

ENTERED DEC 15 2003

This is an electronic copy. Format and font may vary from the official version. Attachments may not appear.

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UM 926

In the Matter of the Investigation Regarding the)
Purchase of Subscription Power from the) ORDER
Bonneville Power Administration.)

DISPOSITION: APPLICATIONS APPROVED

On November 24, 2003, PacifiCorp filed a request for approval of agreements between PacifiCorp, Bonneville Power Administration (BPA), and publicly owned utilities currently challenging the method for determination and level of benefits provided to PacifiCorp's residential and small farm consumers. Portland General Electric Company (PGE) filed a request for approval of similar agreements on the same date.

The agreements in question modify the current financial benefits provided to the utilities' residential and small farm customers by deferring a portion of the Fiscal Year (FY) 2004, 2005, and 2006 payments to the 2006-2011 time period. BPA would defer up to \$19.21 million in payments to PacifiCorp and \$19.34 million in payments to PGE. The deferral balance would accrue interest at an annual rate of 3.09 percent, compounded monthly. The rate would apply to the deferral balance until such monies are disbursed by BPA. PacifiCorp estimates that the effects of this deferral equate to a 4.4 percent increase, and PGE estimates that the effects of this deferral equate to a 2 percent increase in net rates for residential and small farm customers. Neither utility requests a rate change to be implemented with this filing.

The agreements also amend the method by which the level of benefits would be determined for PGE's and PacifiCorp's residential and small farm consumers for the time period from October 1, 2006 through September 30, 2011. The agreements include specifying that all benefits provided in this period would be provided entirely in the form of cash. The agreements also call for dismissal of current litigation before the Ninth Circuit Court and covenants not to sue on issues related to benefits to utility residential and small farm consumers.

Commission Staff reviewed the applications and drafted a Staff report on each of them. The Staff reports recommended that the Commission approve the utilities' requests to execute an agreement with BPA to defer a portion of BPA's FY

2004-2006 subscription¹ payments. The reports further recommended that the companies be directed to amend their agreements with BPA relating to determining the method of delivery (power or cash) and the level and administration of benefits.

Finally, the Staff report concerning PacifiCorp recommended that the Commission approve PacifiCorp's request to defer Oregon monetary benefits and that such amounts shall be no more than \$19,207,962 for FY 2004 and no less than \$10,062,004 and no more than \$19,207,962 per year for the period from October 1, 2004 through September 30, 2006. For PGE, Staff recommended that the Commission approve PGE's request to defer monetary benefits up to \$19,342,105 per year, or the amount necessary to bring the total deferred by all investor owned utilities to \$75 million per year, for the period from October 1, 2003 through September 30, 2006, whichever is less.

In its reports, Staff states that it believes that PacifiCorp and PGE customers benefit from the proposed agreements and provided analysis to that effect. The agreements provide for greater certainty in future subscription benefits and greatly reduce legal risk associated with challenges to the contracts between BPA and the investor owned utilities. Staff's reports for the December 4, 2003 Public Meetings are attached to this order as Appendix A (PacifiCorp) and Appendix B (PGE) and incorporated herein by reference.

At its December 4, 2003 Public Meeting, the Commission voted to adopt Staff's recommendations as amended.

ORDER

IT IS ORDERED that:

1. a. The application of PacifiCorp to execute an agreement with the Bonneville Power Administration to defer a portion of BPA's FY 2004-2006 subscription payments is approved.
 - b. PacifiCorp shall amend its agreement with BPA relating to determining the level of benefits and their administration.
 - c. PacifiCorp's request to defer Oregon monetary benefits is approved. Such amounts shall be no more than \$19,207,962 for FY 2004 and no less than \$10,062,004 and no more than \$19,207,962 per year for the period from October 1, 2004 through September 30, 2006.
2. a. The application of Portland General Electric to execute an agreement with the Bonneville Power Administration to defer a

¹ At its December 4, 2003 Public Meeting, Staff amended the language "residential exchange" in the Staff Reports (attached as Appendices A & B) and replaced it with "subscription."

portion of BPA's FY 2004-2006 subscription payments is approved.

- b. Portland General Electric shall amend its agreement with BPA relating to determining the level of benefits and their administration.
- c. Portland General Electric's request to defer monetary benefits up to \$19,342,105 per year, or the amount necessary to bring the total deferred by all investor owned utilities to \$75 million per year, for the period from October 1, 2003 through September 30, 2006, whichever is less, is approved.

Made, entered, and effective _____.

Lee Beyer
Chairman

John Savage
Commissioner

Ray Baum
Commissioner

A party may request rehearing or reconsideration of this order pursuant to ORS 756.561. A request for rehearing or reconsideration must be filed with the Commission within 60 days of the date of service of this order. The request must comply with the requirements in OAR 860-014-0095. A copy of any such request must also be served on each party to the proceeding as provided by OAR 860-013-0070(2). A party may appeal this order to a court pursuant to applicable law.

any Safety Net Cost Recovery Adjustment Clause (SN CRAC) surcharge. The \$19.21 million per year of PacifiCorp deferrals is based on the four-state commission agreement on the percentage of PacifiCorp residential exchange benefits allocated to each state, for the 2001 through 2006 time period. The \$19.21 per year deferrals is larger than the company's simple pro rata allocation, which is \$10,062,004, because PacifiCorp has elected to be responsible for a greater share of the \$75 million to be deferred among the regions investor-owned utilities. PacifiCorp proposes to defer up to all of Oregon's federal system benefits that are "Monetary" benefits, that is the benefits arising from the 900 aMW of financial benefits of the total initial five-year period of 1900 aMW of benefits for all the investor-owned utilities in aggregate.

PacifiCorp is not requesting any rate change to be implemented with this filing. PacifiCorp anticipates that it will later file for a 4.4 percent increase to its residential rates to be effective March 2004. The range of potential rate increase among all of PacifiCorp's qualifying consumers is 4.2 percent to 5 percent. PacifiCorp proposes to pass through to customers, on a timely basis, the reduction in benefits to levelize rates between the first five-year period of its ten-year contract with BPA, and the second five-year period beginning October 1, 2006. PacifiCorp expects federal system benefits available from BPA will be lower in the second five-year period because BPA rates will be more comparable to market prices. When benefits were established in 2001, the entire western United States was experiencing an energy crisis during which wholesale market prices were extremely high.

Background

For much of 2003, BPA, the Northwest investor-owned utilities, several publicly owned utilities and organizations, and staff from Oregon, Washington and Idaho have participated in settlement negotiations to achieve the following objectives:

- Reduce BPA's near term rates
- Remove the risk that investor-owned utility customers will not receive future BPA benefits
- Promote equitable sharing of federal system benefits among all BPA customers

To achieve near term rate reductions, the parties discussed eliminating the \$200 million litigation risk provision that has these monies being available to Puget and PacifiCorp in the event the utilities are sued over the level and rights to federal system benefits. In addition, parties discussed having the residential and small-farm consumers of investor-owned utilities (Residential) defer current benefits through September 2006 for later distribution from October 1, 2006 through September 30, 2011.

To remove risk that Residential consumers will not receive future benefits, the parties discussed dismissing current litigation threatening Residential benefits and agreeing not to sue on such issues through September 30, 2011.

To promote an equitable sharing of federal system benefits, the parties discussed methods to more frequently, rather than once every five years or BPA rate period, determine the "value" of federal power (how much BPA power is cheaper than market), and use an independent source for the market price of power rather than having BPA decide it in its own rate cases.

The result of these discussions is an agreement between BPA, the Northwest investor-owned utilities (of which PGE, PacifiCorp and Idaho Power serve 75% of Oregonians), and most publicly owned utilities. The provisions of the agreement are as follows:

- 1) BPA will use a new method to calculate how much money goes to the IOUs (such as PGE and Pacific) for the 2007-2011 period. BPA will:
 - a. Use a new independent source for the market price forecast, rather than BPA selecting a number. This new method will apply for the time period October 1, 2006 through September 30, 2011. This approach removes BPA's ability to arbitrarily set the level of benefits for the Residential consumers of the investor-owned utilities; and provides reasonably comparable benefits to those made available to Residential consumers of the publicly owned utilities.
 - b. Establish a floor and cap on the annual level of benefits provided to the Residential consumers of the investor-owned utilities of \$100 and \$300 million, respectively. Using the 4-state PUC agreement² on allocation of benefits for the 2007 – 2011 period, this translates into roughly a floor and cap of \$40 and \$125 million per year, respectively, for Oregon's Residential consumers served by PGE, PacifiCorp and Idaho Power.³ The current level of benefits received by those customers is roughly \$125 million per year. The current \$125 million was set during the 2001 energy crisis and hence represents a time when BPA was envisioned to be well below market; i.e., the value of the federal system was very great.

APPENDIX A
PAGE 3 OF 12

² The September 17, 1999, 4-state agreement regarding allocation of BPA benefits was adopted by BPA in its Record of Decision.

³ PacifiCorp estimates that beginning October 1, 2006, PacifiCorp's Oregon benefits will be at a minimum the sum of \$14,515,920 and \$15,435,208, reflecting the return of the deferral and PacifiCorp's Oregon share of the investor owned utility aggregate \$100 million annual minimum of benefits, respectively. The Oregon PacifiCorp cap in benefits post October 1, 2006, is estimated by PacifiCorp to equal \$46,275,942 not including the return of the deferral.

- 2) BPA will:
 - a. Implement a 7.5% rate decrease on or about March 1, 2004, with no SN CRAC for FY 2004. The rate decrease will be retroactive to October 1, 2003, so there are refunds due but no interest will accrue on the refund amounts. BPA will also revise the way it calculates the SN CRAC with the likely outcome that a zero SN CRAC will be in place for fiscal year 2005.
 - b. Begin a collaborative process to identify cost savings and revenue enhancements that produce, over a two-year period, \$100 million in additional net revenues to BPA. (I doubt the PUC will be active in this process.)
- 3) The investor-owned utilities in aggregate commit to defer receipt of federal system benefits from BPA totaling \$75 million per year for three years, and to have those monies returned during the 2007 through 2011 time period. Puget and PacifiCorp also agree to waive contractual rights to \$200 million in additional benefits that arise from public agency challenges to the level and determination of benefits to the utilities' Residential consumers. The total reduction in benefits for the 2004 to 2006 time period is \$425 million, of which \$225 million is essentially a loan. Oregon's share of this amount, using the 2001 through 2006, allocation of benefits among the investor-owned utilities, will be no more than \$30 million per year or \$90 million over the three years, 2004 through 2006.
- 4) All current litigation claims filed by the publicly owned utilities challenging the level and determination of benefits to Residential consumers will be voluntarily dismissed and utilities will sign covenants not to file, support, or in any way aid any lawsuits regarding the same through 2011.

Some publicly owned utilities might oppose the settlement because they wish to preserve the option to sue, or pursue current litigation challenging BPA's policies with respect to the Residential consumers of the investor-owned utilities. For example, on November 18, 2003, the Snohomish Board unanimously voted not to sign the agreement, in large part because it wanted to maintain its court challenges to the benefits received by Residential customers. The settlement is not voided ab initio because Snohomish could decide to support the settlement before the 90-day period expires as discussed in the utility filings.

Reducing benefits to Residential customers reduces BPA's costs thereby allowing lower rates to the public agencies. (No Oregon publicly owned utility opposition to the settlement is known at this time.) Some environmental groups may oppose the settlement because they perceive greater pressure on BPA to reduce monies for fish restoration and other environmental objectives. BPA is committing to seek \$100 million in cost reductions and revenue enhancements over a two-year

APPENDIX A

period, and BPA's revenue requirements will increase in 2007 to 2011 to repay the \$225 million in deferrals to the IOUs. The Columbia River-Inter Tribal Fish Commission may oppose the settlement based on concerns expressed in correspondence to BPA rate case parties dated October 10, 2003. I believe CUB is supportive of the settlement.

Key Issues

The key issues are:

Is this settlement beneficial for PacifiCorp Residential consumers?

How does PacifiCorp propose to manage the rate impacts of the settlement?

What interest rate should apply to any deferrals related to Residential benefits?

Each of these key issues will be discussed in turn.

Is this settlement beneficial for PacifiCorp Residential consumers?

This settlement benefits PacifiCorp Residential consumers and Oregonians, in general. The settlement benefits all Oregonians because it will allow BPA to reduce its rates. Any reduction in rates is positive for Oregon given the state of its economy.

With respect to benefits to PacifiCorp customers, the agreement provides certainty regarding the minimum and maximum level of benefits available to the Residential consumers for the five-year period beginning October 1, 2006. The agreement will also reduce BPA's activities in the wholesale market by eliminating BPA's obligation to provide any power to the investor-owned utilities. Currently BPA's intent is to provide all 2200 aMW of benefits for the five-year period beginning October 1, 2006, in the form of power.

Further, with respect to PacifiCorp Residential consumers, the settlement greatly reduces the potential for court-ordered reductions in BPA benefits allocated to the Residential consumers of the investor-owned utilities. This is achieved because current litigation challenging the level and method of providing federal system benefits for Residential consumers would be dismissed. Further, all of the public litigants must sign covenants not to challenge the method or level of benefits provided to Residential consumers through September 30, 2011. PacifiCorp currently receives approximately \$63.9 million in annual benefits. If these benefits were eliminated through a successful legal challenge, the result would be a 16 percent rate increase for Residential consumers.

The settlement also removes BPA's discretion to arbitrarily establish the level of benefits available to Residential consumers. The benefit of BPA power is measured by the difference in cost between buying BPA power and an equivalent amount of power in the open market. For example, if the price of BPA power equaled the wholesale market price of power, there is no current benefit of having BPA power. On the other hand, if BPA power were priced much lower than wholesale market alternatives, as was the case in 2001, then there are substantial benefits to having access to BPA power.

The Residential consumers, for the five-year period beginning October 1, 2001, had rights to 1900 aMW of BPA power. During 2001, the wholesale price of power for a flat block power product, provided for a five-year term, was well in excess of \$50 per mWh. BPA reported market prices in excess of \$100 per mWh. Assuming a market price of \$50 per mWh, and 1900 aMW, and a BPA price of a flat-block product of \$20 per mWh, the economic value of the power is $1900 \text{ aMW} * (50 - 20 \text{ \$/mWh}) * 8760 \text{ hours per year} = \500 million . Residential benefits however are not \$500 million annually. Benefits are much lower because BPA determined the wholesale market price forecast in its own rate case. The BPA-established market price is \$38 per mWh. BPA had initially set the wholesale market price at \$28.1 per mWh and only agreed to revise the price after active intervention by the PNW public utility commissions.

BPA has not yet adopted a wholesale market price forecast for the five-year period beginning October 1, 2006. As noted earlier in this memorandum, under this agreement BPA must use independent sources to determine wholesale market prices for the purpose of establishing the level of benefits for Residential consumers. Absent the settlement, the wholesale price forecast would be established by BPA in its rate case. At a recent four-state commission meeting with BPA, Steve Wright, Administrator of BPA, relayed to the four state commissions that BPA would likely adopt a conservative (low) wholesale price forecast. If BPA used a five-year rate period, as it did in the first five years of PacifiCorp's ten-year contract, it would be difficult for the four-state commissions to challenge BPA's order on this issue. The reason is that there is not a liquid market for five-year term power. During the settlement discussions over the course of several months, there were many discussions with power market experts and it was evident that a liquid wholesale market existed out two to perhaps three years at most.

For the five-year period beginning October 1, 2006, the Residential consumers of the investor-owned utilities are to receive 2200 aMW of federal system benefits. Assuming the independent wholesale market price forecast exceeds what BPA would have adopted otherwise through its rate case, by one \$/mWh, Residential benefits increase by roughly \$19 million.

The table below illustrates the economics of the deferral and the use of an independent wholesale market price forecast. Column (B) represents the present value of the total \$75 million deferral. The first three years represent the three years for which the benefits are reduced by \$75 million. The last five years, 2007 through 2011, represent the repayment of the deferral by BPA to the investor-owned utilities.

Economics of Value of Settlement With Respect to
 Deferrals and Independent Market Price Forecast
 (\$000,000)

(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)	(I)
		Present			Present		Present	
	Present	Value of		Present	Value of		Value of	
	Value of	One Mill		Value of	One Mill		Two Mills	
	Deferral	Delta		Deferral	Delta		Delta	
<u>Year</u>	<u>@ 3.09%</u>	<u>@ 3.09%</u>	<u>net</u>	<u>@ 8.0%</u>	<u>@ 8.0%</u>	<u>net</u>	<u>@ 8.0%</u>	<u>net</u>
2004	(\$75.000)		(\$75.000)	(\$71.590)		(\$71.590)		(\$71.590)
2005	(\$75.000)		(\$75.000)	(\$68.336)		(\$68.336)		(\$68.336)
2006	(\$75.000)		(\$75.000)	(\$65.229)		(\$65.229)		(\$65.229)
2007	\$32.625	\$17.063	\$49.688	\$27.085	\$14.165	\$41.250	\$28.331	\$55.416
2008	\$32.625	\$16.552	\$49.177	\$25.853	\$13.116	\$38.969	\$26.232	\$52.086
2009	\$32.625	\$16.056	\$48.681	\$24.678	\$12.145	\$36.822	\$24.289	\$48.967
2010	\$32.625	\$15.574	\$48.199	\$23.556	\$11.245	\$34.801	\$22.490	\$46.046
2011	\$32.625	\$15.108	\$47.733	\$22.485	\$10.412	\$32.897	\$20.824	\$43.309
Total	(\$61.875)	\$80.353	\$18.478	(\$81.498)	\$61.083	(\$20.415)	\$122.167	\$40.669

The reason the total for column (B) is not zero, but in fact is a large negative number equaling almost \$62 million, is due to the BPA proposed ratemaking treatment of the deferral. The monies owed to the investor-owned utilities would be included in BPA's revenue requirement. As such, the obligation increases BPA's costs thereby increasing BPA's rates. Assuming BPA has total loads of 8000 aMW, and Residential benefits are 2200 aMW, then Residential consumers end up paying for 27.5 percent of their own deferral. (The \$32.625 value in Column

"B" is the net payment to the investor-owned utilities reflecting the fact that they, and thus their Residential consumers end up paying for 27.5 percent of BPA's costs including the return of the deferral.)

Column (C) represents the value of increasing Residential benefits by \$1 per mWh. The increase in value, at a 3.09 percent discount rate, exceeds the "cost" of the deferral. Columns (E) through (I) illustrate the analysis using an 8 percent discount rate. The cost of the deferral increases in this example because BPA is accruing interest on the deferral balance at 3.09 percent while Residential consumers could arguably discount the money by 8 percent on an annual basis. The analysis shows that if the independent forecast increases the applicable market price forecast by \$2 per mWh, then this agreement provides \$40 million of benefits to Residential consumers.

There are some countervailing points that can be made regarding the overall analysis. First, is the disturbing feature that PacifiCorp's Residential consumers must "pay" for fair performance by BPA under the terms of the existing contract. (Residential consumers are "paying" \$60 to \$80 million dollars as columns (B) and (E) illustrate.) That is, the independent price forecast could be considered the best unbiased estimate. The reason this whole approach was developed was to nullify BPA's discretion and threats to arbitrarily reduce the market price forecast from its "true" value. It should be recognized that BPA is a political agency. It may be worthwhile to immunize the Residential benefits from near term adverse political considerations.

Second, with Oregon's economy still weak, now is not the time to voluntarily increase rates by reducing Residential benefits. This point can be addressed, however, by recognizing that the Commission could decline to authorize the utility's request to pass through to customers the decrease in Residential benefits but instead build up a large negative balance to be repaid from 2006 through 2011. However, it may be unwise to allow Residential consumers to build up such a large debt to the utility because it is unknown what level of Residential benefits may be established for the time beginning October 1, 2006. If benefits are much less than current benefit levels, significant rate shock could occur as rates are reset to both reflect the reduced Residential benefits and a payback to the utility for excess benefits paid during 2004 through September 2006.

How does PacifiCorp propose to manage the rate impacts of the settlement?

PacifiCorp envisions raising rates roughly 4 percent around March 2004, to reflect the effects of the deferral. PacifiCorp did not identify any rate change unrelated to this agreement that is envisioned to occur over the next few years.

What interest rate should apply to any deferrals related to Residential benefits?

Over the last twenty years of managing Residential benefits, the interest rate applied to any monies owed to customers by the utility, or monies owed by customers to the utility has not been consistent between PGE and PacifiCorp. The Commission policy regarding balancing accounts has been to use the utility's authorized rate of return. PGE has been using its authorized rate of return on the Residential benefits balancing account. This rate is roughly 9 percent. PacifiCorp, by contrast to PGE, has been using its short-term borrowing rate. This approach is consistent with a 1981 letter to PacifiCorp from Bill Kramer, the then Utility Program Director. At the time the letter was issued, short-term interest rates were above long-term interest rates and Commission authorized rates of return. The current short-term borrowing rate is around 1 percent. PacifiCorp also has not charged Residential consumers any interest when monies are owed to the company. The Residential balancing account for PacifiCorp currently has a relatively small balance of about \$1 million owing to Residential consumers.

I recommend that the current disparate treatment between PGE and PacifiCorp continue in the near term. Staff understands that the Commission may open a docket early next year to address the appropriate interest rate for balancing/deferral accounts. Assuming that such a docket is opened, this is the appropriate vehicle to make a policy decision regarding the interest rate for balancing/deferral accounts.

Finally, I believe it is unreasonable to apply interest to the balancing account when the company owes Residential consumers money, but not apply interest when Residential consumers owe the company money. PacifiCorp has adopted this policy, as strange as it may seem for two reasons. First, PacifiCorp interprets BPA contract language as requiring this treatment. Second, PacifiCorp believes that since it can elect whether or not to pass through changes in benefit levels, if a balance is owing to the company it is by company action to manage rates that such a result occurs. I would note that to the contrary, the Commission also, because of rate concerns, might require the company to not raise rates to pass through reductions in Residential benefits. While the Commission is required by federal law to pass through, in full, Residential benefits, there is flexibility afforded in contract language between the utility and BPA such that rate management is available within some bounds. For example, the current contracts require the balancing account to be no larger than total benefits available over a 180-day period. With the deferrals, as requested by the commission staffs and investor-owned utilities, this time period is increased to 36 months. Therefore significant flexibility is available to the Commission to manage rate impacts. If PacifiCorp seeks to continue to not accrue interest on monies owing to the company, that policy should continue as it benefits Residential consumers. I do not support the Commission ordering PGE to do the same.

Other Discussion

The BPA payments to PacifiCorp does not enrich PacifiCorp shareholders

PGE, PacifiCorp and Idaho Power all pass through to customers, in full, these benefits. Shareholders earn no profits on the pass through. Before the October 1, 2003, SN CRAC increase, the Oregon portion of the benefits was \$63 million for PacifiCorp-Oregon, and \$58 million for PGE.

Consequences of no settlement

If there is no settlement, for the five-year period beginning Oct. 1, 2006, BPA must provide 2,200 average megawatts yearly to the IOUs as a whole. However, BPA has the option to provide the benefits in power or cash, or a mix of the two. Utilities thus do not know how much power they must have available to meet loads. Also, the current contracts provide BPA considerable latitude to establish the level of benefits available to the Residential consumers of the investor-owned utilities. This is because BPA sets the market price forecast used to determine the per kWh benefit available to IOU consumers. Finally, if there is no settlement, benefits to the IOU residential and small-farm consumers remain at risk due to outstanding lawsuits challenging the level of benefits provided to these customers.

\$50 million risk litigation monies

To further reduce near term cash outlays, BPA has also obtained the deferral of an additional \$50 million in annual payments due in total to Puget and PacifiCorp relating to exposure to legal contract challenges. The Commission issued Order No. 02-414 on June 20, 2002, approving an agreement between PacifiCorp and BPA that:

....allows BPA to defer the payments that were to begin October 1, 2002. The monies deferred would accrue interest at an annual rate of 4.46 percent, compounded monthly. PacifiCorp may terminate the agreement if it believes that the lawsuit settlement agreement between the publics and the investor-owned utilities will not conclude to PacifiCorp's satisfaction. In addition, the Washington, Idaho or Oregon regulatory commissions may terminate the agreement if any of the commissions objects to or

disapproves continuation of the deferral period. Once the agreement is terminated, beginning on the date of a new six-month period, BPA shall pay PacifiCorp the deferred cash payments and begin the monthly payments associated with the litigation risk.⁴

If the settlement is voided ab initio, because some public agencies seek to pursue their litigation attacking the level and method of benefits to Residential consumers, the Commission might choose to consider directing PacifiCorp to request, or approving PacifiCorp's own request that, the risk litigation payments begin.

Additional Background

Commission authorization with regards to this proposed contract is required pursuant to ORS 757.663, which reads as follows:

In order to preserve the benefits of federal low-cost power for residential and small-farm consumers of electric utilities, the Public Utility Commission may require an electric company to enter into contracts with the Bonneville Power Administration for the purpose of securing such benefits. The contracts shall be subject to approval by the commission....

In docket UM 926, the Commission investigated the residential and small-farm consumers' access to federal system benefits and method of delivery (power or cash). As a result of the UM 926 investigation, the Commission issued Order Nos. 00-678 and 01-427, directing both PGE and PacifiCorp to enter into 10-year power purchase contracts with BPA relating to residential exchange benefits. These contracts provided PGE and PacifiCorp both cash and cost-based federal power. On October 31, 2000, PacifiCorp and PGE executed ten-year subscription settlement agreements with BPA. PacifiCorp and BPA later agreed to convert the power sale portion of the federal system benefits into cash.

ALTERNATIVES FOR COMMISSION CONSIDERATION:

In addition to the staff recommendation, there are alternative actions the Commission could take regarding the PacifiCorp request. One alternative is to not approve amending the current contracts. The effect of this action would likely be a default on the terms of the settlement in that it is unlikely the investor-owned utilities could achieve the \$75 million in deferrals. Staff does not support this alternative.

APPENDIX A
PAGE 11 OF 12

⁴ June 11, 2002, Public Meeting memo by Marc Hellman to John Savage

Another alternative is to direct PacifiCorp to request payment of the litigation risk monies upon April 1, 2004, in the event the settlement is voided.

PROPOSED COMMISSION MOTION:

The Commission approve PacifiCorp's request to execute agreements with the Bonneville Power Administration to defer a portion of BPA's fiscal year 2004 through 2006 residential exchange payments and amend agreements related to determining the level of benefits and their administration.

The Commission approve PacifiCorp's request to defer Oregon monetary benefits and such amounts shall be no more than \$19,207,962 for BPA's Fiscal Year 2004, and no less than \$10,062,004 and no more than \$19,207,962 per year for the period October 1, 2004 through September 30, 2006.

Electronic Copy of Attachments is not Available

APPENDIX A
PAGE 12 OF 12

This rate would apply to the deferral balance until such monies are disbursed by BPA. The payment schedule of the disbursement is 60 equal monthly payments beginning, October 1, 2006, and ending September 30, 2011. The \$19.34 million per year of Portland General Electric deferrals is based on the four-state commission agreement on the percentage of Portland General Electric residential exchange benefits allocated to each state, for the 2001 through 2006 time period. The actual level of deferrals should be significantly smaller than this amount due to Puget Sound Energy's, for 2004, and PacifiCorp's election for all three years of the deferral to be responsible for a greater share of the \$75 million to be deferred among the regions investor-owned utilities. It is likely that no deferrals in fiscal year (FY) 2004 will be needed from PGE Residential consumers in order for the investor-owned utilities, in aggregate, to achieve the \$75 million total. For FY 2005 and 2006, PGE deferrals will likely be less than \$10 million annually.

PGE is not requesting a rate change with this filing. PGE anticipates that it will later request an adjustment to its Schedule 102 rates. PGE's filing provides an analysis of potential rate impacts assuming various deferral amounts. The potential rate increases, in comparison to current levels, are modest, ranging from roughly a 2% increase in 2004 to 1 to 3% increases in 2005 and 2006, depending on the level of deferral and the extent to which the deferral is accrued for later recovery from Residential consumers. In the event PGE defers \$19.34 million in 2004, and PGE requests authority to immediately flow through to customers this reduction in benefits, the rate increase could be as high as 5%.

Background

For much of 2003, BPA, the Northwest investor-owned utilities, many publicly owned utilities and staff of the regulatory commissions in Oregon, Washington and Idaho have participated in settlement negotiations to achieve the following objectives:

- Reduce BPA's near term rates
- Remove the risk that investor-owned utility customers will not receive future BPA benefits
- Promote equitable sharing of federal system benefits among all BPA customers

To achieve near term rate reductions, the parties discussed eliminating the \$100 million litigation risk provision in BPA contracts, with both Puget and PacifiCorp (\$200 million total), that has these monies being available to Puget and PacifiCorp in the event the utilities are sued over the level and rights to federal system benefits. In addition, parties discussed having the residential and small-farm customers of investor-owned utilities (Residential consumers) defer current benefits through September 2006 for distribution from October 1, 2006 through September 30, 2011.

To remove Residential consumers' risk associated with receipt of future benefits, the parties discussed dismissing current litigation threatening Residential benefits and agreeing not to sue on such issues through September 30, 2011.

To promote an equitable sharing of federal system benefits, the parties discussed methods to more frequently, rather than once every five years or BPA rate period, determine the "value" of federal power (how much BPA power is cheaper than market), and use an independent source for the market price of power rather than having BPA decide it in its own rate cases.

The result of these discussions is an agreement between BPA, the Northwest investor-owned utilities (including PGE, PacifiCorp and Idaho Power, who serve 75% of Oregonians), and most publicly owned utilities. The agreement contains the following provisions:

- 1) BPA will use a new method to calculate how much money goes to the investor-owned utilities (such as PGE and Pacific) for the 2007-2011 period. BPA will:
 - a. Use a new independent source for the market price forecast, rather than BPA selecting a number. This new method will apply for the time period October 1, 2006 through September 30, 2011. This approach removes BPA's ability to arbitrarily set the level of benefits for the Residential consumers of the investor-owned utilities; and provides reasonably comparable benefits to those made available to Residential consumers of the publicly owned utilities.
 - b. Establish a floor and cap on the annual level of benefits provided to the Residential consumers of the investor-owned utilities of \$100 and \$300 million, respectively. Using the 4-state PUC agreement on allocation of benefits for 2007 – 2011⁵, this translates into roughly a floor and cap of \$40 and \$125 million per year, respectively, for Oregon's Residential consumers served by PGE, PacifiCorp and Idaho Power. The current level of benefits received by those customers is roughly \$125 million per year. The current \$125 million was set during the 2001 energy crisis and hence represents a time when BPA was envisioned to be well below market; i.e., the value of the federal system was very great.

- 2) BPA will:
 - c. Implement a 7.5% rate decrease on or about March 1, 2004, with no SN CRAC for FY 2004. The rate decrease will be retroactive to October 1, 2003, so there are refunds due but no interest will accrue on the refund amounts. BPA will also revise

⁵ The September 17, 1999, 4-state agreement regarding allocation of BPA benefits was adopted by BPA in its Record of Decision.

- the way it calculates the SN CRAC with the likely outcome that a zero SN CRAC will be in place for fiscal year 2005.
- d. Begin a collaborative process to identify cost savings and revenue enhancements that produce, over a two-year period, \$100 million in additional net revenues to BPA. (I doubt the PUC will be active in this process.)
- 3) The investor-owned utilities in aggregate commit to defer receipt of federal system benefits from BPA totaling \$75 million per year for three years, and to have those monies returned during the 2007 through 2011 time period. Puget and PacifiCorp also agree to waive contractual rights to \$200 million in additional benefits that arise from public agency challenges to the level and determination of benefits to the utilities' Residential consumers. The total reduction in benefits for the 2004 to 2006 time period is \$425 million, of which \$225 million is essentially a loan. Oregon's share of this amount, using the 2001 through 2006, allocation of benefits among the investor-owned utilities, will be no more than \$30 million per year or \$90 million over the three years, 2004 through 2006.
 - 4) All current litigation claims filed by publicly owned utilities challenging the level and determination of benefits to Residential consumers will be voluntarily dismissed and these utilities will sign covenants not to file, support, or in any way aid any lawsuits regarding the same through 2011.

Some publicly owned utilities might oppose the settlement because they wish to preserve the option to sue, or pursue current litigation, regarding BPA's policies with respect to the Residential consumers of the investor-owned utilities. For example, on November 18, 2003, the Snohomish Board unanimously voted not to sign the agreement in large part because it wanted to maintain its court challenges to the benefits received by Residential customers. The settlement is not voided ab initio because Snohomish could decide to support the settlement before the 90-day period expires as discussed in the utility filings.

Reducing benefits to Residential customers reduces BPA's costs thereby allowing lower rates to the public agencies. (No opposition to the settlement by Oregon publicly owned utilities is known at this time.) Some environmental groups may oppose the settlement because they perceive greater pressure on BPA to reduce monies for fish restoration and other environmental objectives. BPA is committing to seek \$100 million in cost reductions and revenue enhancements over a two-year period, and BPA's revenue requirements will increase in 2007 to 2011 to repay the \$225 million in deferrals to the IOUs. The Columbia River-Inter Tribal Fish Commission may oppose the settlement based on concerns expressed in correspondence to BPA rate case parties dated October 10, 2003. I believe CUB is supportive of the settlement.

Key Issues

The key issues are:

Is this settlement beneficial for PGE Residential consumers?

How does PGE propose to manage the rate impacts of the settlement?

What interest rate should apply to any deferrals related to Residential benefits?

Each of these key issues will be discussed in turn.

Is this settlement beneficial for PGE Residential consumers?

This settlement benefits PGE Residential consumers and Oregonians, in general. The settlement benefits Oregonians, because it will allow BPA to reduce its rates, and any reduction in rates is positive for Oregon; provides certainty for the minimum and maximum level of benefits available to the Residential consumers for the five year period beginning October 1, 2006; and reduces BPA activities in the wholesale market by eliminating BPA's obligation to provide any power to the investor-owned utilities. Currently BPA's intent is to provide all 2200 aMW of benefits for the five-year period beginning October 1, 2006, in the form of power.

With respect to PGE Residential consumers, the settlement and consequential dismissal of pending litigation regarding the level of BPA benefits appropriately allocated to Residential customers greatly reduces the potential for court-ordered reductions in BPA benefits. Further, all of the public litigants must also sign covenants not to challenge the method or level of benefits provided to Residential consumers through September 30, 2011. PGE currently receives approximately \$58 million in annual benefits. If these benefits were eliminated through a successful legal challenge, the result would be a 10 percent rate increase for Residential consumers.

The settlement also removes BPA's discretion to arbitrarily establish the level of benefits available to Residential consumers. The benefit of BPA power is measured by the difference in cost between buying BPA power and an equivalent amount of power in the open market. For example, if the price of BPA power equaled the wholesale market price of power, there is no current benefit of having BPA power. On the other hand, if BPA power were priced much lower than wholesale market alternatives, as was the case in 2001, then there are substantial benefits to having access to BPA power. The Residential consumers, for the five-year period beginning October 1, 2001, had rights to 1900 aMW of BPA power. During 2001, the wholesale price of power for a flat block power product, provided for a five-year term, was well in excess of \$50 per mWh. In fact, BPA reported prices in excess of \$100 per mWh. Assuming a market price of \$50

per mWh, and 1900 aMW, and a BPA price of a flat-block product of \$20 per mWh, the economic value of the power is $1900 \text{ aMW} * (50 - 20 \text{ \$/mWh}) * 8760 \text{ hours per year} = \500 million. Residential benefits however are not \$500 million annually. Benefits are much lower because BPA determined the wholesale market price forecast in its own rate case. The BPA-established market price is \$38 per mWh. BPA had initially set the wholesale market price at \$28.1 per mWh and only agreed to revise the price after active intervention by the PNW public utility commissions.

BPA has not yet adopted a wholesale market price forecast for the five-year period beginning October 1, 2006. As noted earlier in this memorandum, this settlement requires BPA to use independent sources to determine wholesale market prices for the purpose of establishing the level of benefits for Residential consumers. Absent the settlement, the wholesale price forecast would be established by BPA in its rate case. At a recent four-state commission meeting with BPA, Steve Wright, Administrator of BPA, relayed to the four state commissions that BPA would likely adopt a conservative (low) wholesale price forecast. If BPA used a five-year rate period, as it did in the first five years of PGE's ten-year contract, it would be difficult for the four state commissions to challenge BPA's order on this issue. This is because there is not a liquid market for five-year term power. During the settlement discussions the parties had many discussions with power market experts and it was evident that a liquid wholesale market existed for two-year, or possibly three years at most.

For the five-year period beginning October 1, 2006, the Residential consumers of the investor-owned utilities are to receive 2200 aMW of federal system benefits. Assuming the independent wholesale market price forecast exceeds what BPA would have adopted otherwise through its rate case, by one \$/mWh, Residential benefits increase by roughly \$19 million.

The table on the following page illustrates the economics of the deferral and the use of an independent wholesale market price forecast. Column (B) represents the present value of the total \$75 million deferral. The first three years represent the three years for which the benefits are reduced by \$75 million. The last five years, 2007 through 2011, represent the repayment of the deferral by BPA to the investor-owned utilities.

Economics of Value of Settlement With Respect to
 Deferrals and Independent Market Price Forecast
 (\$000,000)

(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)	(I)
		Present			Present		Present	
	Present	Value of		Present	Value of		Value of	
	Value of	One Mill		Value of	One Mill		Two Mills	
	Deferral	Delta		Deferral	Delta		Delta	
<u>Year</u>	<u>@ 3.09%</u>	<u>@ 3.09%</u>	<u>net</u>	<u>@ 8.0%</u>	<u>@ 8.0%</u>	<u>net</u>	<u>@ 8.0%</u>	<u>net</u>
2004	(\$75.000)		(\$75.000)	(\$71.590)		(\$71.590)		(\$71.590)
2005	(\$75.000)		(\$75.000)	(\$68.336)		(\$68.336)		(\$68.336)
2006	(\$75.000)		(\$75.000)	(\$65.229)		(\$65.229)		(\$65.229)
2007	\$32.625	\$17.063	\$49.688	\$27.085	\$14.165	\$41.250	\$28.331	\$55.416
2008	\$32.625	\$16.552	\$49.177	\$25.853	\$13.116	\$38.969	\$26.232	\$52.086
2009	\$32.625	\$16.056	\$48.681	\$24.678	\$12.145	\$36.822	\$24.289	\$48.967
2010	\$32.625	\$15.574	\$48.199	\$23.556	\$11.245	\$34.801	\$22.490	\$46.046
2011	\$32.625	\$15.108	\$47.733	\$22.485	\$10.412	\$32.897	\$20.824	\$43.309
Total	(\$61.875)	\$80.353	\$18.478	(\$81.498)	\$61.083	(\$20.415)	\$122.167	\$40.669

The reason the total for column (B) is not zero, but in fact is a large negative number equaling almost \$62 million, is due to the BPA proposed ratemaking treatment of the deferral. The monies owed to the investor-owned utilities would be included in BPA's revenue requirement. As such, the obligation increases BPA's costs thereby increasing BPA's rates. Assuming BPA has total loads of 8000 aMW, and Residential benefits are 2200 aMW, then Residential consumers end up paying for 27.5 percent of their own deferral. (The \$32.625 value in Column "B" is the net payment to the investor-owned utilities reflecting the fact that they, and thus their Residential consumers end up paying for 27.5 percent of BPA's costs including the return of the deferral.)

Column (C) represents the value of increasing Residential benefits by \$1 per mWh. The increase in value, at a 3.09 percent discount rate, exceeds the "cost" of the deferral. Columns (E) through (I) illustrate the analysis using an 8 percent discount rate. The cost of the deferral increases in

this example because BPA is accruing interest on the deferral balance at 3.09 percent, while Residential consumers could arguably discount the money by 8 percent on an annual basis. The analysis shows that if the independent forecast increases the applicable market price forecast by \$2 per mWh, then this agreement provides a \$40 million benefit to Residential consumers.

There are some countervailing points that can be made regarding the merit of the settlement. First, is the disturbing feature that PGE's Residential consumers must "pay" for fair performance by BPA under the terms of the existing contract (Residential consumers are "paying" from \$60 to \$80 million dollars as columns (B) and (E) illustrate.) That is, the independent price forecast could be considered the best unbiased estimate. The reason this whole approach was developed was to nullify BPA's discretion and threats to arbitrarily reduce the market price forecast from its "true" value. It should be recognized that BPA is a political agency. It may be worthwhile to immunize the Residential benefits from near term adverse political considerations.

Second, PGE's rates are relatively high. With Oregon's economy still weak, now is not the time to voluntarily increase rates by reducing Residential benefits. This point can be addressed by recognizing that the Commission could require that the utilities not pass through to customers the decrease in Residential benefits, but instead build up a large negative balance to be repaid from 2006 through 2011. However, it may be unwise to allow Residential consumers to build up a large debt to the utility because it is unknown what level of Residential benefits will be established beginning October 1, 2006. If benefits after October 1, 2006 are much less than current benefits, significant rate shock could occur as rates are reset to reflect both the reduced Residential benefits and a payback to the utility for excess benefits paid during 2004 through September 2006.

How does PGE propose to manage the rate impacts of the settlement?

PGE did not propose a revision to its current rates or identify when rates would be adjusted as a result of executing the proposed agreements. PGE does note that if the Commission were to change its policy regarding the interest rate applied to the Residential benefits balancing account, to reflect short-term interest rates, then PGE would advocate immediately flowing through to customers the reduced federal system benefits. The result would be rate increases of up to 5 percent. More likely however, assuming PGE does not need to participate in the deferrals for FY 2004, a rate increase of roughly 3 percent would take place on October 1, 2004. PGE did not identify rate changes unrelated to this agreement that might occur over the next few years.

What interest rate should apply to any deferrals related to Residential benefits?

Over the last twenty years of managing Residential benefits, the interest rate applied to any monies owed to customers by the utility, or monies owed by customers to the utility has not been consistent between PGE and PacifiCorp. The Commission policy regarding balancing accounts has been to use the utility's authorized rate of return. PGE has been using its authorized rate of return as the interest rate for its Residential benefits balancing account. This rate is roughly 9 percent. Currently, Residential consumers owe PGE roughly \$10 million. PacifiCorp has been using its short-term borrowing rate. This approach is consistent with a 1981 letter to PacifiCorp from Bill Kramer, the then Utility Program Director. At the time the letter was issued, short-term interest rates were above long-term interest rates and Commission authorized rates of return. The current short-term borrowing rate is around 1 percent. PacifiCorp also has not charged Residential consumers any interest when monies are owed to the company. The Residential balancing account for PacifiCorp currently has a relatively small balance owing to Residential consumers.

I recommend that the current disparate treatment between PGE and PacifiCorp continue in the near term for several reasons. First, staff understands that the Commission may open a docket early next year to address the appropriate interest rate for balancing/deferral accounts. Assuming such a docket is opened, this is the appropriate vehicle to consider and revise, if necessary, the Commission's policy regarding the interest rate for monies owed to customers by the utility and vice versa. Second, PGE's current balancing account balance of \$10 million arose under the current Commission policy and practice. The balance reflects the Commission's objective of avoiding PGE rate increases if at all possible. It could be viewed as inequitable to now reduce the applicable interest rate when a significant amount of money is owed to the company. Third, PGE will likely not be participating in the first year of BPA benefit deferrals. Because the region understands that PGE rates are of significant concern to the Commission, and because Puget and PacifiCorp wish to increase their share of the deferrals to levelize benefits between the first five year period beginning October 1, 2001, and the five year period beginning October 1, 2006, both PacifiCorp and Puget have elected to increase their level of deferrals such that PGE participation should not be needed to meet the FY 2004, \$75 million deferral requirement. Accordingly, the Commission can undertake its review of interest rate policy for deferrals prior to the time PGE begins to defer Residential benefits. If the Commission interest rate policy is revisited, PGE can then offer informed recommendations on how to manage rates in light of the deferrals.

Finally, I believe it is unreasonable to apply interest to the balancing account when the company owes Residential consumers money, but not when Residential consumers owe the company money. PacifiCorp has adopted this policy, as strange as it may seem, for two reasons. First, PacifiCorp interprets BPA contract language as requiring this treatment. Second, PacifiCorp believes that since it can elect whether to pass through changes in benefit levels, if a balance is

owing to the company, it is by company action to manage rates that such a result occurs. I would note that to the contrary, the Commission also, because of rate concerns, might not authorize the company to raise rates to pass through reductions in Residential benefits. While the Commission is required by federal law to pass through in full Residential benefits, there is flexibility afforded in contract language between the utility and BPA such that rate management is available within some bounds. For example, the current contracts require the balancing account to be no larger than total benefits available over a 180-day period. Under the proposed settlement agreement, this time period is increased to 36 months. Therefore significant flexibility is available to the Commission to manage rate impacts. If PacifiCorp seeks to continue to not accrue interest on monies owing to the company, that policy should continue as it benefits Residential consumers. However, for the reasons discussed above, I do not recommend that the Commission order PGE to do the same.

Other Discussion

The BPA payments to PGE do not enrich PGE shareholders

PGE, PacifiCorp and Idaho Power all pass through to customers, in full, the BPA benefits. Shareholders earn no profits on the pass through. Before the October 1, 2003 SN CRAC increase, the Oregon portion of the benefits was \$63 million for PacifiCorp-Oregon, and \$58 million for PGE.

Consequences of no settlement

If there is no settlement, for the five-year period beginning Oct. 1, 2006, BPA must provide 2,200 average megawatts in annual benefits to the IOUs as a whole. However, BPA has the option to provide the benefits in power or cash, or a mix of the two. Accordingly, utilities do not know how much power they must have available to meet loads. Also, the current contracts provide BPA considerable latitude to establish the level of benefits available to the residential and small-farm consumers of the investor-owned utilities. This is because BPA sets the market price forecast used to determine the per kWh benefit available to IOU consumers. Finally, if there is no settlement, benefits to the IOU residential and small farm customers remain at risk due to outstanding lawsuits challenging the level of benefits provided to these customers.

\$50 million risk litigation monies

To further reduce near term cash outlays, BPA has also obtained deferral of an additional \$50 million in annual payments due in total to Puget and PacifiCorp relating to exposure to legal contract challenges. The Commission issued Order No. 02-414 on June 20, 2002, approving an agreement between PacifiCorp and BPA that:

....allows BPA to defer the payments that were to begin October 1, 2002. The monies deferred would accrue interest at an annual rate of 4.46 percent, compounded monthly. PacifiCorp may terminate the agreement if it believes that the lawsuit settlement agreement between the publics and the investor-owned utilities will not conclude to PacifiCorp's satisfaction. In addition, the Washington, Idaho or Oregon regulatory commissions may terminate the agreement if any of the commissions objects to or disapproves continuation of the deferral period. Once the agreement is terminated, beginning on the date of a new six-month period, BPA shall pay PacifiCorp the deferred cash payments and begin the monthly payments associated with the litigation risk.⁶

If the settlement is voided ab initio, because some public agencies seek to pursue their litigation attacking the level and method of benefits to Residential consumers, the Commission might choose to consider directing PacifiCorp to request, or approving PacifiCorp's own request that, the risk litigation payments begin.

Additional Background

Commission authorization for this proposed contract is required pursuant to ORS 757.663, which reads as follows:

In order to preserve the benefits of federal low-cost power for residential and small-farm consumers of electric utilities, the Public Utility Commission may require an electric company to enter into contracts with the Bonneville Power Administration for the purpose of securing such benefits. The contracts shall be subject to approval by the commission....

In docket UM 926, the Commission investigated the residential and small farm consumers' access to federal system benefits and method of delivery (power or cash). As a result of the UM 926 investigation, the Commission issued Order Nos. 00-678 and 01-427, directing both PGE and PacifiCorp to enter into 10-year power purchase contracts with BPA relating to residential exchange benefits. These contracts provided PGE and PacifiCorp both cash and cost-based federal power. On October 31, 2000, PacifiCorp and PGE executed ten-year subscription settlement agreements with BPA. PacifiCorp and BPA later agreed to convert the power sale portion of the federal system benefits into cash.

⁶ June 11, 2002, Public Meeting memo by Marc Hellman to John Savage

ALTERNATIVES FOR COMMISSION CONSIDERATION:

In addition to the staff recommendation, there are alternative actions the Commission could take regarding the Portland General Electric request. One alternative is to not approve amending the current contracts. The effect of this action would likely be a default on the terms of the settlement in that it is unlikely the investor-owned utilities could achieve the \$75 million in deferrals. Staff does not support this alternative.

The other alternative is to approve the contract amendment contingent on PGE electing to defer zero dollars for FY 2004, and up to \$19.34 million for FY 2005 and 2006. The point of this alternative is to diminish the near term rate impact pressures on PGE.

PROPOSED COMMISSION MOTION:

The Commission approve Portland General Electric's request to execute agreements with the Bonneville Power Administration to defer a portion of BPA's fiscal year 2004 through 2006 residential exchange payments and amend agreements related to determining the level of benefits and their administration.

The Commission approve PGE's request to defer monetary benefits up to \$19,342,105 per year, or the amount necessary to bring the total deferred by all investor-owned utilities to \$75 million per year, for the period October 1, 2003 through September 30, 2006, whichever is less.

ORDER NO. 03-114

Electronic Copy of Attachments is not Available