will be charged energy imbalance charges entirely based on the Four Hubs, not the Mid-Columbia market hub only. It is

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inappropriate to base a Transition Adjustment on valuing the Company's resources at only the Mid-Columbia market hub, because it will undervalue PacifiCorp's freed-up resources and fail to pass through the full value of the Company's economic utility investment.

E. PacifiCorp Admits that Failure to Adopt an Avoided Purchase Transition Adjustment Will Prevent Direct Access in Its Service Territory

PacifiCorp's Brief admits that neither its current nor its proposed Transition Adjustment will provide an economic option for customers to elect direct access. PacifiCorp and Staff acknowledge that no customers have elected direct access and that the current Transition Adjustment is at least partly to blame. PacifiCorp Brief at 4-5; Staff Brief at 4-5. PacifiCorp also recognizes that, if the Commission adopts the Company's proposed Transition Adjustment, the only economic option for large direct access eligible customers will be the Company's Kickstart pilot program. PacifiCorp Brief at 1. In addition, Mr. Galbraith admitted at hearing that the Staff/PacifiCorp proposal would render direct access uneconomic. Tr. at 140, lines 22-25.

Despite the failure to provide a workable direct access proposal, PacifiCorp disingenuously claims that its proposals in this proceeding have been "designed to encourage greater direct access participation." Id. at 5. This assertion is false because PacifiCorp knew that its initial proposal in this case would not result in much direct access load. Confidential ICNU/116 at 11. ICNU has demonstrated in this

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proceeding that the Staff/PacifiCorp proposal will make direct access uneconomic, while the ICNU proposal is nearly neutral. Revised ICNU/107.[1/]

PacifiCorp attributes the failure of its direct access program to its "low cost of service rates and satisfied customers." PacifiCorp Brief at 4. This claim is inaccurate. By using a methodology that requires PacifiCorp to dispose of surplus power when customers choose direct access, the Transition Adjustment will make direct access uneconomic regardless of whether the cost of service rate is lower or higher than market prices. Hence, customers are not necessarily satisfied with PacifiCorp, they simply are avoiding uneconomic choices.

F. There is No Consensus Agreement Regarding PacifiCorp's Long-term Transition Adjustment

PacifiCorp and Staff assert that the Commission should approve the use of the Company's GRID model for the Company's long-term Transition Adjustment. Staff Brief at 5-6; PacifiCorp Brief at 6-7. PacifiCorp asserts that this is the "consensus" position that all parties have agreed upon. PacifiCorp Brief at 6. All the parties have not agreed to the use of the GRID model for the Company's long-term Transition Adjustment. ICNU has expressed serious concerns about the use of GRID given the Company's rolling 24-month resource acquisition strategy. *See* ICNU Brief at 7-8, 15-16.

In addition to the problems identified in ICNU's Opening Brief, the GRID model inappropriately assumes that PacifiCorp is in load/resource balance before

[1/] While the avoided purchase methodology based on Mid-Columbia prices results in an overall savings, the cost of imbalances charges was not included in the Exhibit.

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calculating the impact of direct access load loss. This assumption is based on PacifiCorp's goal to acquire sufficient resources to meet its short-term load over a rolling 24-month period. Id. at 15. However, PacifiCorp does not plan on any load electing direct access. This results in the Company acquiring power to serve customers who select direct access. *See* id. at 23-24. As long as the GRID model assumes zero direct access participation, then it will show PacifiCorp selling previously acquired power when customers elect direct access, and the value of the Transition Adjustment will be artificially reduced. Mr. Widmer's testimony demonstrates that absent a change in the planning methodology, a GRID-based solution that assumes PacifiCorp is in resource balance will make direct access even more uneconomic. Revised ICNU/107; PPL/103; PPL/300, Widmer/3; PPL/302. While it may be appropriate to use the GRID model to implement an avoided purchase approach to calculating the Transition Adjustment, these issues would more appropriately be addressed in a follow-on proceeding.

III. CONCLUSION

ICNU respectfully requests that the Commission adopt ICNU's proposed Transition Adjustment, which is based on a avoided purchase approach. In contrast, PacifiCorp and Staff's Transition Adjustment does not ensure that the full benefits of PacifiCorp's economic utility investment are passed through to direct access customers. In addition, PacifiCorp and Staff's Transition Adjustment is based on the inappropriate assumption that no load will elect direct access. Finally, PacifiCorp's proposal does not accurately reflect the operation of PacifiCorp's system or pass through the benefit of PacifiCorp's ability to avoid purchases at the Four Hubs. ICNU's Transition Adjustment is more reflective of how the Company operates, more accurately values PacifiCorp's resources, and is consistent with the Commission's obligation to remove barriers to a competitive retail market.

Dated this 13th day of August, 2004.

Respectfully submitted,

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