ORDER NO. 05-1050

ENTERED 09/28/05

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UE 170

In the Matter of	)	
	)	
PACIFIC POWER & LIGHT COMPANY	)	ORDER
(dba PacifiCorp)	)	
	)	
Request for a General Rate Increase in the	)	
Company's Oregon Annual Revenues.	)	

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APPENDICES

SUMMARY

In this order, the Commission approves new rate schedules for PacifiCorp. The allowed revenue requirement increase is approximately $25.9 million, or 3.17 percent. This is a reduction of $76.1 million from PacifiCorp's initial request of approximately $102.0 million. The specific rate changes will take effect on October 4, 2005.

The Commission determined that the provisions of SB 408 apply to this rate case, and authorized a $16.07 million adjustment to PacifiCorp's tax expense. The Commission further adopted numerous stipulations agreed to by various parties in this proceeding. One of these stipulations authorizes a change in billing so that customers will not be billed at a higher rate due to a variance in the monthly billing cycle. Finally, the Commission is approving PacifiCorp's transition adjustment mechanism.

INTRODUCTION

Procedural Background

On November 12, 2004, Pacific Power and Light (PacifiCorp) filed Advice No. 04-018, an application for a general rate increase of approximately $102.024 million, or 12.5 percent, in Oregon revenues. PacifiCorp asked for the new rates to take effect on December 12, 2004.

On December 7, 2004, the Commission found good and sufficient cause to investigate the propriety and reasonableness of the tariff sheets pursuant to ORS 757.210 and 757.215. The Commission ordered the rates to be suspended for nine months from December 12, 2004. The initial suspension period expired on September 11, 2005. PacifiCorp subsequently extended the suspension period through October 3, 2005.

Conferences

On December 7, 2004, a prehearing conference was held in Salem, Oregon, to identify parties and interested persons, and to adopt a procedural schedule. The following entities either had party status or participated in the proceeding: Portland General Electric (PGE), Oregon Department of Energy (ODOE), Fred Meyer Stores and Quality Food Centers, Divisions of Kroger Company, Inc. (Fred Meyer), Citizens' Utility Board (CUB), Industrial Customers of Northwest Utilities (ICNU), Community Action Directors of Oregon, Oregon Energy Coordinators Association, Utility Reform Project, Nancy Newell, Klamath Off-Project Water Users, Inc., Klamath Water Users Association, WaterWatch of Oregon, Oregon Natural Resources Council and Commission Staff (Staff) .

During the course of these proceedings, a new docket (UE 171) was opened to address issues about the future rates of irrigators in the Klamath Basin. That docket was later closed by the Commission (Order No. 05-726). Further proceedings regarding Klamath Basin irrigators' rate issues were remanded to this docket. Due to the remand, a bifurcated proceeding was necessary. All general rate issues, excluding Klamath Basin irrigator issues, are being resolved in this order. As discussed below, the current Schedule 33 will be used for interim rates until the Klamath Basin irrigator issues are addressed and resolved in a separate order.

Public Comment Meetings

The general public was given an opportunity to attend open houses to learn about and make comment on PacifiCorp's application. These open houses were held in Bend on February 28, 2005; Portland on March 9, 2005; Klamath Falls on March 15, 2005; and Medford on March 16, 2005.

Evidentiary Hearings

Hearings were held in Salem, Oregon, on July 20 and 21, 2005. During those proceedings, the following appearances were entered:

> Katherine McDowell and Marcus Wood, attorneys, represented PacifiCorp.
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> Jason Eisdorfer, attorney, represented CUB.
>
> Melinda Davison and Irion Sanger, attorneys, represented ICNU.
>
> Michael Kurtz, attorney, represented Fred Meyer Stores.
>
> Jason Jones and David Hatton, attorneys, represented Staff.

Briefing and Oral Arguments

Prehearing briefs were filed by PacifiCorp, ICNU, Klamath Water Users Association, CUB, Staff and Fred Meyer Stores on July 13 and 14, 2005. Posthearing opening and reply briefs were filed by PacifiCorp, ICNU, CUB and Staff on August 4 and 11, 2005, respectively.

Oral argument was held before the Commission on August 15, 2005. PacifiCorp, ICNU, CUB and Staff participated in the oral argument.

Stipulations

Five stipulations were filed during the course of these proceedings. The subject matter and signatories of the stipulations are identified below. The contents of each stipulation are discussed in further detail in this order, below at 4.

On May 4, 2005, a partial stipulation was filed that addressed some revenue requirement issues. If adopted, the stipulation would reduce PacifiCorp's revenue requirement by approximately $31 million. This stipulation, which was supported by the joint testimony of Paul Wrigley (PacifiCorp), Ed Durrenberger (Staff), Bob Jenks (CUB), Randall Falkenberg (ICNU) and Kevin Higgins (Fred Meyer), is attached as Appendix A.

On May 6, 2005, a Partial Requirements and Economic Replacement Power Tariffs stipulation was filed, which addressed issues involving PacifiCorp's tariff schedules for standby electric service for consumers supplying all or part of their load by self-generation. This stipulation, which was supported by the joint testimony of William Griffith (PacifiCorp), Lisa Schwartz (Staff) and Kathryn Iverson (ICNU), is attached as Appendix B.

On June 29, 2005, a second partial stipulation was filed addressing some additional revenue requirement issues. If adopted, this stipulation would further reduce PacifiCorp's revenue requirement by $2.44 million. The stipulation, which was supported by the joint testimony of Paul Wrigley (PacifiCorp), Ed Durrenberger (Staff), Bob Jenks (CUB), James Selecky (ICNU), and Kevin Higgins (Fred Meyer), is attached as Appendix C.

Also on June 29, 2005, a third partial stipulation was filed by PacifiCorp and Staff to address other revenue requirement issues. If adopted, this stipulation would increase PacifiCorp's revenue requirement by approximately $2.49 million. The stipulation, which was supported by the joint testimony of Mark Widmer (PacifiCorp) and Bill Wordley (Staff), is attached as Appendix D.

On July 29, 2005, the fourth partial stipulation was filed addressing additional revenue requirement issues, capital structure and cost of capital. If adopted, this stipulation would reduce PacifiCorp's proposed revenue requirement increase to approximately $52.5 million. The stipulation, which was supported by the joint testimony of Laura Beane (PacifiCorp), Ed Durrenberger (Staff), Bob Jenks (CUB), James Selecky (ICNU), and Kevin Higgins (Fred Meyer), is attached as Appendix E.

The stipulations and supporting testimony were entered into the record as evidence pursuant to OAR 860-014-0085(1).

Based on the record in these proceedings, the Commission makes the following:

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Applicable Law

In a rate case, the Commission's function involves two primary steps. First, we determine the amount of revenue an entity, such as PacifiCorp, is entitled to receive. The utility's revenue requirement is determined on the basis of the utility's costs. Second, we allocate the burden of paying the revenue requirement among the utility's customer classes and design rates for each class.[1]

In the revenue requirement phase of a rate case, the Commission must determine for a specified test year: (1) the gross utility revenues; (2) the utility's reasonable operating expenses to provide utility service; (3) the rate base on which a return should be earned; and (4) the rate of return to be applied to the rate base to establish the return to which utility stockholders are reasonably entitled.[2] Once these components are known, the Commission is then able to set utility rates that are at fair, just and reasonable levels.

STIPULATED ISSUES

Various parties submitted five stipulations throughout the course of these proceedings. One stipulation addresses issues regarding partial requirements consumers, three stipulations solely address revenue requirement issues, and the final stipulation addresses cost of capital, rate spread and rate design and revenue requirement issues. There was also an agreement regarding interim rates for the Klamath Basin irrigators. For purposes of our discussion, we divide the stipulations and agreement into three groups: (1) Partial Requirements Stipulation; (2) Revenue Requirement, Cost of Service and Rate Design Stipulations; and (3) Klamath Basin Irrigators' Interim Rate Proposal.

1. Partial Requirements Stipulation

On May 6, 2005, PacifiCorp filed a stipulation regarding partial requirements and economic replacement power tariffs (Schedules 47, 247, 747, 76R, 276R and 776R), which was signed by Staff, ODOE, ICNU, and PacifiCorp.

Partial requirements consumers regularly provide all or part of their load by self-generation. The tariffs embodied in Schedules 47, 747 and 247 more closely reflect the cost of providing standby service to these partial requirements consumers. The proposed economic replacement tariffs (Schedules 76R, 276R and 776 R) provide partial requirements consumers an opportunity to purchase energy from PacifiCorp or an energy service supplier (ESS) that replaces all or some of the power that could be self-generated, particularly when the consumer decides that purchased energy is economically beneficial. Current Schedule 47 partial requirements consumers, of which there are seven, will have to enter into new partial requirements service agreements.

The proposed Schedule 247 uses PowerDex Hourly as the market index to be used for determining unscheduled energy charges. *See* Partial Requirement Stipulation, Exhibit B at 2. ICNU does not agree with the use of PowerDex Hourly for determining unscheduled energy charges, but did agree not to file testimony or take any

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[1] *See, e.g.., American Can Co. v. Lobdell,* 55 Or App 451, 454-55, *rev den* 293 Or 190 (1982).
[2] *See Pacific Northwest Bell Tel. Co. v. Sabin,* 21 Or App 200, 205 n.4, *rev den* (1975).

action to oppose use of the PowerDex Hourly index. ICNU supports Commission approval of the stipulation as presented.

Several of the charges in the six rate schedules reflect the revenue requirement as originally filed by PacifiCorp. These include: 1) Schedule 47 – Distribution, Reserves, and Transmission and Ancillary Service Charges; 2) Schedule 747 – Distribution and Reserves Charges; 3) Schedule 76R – Transmission and Ancillary Services and Daily ERP Demand Charges; and 4) Schedule 776R – Daily ERP Demand Charge. Once a final revenue requirement is established, PacifiCorp will file compliance tariffs to reflect changes in revenue requirement.

Commission Resolution

Having reviewed the partial requirements and economic replacement power tariffs stipulation and supporting testimony, we find the proposed tariffs to be fair and reasonable, subject to our review of the compliance tariffs as required by this order. The stipulation set forth in Appendix B is adopted.

2. Revenue Requirement, Cost of Service and Rate Design Stipulations

While the remaining four stipulations have numerous agreements involving revenue requirement, they also contain agreements about other contested matters. We summarize the contents and discuss our resolution of each stipulation. While we reserve our discussion about most of the disputed issues for later in this order, some disputed issues are resolved during our discussion of the stipulation. To make our holdings as clear as possible, we will indicate whether we adopt, or do not adopt, each stipulation in this portion of the order.

A. Partial Stipulation filed May 4, 2005

PacifiCorp, Staff, CUB, ICNU and Fred Meyer entered into this stipulation, the effect of which reduced PacifiCorp's proposed revenue requirement increase by approximately $31 million. The adjusted revenue requirement increase, based on this stipulation, is approximately $71 million.[3]

The parties agreed to the following:

1. Annual Net Power Costs will be set at approximately $785 million on a Total Company basis, subject to adjustments based on the resolution of Net Power Costs not resolved by this stipulation.

2. PacifiCorp will commit necessary resources to evaluate stochastic modeling of Net Power Costs for possible incorporation into rates. The analysis will consider volatility of hydro generation, electricity

[3] $8.00 million will be incorporated into PacifiCorp's RVM, if approved.

and natural gas prices, system load and forced outages, along with the correlations among these variables. With Staff input, PacifiCorp will develop a plan to complete the stochastic modeling. Quarterly public workshops will be held to report progress made and receive input from interested persons.

3. Line losses in the load forecast will be updated, resulting in a reduction in the filed revenue requirement of $9.16 million. The revenue requirement will also be updated based on the new allocation factors resulting from the changes in PacifiCorp's load forecast.

4. PacifiCorp will not take an operating deduction for the Oregon Commission fee, resulting in a $0.138 million revenue requirement reduction.

5. The annual net cost for employee incentive programs for the 2006 test year will be set at $35.6 million on a Total Company basis. This adjustment ties PacifiCorp's total compensation to market, rather than to financial performance. PacifiCorp's Long Term Incentive Compensation is completely excluded. These adjustments result in a $5.5 million revenue requirement reduction.

6. Non-labor administrative and general costs are reduced by $6.123 million.

7. Due to growth in revenue accounts 450, 451, 454 and 465, a $2.2 million revenue requirement reduction will be taken.

8. The impact of nonrecurring coal costs associated with Bridger will be computed by amortizing the difference between actual 2004 costs and forecasted 2006 costs over a three-year period, with PacifiCorp recovering a return on the unamortized balance. This process results in a $2.4 million revenue requirement reduction.

9. PacifiCorp's federal and state income expense will be adjusted based upon the final weighted average cost of debt.

10. The production activity deduction methodology proposed by PacifiCorp will be used. The actual amount of the deduction will be based upon the final revenue requirement authorized by this order. If the Internal Revenue Service approves the production activity methodology proposed by the Edison Electric Institute (EEI), PacifiCorp reserves the right to file for deferred accounting treatment for the difference between the PacifiCorp and EEI methodologies.

11. Several adjustments will increase PacifiCorp's revenue requirement by $2.54 million. These are:

    $1.3 million – DITBAL allocation
    $0.992 million – Hermiston and Gadsby allocation factor corrections
    $0.250 million – Little Mountain and WSCC membership costs

12. The Cost-Based Supply Service Energy Charges in Schedule 200 will have equal tailblock charges applicable for Schedules 28 and 30.

13. Change the graveyard market caps for the Transition Adjustment calculation depending on the assumed amount of direct access load.

The parties listed the outstanding issues to be resolved during the proceedings. They agreed to support adoption of the stipulation, stating that the adjustments, along with the revenue requirement levels resulting from adjustments, are fair and reasonable.

Commission Resolution

This stipulation attempts to resolve numerous revenue requirement issues, and results in an approximate $31 million decrease in PacifiCorp's filed revenue requirement. PacifiCorp, Staff, CUB, ICNU and Fred Meyer believe these adjustments are supported by the evidence and are fair and reasonable. We agree. The stipulation set forth in Appendix A is adopted.

B. Second Partial Stipulation filed June 29, 2005

PacifiCorp, Staff, CUB, ICNU, and Fred Meyer entered into this stipulation. The parties agreed to reduce PacifiCorp's filed revenue requirement for full-time employee benefits by $2.44 million. This reduction reflects a change in base data and escalation rates for medical benefits and workers compensation, as well as amortization of external system development costs associated with Other Salary Overhead over two years.

The parties further stated that the adjustments, along with the revenue requirement level resulting from the adjustments, are fair and reasonable and recommended that the stipulation be adopted.

Commission Resolution

This stipulation addresses employee benefits. It results in a $2.44 million revenue requirement reduction, and allows PacifiCorp to amortize some development costs involving Other Salary Overhead over two years. PacifiCorp, Staff, CUB, ICNU and Fred Meyer believe these adjustments are supported by the evidence and are fair and reasonable. We agree. The stipulation set forth in Appendix C is adopted.

C. Third Partial Stipulation filed June 29, 2005

PacifiCorp and Staff entered into this stipulation, the effect of which increased PacifiCorp's proposed revenue requirement by $2.49 million. The settlement contains various matters:

RVM - If RVM is implemented, adoption of this stipulation would result in a decrease from PacifiCorp's original proposed revenue requirement for RVM on January 1, 2006. Further, if RVM is implemented as proposed by PacifiCorp, Staff and PacifiCorp agreed that the RVM power costs should be set at $800.5 million, prior to the inclusion of RVM updates. The actual change to the revenue requirement will be determined by the November 15, 2005, final GRID power cost model run. This final GRID run will include all the adjustments proposed by PacifiCorp in its testimony (PPL/Widmer; 604-606 and 607-608) except for the Deferred Maintenance, Thermal Ramping, Station Service, and Planned Outages adjustments.

Fuel Handling Charge – PacifiCorp and Staff agreed that the revenue requirement should be corrected to include a fuel handling charge, resulting in a $2.49 million revenue requirement increase.

Other Matters – Staff agreed to the following:

1. Support waiver of OAR 860-038-0080(1)(b) as to West Valley Lease, the Gadsby CTs and Currant Creek projects.

2. Accept PacifiCorp's level of plant forced outages.

3. Support treatment of four qualifying facilities as "new" under the terms of the Revised Protocol.

4. Will not raise any issue about any "mismatch" between a September 12, 2005, base rate change effective date[4] and the calendar year 2006 test period.

Staff and PacifiCorp stated that the adjustments, along with the revenue requirement level resulting from the adjustments, are fair and reasonable and recommended that the stipulation be adopted.

[4] This date has been changed to October 4, 2005.

Commission Resolution

This stipulation, entered into by PacifiCorp and Staff, provides for a $2.49 million revenue requirement increase due to an incorrect fuel handling charge. In June 2005, PacifiCorp increased its original filed fuel handling charge by approximately $2.5 million to correct an error. *See* PPL/1600, Wrigley/4. According to Paul Wrigley, Manager of Revenue Requirement, when PacifiCorp prepared the results of operations exhibit (PPL 801) for this proceeding, the fuel handling costs were erroneously removed. PPL/1600, Wrigley/2.

ICNU recommends that we reject PacifiCorp's fuel handling adjustment because it establishes a poor precedent to allow a utility to include additional costs in the middle of a rate case, and because PacifiCorp has not established that the costs are reasonable. ICNU also finds it "suspicious" that PacifiCorp identified its error at the same time it agreed to make an offsetting $2 million power cost adjustment related to the Camas facility.

While the timing may be "suspicious," nevertheless it was an error on PacifiCorp's part to exclude the fuel handling costs. The costs are not additional expenses, but expenses inadvertently omitted by PacifiCorp. ICNU had sufficient time to respond to PacifiCorp's correction. Further, Staff reviewed the expense, agreed that an error had occurred, and recommended that the expense be included in revenue requirement so that test year 2006 can accurately reflect PacifiCorp's costs. We agree with Staff and PacifiCorp that the fuel handling charge should be corrected.

The stipulation also sets forth an agreement between Staff and PacifiCorp about the appropriate number for RVM power costs. As discussed later in this order, we adopt PacifiCorp's Transition Adjustment Mechanism (TAM) proposal. Our discussion will explain why we believe that the TAM proposal is appropriate. Therefore, we find that this stipulation set forth in Appendix D is fair and reasonable, and we adopt it in its entirety.

D. Fourth Partial Stipulation filed July 29, 2005

PacifiCorp, Staff, ICNU, CUB and Fred Meyer entered into this stipulation regarding cost of capital and specific revenue requirement adjustments. The effect of this stipulation is a $23.4 million reduction in PacifiCorp's proposed revenue requirement of $75.9 million, resulting in an approximate $52.5 million total revenue requirement increase.

Capital Structure, Cost of Capital and Rate of Return - The signatories agreed to the cost of capital, capital structure and rate of return (8.057 percent) as shown in the following chart:

Capital Component	Percent	Cost	Weighted Cost
Long Term Debt	51.34%	6.288%	3.228%
Preferred Stock	1.10%	6.590%	0.073%
Common Equity	47.56%	10.000%	4.756%
Total	100.00%		8.057%

Rate Spread/Rate Design - The signatories also agreed to a rate spread methodology,[5] with an understanding that none of the major rate schedules will receive more than 1.5 times the net increase, unless such computation is less than two percentage points above the net increase. In that instance, the cap on any major rate schedule net increase shall be the sum of the net increase plus two percentage points. However, Schedule 48 (Large General Service) will not increase more than 1.45 times the net increase. Finally, Residential Schedule 4 will not have a Rate Mitigation Adjustment (RMA) surcharge or surcredit, while Schedule 48 may have a surcredit but no surcharge. Other rate schedules may have RMA surcharges or surcredits if needed to implement the rate spread methodology.

As for rate design, the signatories agreed to implement time of day demand and energy pricing on an experimental basis for Schedules 48/200. This experiment will continue until PacifiCorp's next general rate case. PacifiCorp will complete a study within 12 months that analyzes the wholesale cost differences between on-peak and off-peak rate differentials. PacifiCorp will also collect data to analyze the effectiveness of this program, including analysis of the ability of Schedule 48 customers to change usage patterns. Finally, Schedule 28/200 tailblock equalization "shall be as described in PPL Exhibit 1204, Griffith/6-7 and Staff Exhibit 900, Breen/15." Stipulation at 6.

The signatories agreed to adopt CUB's proposed bill proration method, which prorates residential bills based on the number of billing days in the meter read cycle.[6] The proration provides a more equitable treatment of kWh allocation, so that customers with a longer billing cycle, particularly in the winter months, will not be penalized. The signatories further agreed that any consumer complaints that relate to the

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[5] The stipulation states:

> Except for the modification indicated, the Parties agree that the rate spread methodology as shown in PPL Exhibit 1210, Griffith/1 is the appropriate rate spread methodology to employ in setting rates in UE 170.

PPL Exhibit 1210, Griffith/1 is an Excel spreadsheet. While the formula is embedded in the spreadsheet, the spreadsheet itself does not explain the methodology used to generate the numbers shown on the spreadsheet.

[6] This essentially implements daily blocks for all bills.

correct application of the bill proration proposal for residential customers will not be counted against PacifiCorp's consumer complaint metrics.

Finally, the signatories agreed that rate changes due to the order in this docket will go into effect October 4, 2005. PacifiCorp previously submitted a letter extending the suspension period through October 3, 2005.

Pension Expense - PacifiCorp will adjust its pension expense to reflect the $52.5 million revenue requirement increase in light of the cost of capital agreement. This permits PacifiCorp to recover its full FAS 87 pension expense.

The parties agreed that the following issues were excluded from the fourth partial stipulation:

For Staff, ICNU and CUB – tax adjustments.

For ICNU and CUB – RVM proposal and RVM power cost adjustments.

For ICNU – fuel handling correction; allocation treatment of certain qualifying facilities; prudence of West Valley Lease, the Gadsby CTs and Currant Creek projects; UM 995 deferral period outages; waiver of OAR 860-038-0080(1)(b); treatment of costs related to development of RTO; and Third Partial Stipulation issues, including a GRID model outage and heat rate update adjustment.

The parties agreed that the stipulated adjustments, and the revenue requirement level resulting from application of the adjustments, are fair and reasonable and recommended that the stipulation be adopted.

Commission Resolution

This stipulation also was supported by PacifiCorp, Staff, CUB, ICNU and Fred Meyer. As we previously stated, the effect of this stipulation would reduce the revenue requirement increase to approximately $52.5 million.[7] While not all parties agree on each of the specific capital components set forth in the table, above at 10, they do agree that the cost of capital resolution results in a reasonable overall revenue requirement.

The parties also agreed to rate spread and rate design, as well as to an October 4, 2005, effective date for the rate changes. Finally, the parties accepted CUB's proposal for prorating bills. This proposal ensures that customers won't be charged at a higher rate simply because one billing cycle was longer than another billing cycle, causing the customer to be billed at a higher block rate due to usage.

[7] This amount will change based on our decision in this order on the matters the parties were unable to resolve.

The signatories believe these adjustments are supported by the evidence and are fair and reasonable. We agree. The stipulation set forth in Appendix E is adopted.

3. Klamath Basin Irrigators' Interim Rate Proposal

In its rate filing, PacifiCorp sought to change rates paid by irrigators in the Klamath Basin. That issue has been removed from this portion of the proceeding, and will be resolved by separate order. However, we've been asked to adopt a proposal to allow the current rates to serve as interim rates until the Klamath Basin irrigator rates are resolved. We address this proposal under stipulated issues.

For almost 50 years, PacifiCorp served irrigators located in the Klamath Basin under historic contracts that provide rates below PacifiCorp's general tariff schedules. Irrigators located within the federally-designated boundaries of the Klamath Project (On-Project Irrigators) buy power from PacifiCorp at rates established pursuant to a contract between PacifiCorp's predecessor, the California-Oregon Power Company (Copco), and the United States Bureau of Reclamation. This contract (On-Project Contract) expires by its terms in April 2006. The Klamath Basin irrigators located outside the boundaries of the Klamath Reclamation Project (Off-Project Irrigators) buy power from PacifiCorp pursuant to a separate contract between Copco and an association representing irrigation customers. This second contract (Off-Project Contract) was executed April 30, 1956, but contains no express termination date.

As part of its general rate filing in this docket, PacifiCorp proposed to move both the On-Project and Off-Project irrigators to standard tariff rates concurrent with the expiration of the On-Project Contract. The Commission opened a separate docket, UE 171, to separately address PacifiCorp's proposal, but later remanded the issue back to this proceeding. *See* Order No. 05-726.

Organizations representing the irrigation customers and other interested parties agree that the rate for Klamath Basin irrigation customers need not be completed prior to the suspension date for this general rate proceeding, but should be resolved prior to the expiration date of the 1956 on-project contract. *See,* ALJ Ruling issued June 30, 2005. To accomplish this, the parties suggest that the Commission use the current historic contract rates, set forth in Schedule 33, as interim rates for these irrigation customers when setting PacifiCorp's revenue requirement in the general rate proceeding. The parties further agreed that, once a Commission decision is made regarding the rates for the Klamath Basin irrigators, PacifiCorp should spread any revenue requirement impact of that decision to other customer classes through an adjustment to its rate spread/rate design.

Commission Resolution

Under the unique circumstances presented in this proceeding with the expiration of the On-Project contract in 2006, the test year for this rate proceeding, we agree with and adopt the parties' proposal. The current historic contract rates, set forth in PacifiCorp's Schedule 33, will be adopted as interim rates for these irrigation customers for purposes of setting PacifiCorp's revenue requirement in this proceeding. Once a decision is made regarding the rates for the Klamath Basin irrigators, we will direct PacifiCorp to spread any revenue requirement impact arising from that decision to other customer classes through a revenue-neutral adjustment to its rate spread/rate designs.

CONTESTED ISSUES

Having addressed the five filed stipulations, we turn to the remaining contested issues in this case: treatment of taxes; RVM and power cost adjustments; prudence of West Valley Lease, Gadsby CTs and Currant Creek projects; waiver of OAR 860-038-0080(1)(b); treatment of costs related to development of a Regional Transmission Organization (RTO); UM 995 deferral period outages; and allocation treatment of certain qualifying facilities under the Revised Protocol.

1. Taxes

The issue of how to address income taxes as part of the revenue requirement was an area of fundamental disagreement between PacifiCorp on one side and Staff and intervenors on the other. To a lesser degree, Staff and intervenors disagreed among themselves as to the appropriate way to handle this issue. We first provide a background and factual findings for the present dispute and then discuss the various positions of the parties. Next, we discuss legal parameters to our decision, including the overlay, if any, of recently enacted SB 408. Finally, we set forth our decision as to how taxes will be addressed in this docket.

<u>Background and Factual Findings</u>

A utility's federal and state income taxes are allowed as operating expenses for ratemaking purposes. To calculate these taxes, the Commission has historically used a stand-alone methodology. "Under the 'stand-alone' method, ratemaking tax expense is calculated based on the items of income and expense included in the regulated utility's revenue requirement calculation." Staff/1000, Conway-Johnson /2. This method looks only to the regulated revenues and operating costs of the utility itself, without regard to the utility's unregulated activities or the operations and actions of its parent and other affiliated companies.

Recently, the Commission's use of the stand-alone methodology has come under criticism due to the potential mismatch between monies collected from ratepayers to pay taxes and the actual amount of taxes paid to the taxing authorities. Because tax laws allow a utility's corporate holding company to file consolidated tax returns reflecting its full span of operations, losses in some operations can offset profits in others. Thus, consolidated tax reporting may result in amounts collected for taxes in a utility's rates to exceed the taxes the parent company actually pays.

In response to these concerns, the 2005 Oregon Legislative Assembly passed SB 408. This bill requires utilities to file certain utility tax information with this Commission. After reviewing this information and upon making specific findings, the Commission must direct the utility to implement an automatic adjustment clause to ensure that ratepayers are not charged more tax than the utility or its affiliated group pays to units of government that is properly attributed to the regulated operations of the utility. Although SB 408 contained an emergency clause, making the bill effective upon the Governor's signature, which occurred on September 2, 2005, the automatic adjustment clause applies only to taxes paid to units of government and collected from ratepayers on or after January 1, 2006.

The controversy relating to utility taxes affects PacifiCorp, which was purchased by ScottishPower in 1999. *See,* Order No. 99-616. Shortly after the purchase, ScottishPower created PacifiCorp Holdings, Inc. (PHI) to serve as a non-operating, direct, wholly owned subsidiary. PHI was capitalized with an intercompany acquisition-related loan, which is a loan on PHI's books, rather than PacifiCorp's. PHI then used that loan to acquire ScottishPower's shares of PacifiCorp's. The interest that PHI pays to ScottishPower is deductible on PHI's consolidated income tax returns (filed on behalf of PacifiCorp and other PHI affiliates). The effect of this deduction is to eliminate or substantially reduce the consolidated group's taxable income, resulting in PacifiCorp collecting more money from ratepayers than the consolidated group pays in taxes to governmental units. CUB/100, Jenks/5.

Parties' Positions

Both CUB and ICNU recommend abandonment of the stand-alone methodology, with each party proposing slightly different tax adjustments utilizing the interest deduction at PHI.[8] CUB allocates the $160.31 million interest expense deduction using PacifiCorp's proportionate share of gross profits to PHI (91.5 percent). CUB adjusts this system-wide figure to determine Oregon's jurisdictional share (28.8 percent), and then calculates the tax deduction using the 35 percent federal tax rate. CUB contends that its methodology, which results in an adjustment of $14.83 million, is an attempt to make a better forecast of PacifiCorp's tax liability in test year 2006. CUB asserts that the adjustment is reasonable. It notes that, although PacifiCorp is the primary asset of PHI, and PacifiCorp's rates are the main source of income to pay the PHI debt, its customers are not the primary recipients of the consolidated tax deductions that come from the interest payments on that debt.

ICNU allocates the $160.31 million interest expense adjustment using the percentage of PHI assets related to PacifiCorp's activities (94.72 percent). Like CUB, ICNU similarly adjusts this amount to determine the Oregon jurisdictional share based on percentage of rate base, but then uses the Oregon composite tax rate of 37.95 percent to

[8] Although CUB and ICNU both claim their adjustments are consistent with the stand-alone methodology, the fact that their adjustments are based on the actions of PacifiCorp's parent company necessarily implies the rejection of this historically used methodology.

calculate its proposed $16.64 million tax adjustment. ICNU contends the Commission should adopt this adjustment to reduce PacifiCorp's revenue requirement and eliminate the amount of "phantom taxes" being assessed by PacifiCorp that will never be paid to taxing authorities. ICNU adds that PHI will retain the tax benefit of its corporate structure, while little or no taxes will be paid on PacifiCorp's income.

ICNU also asserts that newly enacted SB 408 applies to this proceeding. Specifically, ICNU cites Section 2 (1)(f) and Section 5:

> Utility rates that include amounts for taxes should reflect the taxes that are paid to units of government to be considered fair, just and reasonable.
>
> ORS 757.210 is amended to read:
>
> * * *
> The commission may not authorize a rate or schedule of rates that is not fair, just and reasonable.

ICNU argues that the Commission must, in this order, consider the taxes paid to units of government when establishing rates.

Staff continues to support a stand-alone methodology for calculating taxes, with one significant change. Staff contends that the Commission can consider tax benefits at the holding company level, in this case, at PHI, if the Commission determines that including the benefits in rates meets the benefits/burdens test outlined in *City of Charlottesville, Virginia v. FERC,* 294 U.S. App. C.C. 236, 774 F.2d 1205 (1985). This test is applied when a stand-alone methodology is used. Simply stated, it provides:

> The benefits of consolidated tax savings are given to ratepayers (by reducing the jurisdictional affiliate's tax allowance) if they bore the burden of paying the deductible expenses that generated the savings. *Id.* at 1208.

Staff did not allocate any of the PHI tax benefit to customers. Instead, it treated the PHI load and attendant tax benefits as events that would reduce PacifiCorp's cost of debt. Staff found it necessary to make some assumptions to estimate the effect of PHI's debt on PacifiCorp's cost of borrowing. Using its assumptions, Staff estimates that PacifiCorp's ratings could be as much as one full rating higher (BBB to A) if the PHI debt did not exist. Staff states this lower rating results in an approximate increase in all-in costs of 53 basis points. PacifiCorp issued $1.9 billion in debt between 2000 and June 2005, which accounts for 47 percent of PacifiCorp's total debt. Using the revenue requirement model in this docket with the 53 basis points and the 47 percent ratio, Staff calculates this change is worth approximately $4.6 million annually. Therefore, Staff recommends that PacifiCorp's tax expense be reduced by $4.6 million to reflect the burden customers are bearing due to PHI's debt.

PacifiCorp argues that the Commission's long-standing practice of treating taxes on a stand-alone basis should be maintained and upheld as the practice has been consistently used in prior rate cases and is codified in the Commission's own rules.[9] It strenuously asserts that any change to that policy in this docket would be inappropriate, and possibly illegal.

PacifiCorp claims that none of the parties questioned the accuracy of its stand-alone tax expense, but rather proposed adjustments based upon the tax liability of its parent, PHI. These adjustments are tax "savings" which result from PHI's interest payments on the debt used to finance ScottishPower's acquisition of PacifiCorp. According to PacifiCorp, the three proposed adjustments are contrary to the Commission's obligation to prevent cross-subsidization of regulated and unregulated activities. *See*, Order No. 03-691.

Even if the Commission determines that adjustments to the revenue requirement for taxes are permissible, the application of the benefits/burden standard does not show that ratepayers have had the burden of paying the deductible expenses that generated the savings. Therefore, according to PacifiCorp, since there is no burden, but actually a benefit, no adjustment should be made to PacifiCorp's revenue requirement under any benefits/burdens approach.

Commission Discussion and Resolution

SB 408 and its application to this proceeding - The issue of tax treatment for utilities was debated in the legislature and in the media. The legislative result was SB 408, which was a response to the reaction caused by the inclusion of earmarked taxes in rates and the fact that, in some cases, the utility (or the affiliate that pays taxes on behalf of the utility) does not deliver all of the earmarked taxes to tax authorities.

This bill, which has only recently been enacted, is complex. At the time of signing the bill, Governor Kulongoski noted that many "difficult questions about the impact and implementation of SB 408 [were left] to the Oregon Public Utility Commission."[10] We share the Governor's observations, and have opened a permanent

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[9] PacifiCorp is referring to OAR 860-027-0048. The relevant sections are:

> (4) The energy utility shall use the following cost allocation methods when transferring assets or supplies or providing or receiving services involving its affiliates:
>
> * * *
>
> (h) Income taxes shall be calculated for the energy utility on a standalone basis for both ratemaking purposes and regulatory reporting. When income taxes are determined on a consolidated basis, the energy utility shall record income tax expense as if it were determined for the energy utility separately for all time periods.

[10] We take official notice of the letter from Theodore R. Kulongoski, Governor to Honorable Bill Bradbury, Secretary of State, dated September 2, 2005.

rulemaking docket (AR 499) to address the many uncertainties of the interpretation and application of SB 408.

In the meantime, ICNU has raised the issue of whether SB 408 applies to this proceeding. It argues that it does, and we agree. The plain language of Section 6 of SB 408 declares that "this 2005 Act takes effect on its passage." While certain portions of the bill cannot be implemented until a later date[11], other sections of the bill can be implemented immediately.[12]

In Section 5 of the bill, the legislature specifically added language to ORS 757.210(1). First, the word "fair" was added to the utilities' burden and Commission's determination. This word, in and of itself, may not be significant. While we are to assume that language which modifies a statute intends to change existing law, there is nothing in the legislative history to indicate the intent of the legislature when it added this word. *See, Jones v. General Motors Corp.,* 325 Or. 404, 414 at Fn 6, 939 P.2d 608 (1997), *clarifying Fifth Avenue Corp. v. Washington Co.,* 282 Or. 591, 597-98, 581 P.2d 50 (1978). Another change to ORS 757.210(1)(a) was the addition of a sentence to the end of the section: "The commission may not authorize a rate or schedule of rates that is not fair, just and reasonable." Again, as we have always been required to establish fair and reasonable rates[13], we still were not convinced that the addition of this sentence by the legislature had added to or changed our ratemaking authority.

However, a review of the general policy statement found in the preamble of SB 408 causes us to believe that the legislature intended immediate action. This preamble language states: "Utility rates that include amounts for taxes should reflect the taxes that are paid to units of government to be considered fair, just and reasonable." SB 408, Section 2 (1)(f). While general policy statements can serve as contextual guides, "they are instructive only insofar as they have genuine bearing on meaning of provision that is being construed." *DLCD v. Jackson County,* 151 Or.App. 210, 218, 948 P2d 731 (1997), *rev. den.* 327 Or 620, 971 P2d 412. In this instance, the legislature adopted a statute requiring that consideration be given to taxes paid by certain public utilities.[14] The policy statement language of Section 2(1)(f) uses the same words as are found in revised ORS 757.210(1)(a). In interpreting this language, we believe we are required to consider taxes paid to governmental units when setting rates for PacifiCorp in this docket.

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[11] For example, review of the utility filed tax reports and implementation of an automatic adjustment clause.

[12] For instance, revisions to ORS 757.210(1)(a) found in Section 5.

[13] "The commission shall balance the interests of the utility investor and consumer in establishing fair and reasonable rates." ORS 756.040(1).

[14] SB 408, Section 3(12) applies to certain specific public utilities described by the following language:

A) A regulated investor-owned utility that provided electric or natural gas service to an average of 50,000 or more customers in Oregon in 2003; or

B) A successor in interest to an entity described in subparagraph (A) of this paragraph that continues to be a regulated investor-owned utility.

PacifiCorp is one of four utilities that meets these requirements.

The legislative intent behind SB 408 is clear – we are to depart from historic practice and consider taxes paid by a utility or its parent when setting rates.[15] When we authorize rates for the utilities covered by the bill, those rates must reflect the taxes paid to units of government in order to be fair, just and reasonable.

Determining a tax adjustment - Having decided that we must apply SB 408 to this docket, we turn to the positions of the parties. We must reject PacifiCorp's recommendation to maintain our stand-alone approach as we are required to attempt to match the taxes collected from ratepayers to the taxes paid by the utility and its parent to governmental units.

We also reject PacifiCorp's argument that our administrative rule requires a stand-alone approach. *See* fn. 9. While we agree with PacifiCorp that we must follow our own rules, we view this rule differently than PacifiCorp. This rule is an accounting rule, which requires an energy utility to keep its books of account on a stand-alone basis. Frankly, that is reflective of our historic practice, which the legislature has told us to change. In the past, we have always done the tax calculation on a stand-alone basis, so we ask utilities to keep books of account that reflect our practice. We are not, however, bound to maintain our practice of stand-alone calculations, particularly when a new statute comes into play. The rules promulgated under SB 408 may require adoption of different accounting rules. If so, we will amend OAR 860-027-0048 rule so that utilities can provide the information we need for ratemaking purposes and regulatory reporting.

We also reject Staff's proposed adjustment. We acknowledge that customers may be bearing the burden of PHI debt if such debt caused PacifiCorp's debt costs to be higher than they would have otherwise been. However, Staff acknowledges that its estimates as to the amount of that burden are "imprecise" because rating agencies use their discretion in making ratings and do not simply rely on credit metric formulas. More importantly, however, Staff does not allocate any of the interest expense deduction or tax benefit among the various PHI affiliates, and specifically PacifiCorp. As this is the process envisioned in SB 408, we reject the adjustment recommended by Staff.

Accordingly, we are left with the adjustments proposed by CUB and ICNU. As described above, the parties' adjustments are similar, but differ in methodology. The primary difference between the two is the method of allocating the interest expense deduction among PHI affiliates. CUB bases its allocation on gross profits, while ICNU uses PacifiCorp's share of net assets. Of the two, we find CUB's methodology more persuasive, even though it based its methodology on gross profits, rather that net taxable income, which is the basis for taxes. While gross profits are obviously distinguishable from net taxable income, CUB's adjustment is based on profits, which represents a better allocation factor than using net assets, as proposed by ICNU.

[15] Assuming, *arguendo,* that we are incorrect in holding that the legislature intended SB 408 to apply to this rate case, we choose to use our discretion and apply SB 408 principles to this rate case.

CUB chose to make its adjustment based solely on federal taxes, and declined to make any recommendations concerning Oregon taxes. We believe it is more appropriate to use a composite rate in an attempt to have taxes collected from ratepayers more closely match taxes paid to the state and federal governments. Therefore, CUB's $14.8 million should be adjusted to use the composite tax factor of 37.95 percent rather than solely using the federal rate of 35 percent. This results in an adjustment to taxes of $16.07 million. Interestingly, CUB's revised adjustment of $16.07 million and ICNU's recommended adjustment of $16.64 million turn out to be fairly close, differing by just $0.57 million.

In reaching this decision, we acknowledge that this adjustment is not precise. But it is reasonable, and it is the best we can do under present circumstances.

Our first goal – one which we believe SB 408 requires – is to do our best to align the estimated taxes included in PacifiCorp's rates with the amount that PacifiCorp (or its affiliated group) will eventually pay. It is not possible to know what PacifiCorp (or its affiliated group) will pay each year, but we know that the PHI tax benefit is a constant that SB 408 requires to be passed on to customers. That means that, over time, we will do a better job of meeting the goals of SB 408 if we reflect that tax benefit in the rates we are now setting for PacifiCorp.

Doing a better job of aligning estimated taxes included in rates with the amount that a utility or its affiliate group eventually pays is consistent with our second goal. That goal is to reduce, to the extent possible, the amount that flows through the automatic adjustment clause. Because we know that the PHI tax benefit will flow to customers, we will likely reduce, over time, the amount flowing through the clause if we now lower what we allow PacifiCorp for taxes in this case. As we say above, because there is no way to predict the actual tax payment of PacifiCorp (or its affiliate group) for each year, we cannot say that reflecting this benefit will precisely match taxes in rates with taxes PacifiCorp will pay each year, but we can say that, over time, our decision should reduce what flows through the account.

2. Transition Adjustment Mechanism (TAM)[16]

In Order No. 04-516 (Docket No. UM 1081), this Commission adopted an interim transition adjustment mechanism for PacifiCorp to use for direct access during the Fall 2004 open enrollment window. In our order, we mused about some items that should be included a long-range transition adjustment. For example, we stated that, "Ideally, a transition adjustment will value utility resources impacted by direct access based on actual, appropriate operational responses." *Id.* at 10. We also said our desire was to develop a TAM that values resources on PacifiCorp's actual operational responses based on appropriate planning. *Id.* at 12. We directed PacifiCorp, Staff and other parties

[16] Parties have used the terms "Transition Adjustment Mechanism (TAM) and Resource Valuation Mechanism (RVM) interchangeably throughout the proceedings. We use the term "Transition Adjustment Mechanism (TAM) in this order as it applies to PacifiCorp. We maintain usage of RVM when referring to PGE.

to meet and work towards developing a TAM that values resources affected by direct access using actual, appropriate operational responses, and addresses how GRID model projections would change if PacifiCorp's operational assumptions change, or if the characteristics of direct access programs change. *Id.* at 11, 12-13. Finally, we directed PacifiCorp, Staff and other parties to continue investigating the utilization of transmission rights and the proper value of avoided transmission. PacifiCorp was ordered to file a TAM by November 15, 2004. PacifiCorp complied with this order by filing its TAM as part of the general rate case filing.

Parties' Positions

PacifiCorp's proposed TAM relies on its power cost model, GRID. PacifiCorp proposes to make two GRID runs for each rate schedule, one with full Oregon load and one with a 25 MW load reduction shaped according to the rate schedule. These runs will be used to calculate the weighted market value of the energy used to serve direct access customers. The TAM then calculates the adjustment by comparing the weighted market value to the cost of service rate under the customers' specific, energy-only tariff. Included in the process is an annual power cost update to ensure that both the weighted market value and the cost of service are calculated for the same period using the same data. PacifiCorp chose to procedurally base its TAM on the RVM utilized by PGE, with the hope that it would be easier to use a model that has already been tested by the Commission.

Staff agrees that a TAM should be in place, and should be updated annually. In the Third Partial Stipulation, Staff reached agreement with PacifiCorp as to the costs to be included in the 2006 TAM.[17] No agreement has been reached as to costs to be included in any future TAMs. Staff believes that the agreed-to TAM will provide an accurate accounting of the likely impacts of direct access on PacifiCorp's system operations. According to Staff, this process should result in transition adjustment rates that prevent unwarranted cost shifts between utility investors and direct access customers.

CUB does not take a position on the specific calculation of adjustment rates, but rather argues that whatever process is adopted should not apply to residential customers. CUB states that the purpose of the TAM is to identify the transition benefit or charge for direct access customers. Since residential customers are neither eligible for nor benefit from direct access, residential customers should be exempt from its application and not subject to the annual Net Variable Power Cost update.

ICNU advocates for a "market-plus" approach, similar to the approach it argued in Docket No. UM 1081. This approach assumes that PacifiCorp will avoid energy purchases and related transmission expenses due to customers going direct access. ICNU also objects to an annual process, stating that it is unnecessary, harmful to

[17] In the Third Partial Stipulation, Staff and PacifiCorp agreed that if the Commission approved PacifiCorp's TAM, the final GRID run will exclude deferred maintenance, thermal ramping, station service and planned outages adjustments for 2006.

ratepayers, unduly burdensome, and addresses a non-existent problem. According to ICNU, the PacifiCorp TAM does not capture the value of the freed-up resources because it does not simulate the planning and operational changes that would occur if customers elect direct access, does not reflect changes in transmission costs, and may include other "biases" that undervalue resources used to serve direct access customers. ICNU Opening Brief at 39.

Staff opposes ICNU's market-plus approach as it would not accurately account for the likely impacts of direct access on PacifiCorp's operations. Staff Prehearing Brief at 17. Staff also opposes CUB's recommendation as it would create two cost-of-service rates for customers, one for direct access eligible customers and one for non-eligible customers, adding unwieldy complexity to the ratemaking process.

PacifiCorp also opposes both ICNU's and CUB's recommended approaches. PacifiCorp states that ICNU's approach has already been rejected by the Commission in Order No. 04-516. Further, PacifiCorp asserts, any argument about graveyard hour market liquidity caps has been mooted by the stipulation submitted May 4, 2005. As to ICNU's issue about planning for direct access load loss, PacifiCorp points out that this is an issue in its current integrated resource plan, Docket No. LC 39. Finally, PacifiCorp argues that annual updates are not unduly burdensome, and that the updates ensure that the TAM applied to departing customers is accurate.

PacifiCorp urges us to reject CUB's proposal, as updating power costs for a subset of customers would be extremely difficult. PacifiCorp also agrees with the Staff that it is desirable to maintain a single set of cost-of-service rates.

Commission Resolution

We adopt the TAM proposed by PacifiCorp with annual updates, and we adopt the specific 2006 adjustments agreed to by Staff and PacifiCorp as shown in PPL/604-606 and PPL/607-608 except for the Deferred Maintenance, Thermal Ramping, Station Service and Planned Outages adjustments. These exhibits are attached as Appendices F and G and incorporated herein. We find that the TAM proposed by PacifiCorp, with annual updates, most closely meets the requirements established in Order No. 04-516. The purpose of the TAM is not to promote direct access, as ICNU would have us do. Rather, the TAM is to capture costs associated with direct access, and prevent unwarranted cost shifting. We also agree that adopting an approach similar to PGE's RVM will hopefully mitigate some of the complexity involved in this process.

Having adopted the TAM, however, we believe that further investigation is necessary into some of the concerns raised by the parties. We are somewhat concerned about establishing the TAM with its annual update because there is a certain amount of one-sidedness to PacifiCorp's annual updates without concomitant adjustments by intervenors and Staff. We will continue to look at the TAM and investigate to whatever extent we believe is necessary.

3. Prudence Issues

West Valley Lease

PacifiCorp entered into the West Valley lease on March 5, 2002. On May 31, 2002, the Commission approved the lease pursuant to ORS 757.495, determining that the lease met the requirements of our administrative rules by complying with the "lower of cost or market" standard. *See,* Order No. 02-361, Appendix A at 6. Since June 1, 2002, the West Valley lease has been included as part of net power costs in PacifiCorp's rates.

In 2004, PacifiCorp issued RFP 2004-X, which solicited proposals for a lower-cost alternative to the West Valley lease. As PacifiCorp did not find a lower-cost alternative, it decided not to exercise its option of terminating the lease. PPL/901, Tallman/7.

Due to ICNU's assertion that PacifiCorp could have met its need through RFP 2003-A, PacifiCorp analyzed the RFP 2003-A market offerings and compared them to the West Valley lease. The results of the analysis showed the market alternatives to be $181 million less economical than the West Valley lease, if costs of direct debt are included. PPL/903, Tallman/2.

Staff analyzed the acquisition of the West Valley lease in 2002 in Docket UE 134, and concluded that PacifiCorp was acting prudently in entering into the lease. (UE 134; Staff 200). Staff asserts that the initial acquisition of this resource in 2002 was prudent. In 2004, PacifiCorp also made a prudent decision when it passed on an option to terminate the lease, says Staff. In this docket, Staff reviewed the RFP 2004-X process, which solicited market proposals as alternatives to West Valley. Upon review, Staff concluded that PacifiCorp acted prudently in retaining the lease. Staff recommends that the Commission reject ICNU's proposed adjustment related to West Valley.

Gadsby CT

In late 2001, PacifiCorp entered into a contract with General Electric (GE) to lease some mobile CT peaking units to be installed at PacifiCorp's Gadsby site. During the life of the agreement, GE offered PacifiCorp larger and more efficient equipment to install at the Gadsby site. As part of the offer, GE agreed to waive the remaining $7.5 million lease obligation due under the initial contract. PacifiCorp accepted the offer.

ICNU proposes a $7.5 million adjustment, as PacifiCorp received a one-time savings that should flow through to customers rather than shareholders. The cost reduction was never reflected in rates. Further, PacifiCorp had a conflict of interest when it negotiated for the new equipment. In its review, the Utah Division of Public Utilities' Staff supported such a disallowance in Utah.

Staff recommends that we reject ICNU's proposed adjustment, stating that it did not see any conflict of interest. Further, according to Staff, GE's offer was better than the competing offers PacifiCorp was pursuing for replacement, even excluding the waiver of the remaining lease obligation.

Currant Creek, Phase One

After evaluating the alternatives presented through RFP 2003-A, PacifiCorp determined to construct the Current Creek project. PacifiCorp's assessment was supported by the external consultant hired by PacifiCorp to evaluate the bids. This consultant, Navigant Consulting, Inc., determined Current Creek to "be the lowest cost resource option within the contest of the RFP process." PPL/900, Tallman/5, citing Navigant report at 5.

ICNU contends that the costs of Current Creek are above market and should be excluded as imprudent expenses.

Staff analyzed the economic evaluation done by PacifiCorp supporting the acquisition of Currant Creek, and concluded that the resource was the least cost option, and would provide benefits to customers.

Commission Resolution

When reviewing PacifiCorp's decisions about West Valley, Gadsby and Currant Creek, we look to whether the actions were reasonable at the time that PacifiCorp made those decisions. As we have previously stated: "Prudence is determined by the reasonableness of the actions 'based on the information that was available (or could reasonably have been available) at the time.'" *In re PacifiCorp,* Docket Nos. UM 996/UE 121/UC 578, Order No. 02-469 at 4, citing *In re PGE,* UE 102, Order No. 99-033 at 36-37 (footnote omitted). In a prudence review, "we cannot let the luxury of hindsight allow us to second guess a utility's conduct." *In re PGE,* Docket No. UE 139, Order No. 02-792 at 11. It is possible that a prudently-made decision in the past might turn out to be "wrong" in the future. We cannot use hindsight, however, to judge the utility's decision.

We hold that PacifiCorp's decisions regarding the West Valley Lease, Gadsby CTs and Currant Creek Phase I were prudent decisions and the costs of these resources should be included in rates. Staff review of all three resources establishes that PacifiCorp acted prudently in its actions for all three resources, as all three were analyzed against results of a competitive bidding process.

4. Waiver of OAR 860-038-0080(1)(b)

On June 6, 2005, PacifiCorp filed an application for waiver of OAR 860-038-0080(1)(b)[18] as to its acquisition of three generating resources: West Valley lease, Gadsby, and Phase One of Currant Creek. PacifiCorp wished to include the following in revenue requirement: 1) the capital costs of Gadsby and Currant Creek in rate base for ratemaking purposes; 2) the operations and maintenance costs of Gadsby and Currant Creek; and 3) the costs associated with the West Valley lease. PacifiCorp's Application for Waiver at 1.

Parties' Positions

In its application, PacifiCorp cited OAR 860-038-0001(4)[19] which allows the Commission to waive a Division 38 rule upon "good cause shown." PacifiCorp noted that costs of two of the resources (Gadsby and West Valley) are already included in revenue requirement, and that Gadsby is currently included in rate base.

The waiver is in the best interests of customers, asserts PacifiCorp, because it has already shown in its Integrated Resource Plan, through testimony in Dockets UE 134 and UE 147, and testimony in this case that its generating resource portfolio, which includes all three resources, provides its customers with price and rate stability. Currant Creek and West Valley were procured through a competitive process, and Gadsby compares favorably with both, PacifiCorp argues. These resource decisions are sound, and, PacifiCorp asserts, are in the best interests of customers. PacifiCorp asks that the Commission waive application of the rule.[20]

On June 23, 2005, ICNU filed a response to PacifiCorp's application. ICNU itemized numerous reasons in its response and in its briefs why the application should be denied:

1. Filed too late in the proceeding.
2. Commission never determined that costs of the three resources were prudent, or that they should be included in rates at cost.
3. Granting application would violate SB 1149 because direct access customers would be subject to the costs of new resource decisions, and it could result in new stranded costs.

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[18] This rule states:

> Electric companies must include new generating resources in revenue requirement at market prices, and not at cost, and such new generating resources will not be added to an electric company's rate base even if owned by the electric company.
>
> [19] Upon application by an entity subject to these rules and for good cause shown, the Commission may relieve it from any obligations under these rules.

[20] In Order No. 05-133, Docket No. UM 1066, we stated:

> If an electric utility wants to include a new resource in its revenue requirement at cost . . . then the utility must file a request to waive the administrative rule. *Id.* at 2.

4. Granting application would violate ORS 757.646 by increasing PacifiCorp's vertical and horizontal market power.
5. PacifiCorp has not developed an opt-out option as required by Order No. 05-133.
6. PacifiCorp has not proposed any way to mitigate the anticompetitive impacts of cost-based treatment for new resources.
7. Waiving the rule after construction or purchase of resource provides inappropriate incentives to the utility if "market price" means current market price.
8. PacifiCorp failed to meet its burden of proof in establishing that waiver of rule is in the public interest.

Staff asserts that PacifiCorp has shown that including these facilities in rates at cost is beneficial to customers. The acquisition process, cost and impact upon customers of the West Valley CTs were analyzed in UI 196 and UE 134. Staff concluded in UE 134 that PacifiCorp was prudent in entering into the lease agreement. Further, the Commission has already concluded, in Order 02-361 (Docket No. UI 196) that the lease agreement was fair, reasonable and not contrary to the public interest. Staff/800, Wordley/4, citing UE 134, Staff/200 (testimony in Docket No. UE 134). The Gadsby CTs were included in rates at the same time as West Valley. *See*, Order No. 02-343.

As for Currant Creek, it resulted from RFP 2003A, and will be coming on line shortly before the entry of an order in this docket. Staff analyzed the economic evaluation done by PacifiCorp supporting the acquisition of Currant Creek, and concludes that the resource was the least cost option, and will provide benefits to customers. Staff recommends the Commission approve the waiver, and include the three resources at cost.

Commission Resolution

We previously approved a waiver of this rule in Order No. 04-376, Docket No. LC 33. In that instance, PGE asked for a waiver of the rule for the new generating plant it was planning to build (Port Westward). Specifically, PGE asked that the rule be waived so it would not be prohibited from including: 1) Port Westward capital costs in PGE's rate base; 2) operation and maintenance costs of Port Westward in its revenue requirement; and 3) acknowledged contracts with third parties in PGE's revenue requirement. *Id.* at 1.

PGE's request came as part of its Integrated Resource Plan (IRP), and we carefully walked the line about not making a ratemaking decision in an IRP docket. In making our decision, we reviewed the process undertaken by PGE, and the analysis it presented, and determined that including Port Westward's capital costs in rate base and Port Westward's operation and maintenance costs in revenue requirement was appropriate.

In this case, we are making a ratemaking decision. We have already determined that PacifiCorp acted prudently in its actions regarding these three generating resources. Order, *supra* at 23. The question now is whether to waive the rule and allow PacifiCorp to include the resources into its rate base and revenue requirement at cost. We agree with Staff's recommendation, and grant the application to waive OAR 860-038-0080(1)(b).

Although we have considered all of ICNU's objections, we will respond to only a few of them here. We do not agree that we have violated any provisions of SB 1149 or ORS 757.646 in granting this application. On the contrary, we have engaged in a similar review process as to the one undertaken for PGE. Our review supports our determination that least cost options have been used, and that these resources will provide benefits to customers. While we have asked parties to continue working on an opt-out option, we never made an opt-out option a requirement for our case-by-case determination of whether the rule should be waived for specific generating resources. The burden to be met by PacifiCorp is "good cause," which it has established.

5. Regional Transmission Organization (RTO) Costs

PacifiCorp has been involved for at least five years in developing an RTO, currently known as Grid West. PacifiCorp included Grid West expenses as an ongoing regulatory expense. PacifiCorp expects the level of costs for consulting, airfare, lodging, along with secondary salary, legal and other employee expenses to remain the same after Grid West becomes operational. These costs total, on a company-wide basis, $3.057 million for the 2006 test year, of which approximately $0.9 million is the Oregon-allocated amount.

ICNU, through witness James Selecky, states that because the RTO is neither operational nor expected to be operational during the test year, the expenses associated with the RTO are neither used nor useful during test year 2006. Further, these RTO related expenses do not provide any current benefit to ratepayers. Therefore, RTO related expenses should be excluded from the revenue requirement until such time as an RTO is operating and providing a benefit to customers. ICNU recommends that a deferred account be established for RTO expenses, which should be subject to a comprehensive prudency review once an RTO provides benefits to Oregon ratepayers.

Staff agrees that these RTO expenses should be included in revenue requirement as on-going costs. Staff points out that the Grid West proposal includes staged implementation, which requires ongoing development work by PacifiCorp and other entities in the region.[21] The costs are reasonable, and should be included in the test year revenue requirement.

[21] According to Staff, the testimony supporting *Partial Stipulation filed May 4, 2005,* indicates that CUB and Fred Meyer, along with PacifiCorp and Staff, support including Grid West development costs. *See,* Staff/1400; Brown/3. CUB, however, in its prehearing brief says that it takes no position on the issue. CUB Prehearing Brief at 5, dated July 13, 2005.

Commission Resolution

The RTO related costs, which include consulting, airfare, lodging, other employee expenses, legal and secondary salary expenses, are expected to continue after Grid West becomes operational. Although initial operations are not expected to begin until 2007 (*See,* Staff/1402; Brown/2), these expenses have been incurred while meeting FERC requirements to develop regional transmission entities. We find these expenses to be reasonable and hold that they should be included in PacifiCorp's test year revenue requirement.

6. Outages During UM 995 Deferral Period

PacifiCorp uses a rolling 48-month amortization of thermal plant outages. This methodology allows PacifiCorp to include a normal level of thermal plant outages in rates, based on historical information. In this proceeding, the four-year period used includes November 1, 2000 through September 9, 2001, known as the "UM 995 deferral period." As part of *In re PacifiCorp,* Order No. 02-469, the excess net power costs associated with PacifiCorp power plant outages occurring from November 2000 to September 2001 were placed in a deferred account. ICNU alleges that costs incurred during this time have already been paid by Oregon ratepayers, and that PacifiCorp should be required to remove all power plant outages that occurred during this time period. Unless these outages are removed, ICNU contends, PacifiCorp will recover its costs twice.

As part of its calculation, PacifiCorp completely removed the Hunter 1 outage from its calculation by excluding five months of outage information. According to PacifiCorp, if all of the other outages were removed, as requested by ICNU, the net power costs would be much greater. Further, the proposed ICNU adjustment is flawed because all of the outages other than Hunter 1 were consistent with the normal four-year average outage level as shown in power costs in base rates in effect during that specific period.

Staff does not support ICNU's adjustment. Staff explains that all outages for a portion of the historical four-year period were excluded, then the four-year average would be distorted and not reflective of what has occurred. While it makes sense to exclude a one-time aberration such as the Hunter 1 outage, it is nonsensical to exclude other normal, expected outages.

Commission Resolution

We do not agree with ICNU that an adjustment needs to be made. We are looking at the historical trend, absent any unusual circumstances, to forecast what outages may occur in the future. There is no "double recovery" by PacifiCorp by including the normal outages that occurred during the UM 995 deferral period. We agree with the Staff recommendation to include all outages, except for Hunter 1.

7. Revised Protocol (RP) Treatment of Qualifying Facility (QF) Contracts

In Order No. 05-021, this Commission ratified the use of the RP in future rate cases to determine how costs and wholesale revenues associated with PacifiCorp's generation, transmission and distribution systems would be allocated among the six states that comprise PacifiCorp's service territory. One of the elements of the RP is the treatment of new and existing QF contracts.

"Existing QF contracts" are defined as contracts entered into prior to the effective date of the RP, while "new QF contracts" are all QF contracts that are not existing QF contracts. *See,* Order No. 05-021, Attachment A at 50, 52. The costs of new QF contracts are allocated on a system-wide basis, while the costs of existing QF contracts are allocated on a situs basis. *See, Id.*, Attachment A at 38-39. According to the RP, the "Protocol will be effective and apply to all PacifiCorp retail general rate proceedings initiated subsequent to June 1, 2004." *Id.*, Attachment A at 35. While the parties do not dispute that the RP applies to this rate case, they do disagree as to whether four QF contracts (US Magnesium, Desert Power, Kennecott and Tesoro)[22] should be treated as new or existing QF contracts.

ICNU contends that the earliest "effective" date of the RP is January 12, 2005, the date this Commission entered Order No. 05-021. Since the four QF contracts were in place before January 12, 2005, ICNU argues that the contracts should be treated as existing, and not new, contracts. ICNU further argues that June 1, 2004, was merely the "proposed" effective date,[23] and that the RP only became effective upon Commission ratification. [24]

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[22] The initial delivery date for each contract is as follows:

US Magnesium – January 2005
Desert Power – September 2004
Kennecott – October 2004
Tesoro – September 2004

[23] Section II states:

II. Proposed Effective Date
The Protocol will be effective and apply to all PacifiCorp general rate proceedings initiated subsequent to June 1, 2004. *Id.,* Attachment A at 13.

[24] The relevant language is found in Section XIII D, which states:

Interdependency among Commission Approvals
The Protocol has been developed by the parties as an integrated, interdependent, organic whole. Therefore, final ratification of the Protocol by any of the Commissions of Oregon, Utah, Wyoming and Idaho, is expressly conditioned upon similar ratification of the Protocol by the other mentioned Commissions, without any deletion or alteration of a material term, or the addition of other material terms or conditions. Upon any rejection of the Protocol, or any material deletion, alteration, or addition to its terms, by any one or more of the four Commissions, the Commissions who have previously conditionally adopted the Protocol shall initiate proceedings to determine whether they should reaffirm their prior ratification of the Protocol, notwithstanding the action of the other Commission or Commissions. ***The Protocol shall only be in effect for a State upon final ratification by its Commission.*** The Company will continue to bear the risk of the inconsistent allocation methods among the States. *Id.,* Attachment A at 44, emphasis added.

Staff and PacifiCorp disagree with ICNU's interpretation. They contend that the contracts should be treated as new as they were entered into after June 1, 2004, the effective date of the RP. PacifiCorp points out that the RP was filed May 20, 2004, and that the June 1, 2004, effective date would obviously precede the final ratification date by Oregon and other states. The expectation of the signing parties[25] is that the effective date would remain June 1, 2004, unless specifically modified by one or more of the state commission approval orders. In essence, according to PacifiCorp, this Commission ratified the June 1, 2004, effective date when it ratified the RP in January 2005.

Commission Resolution

While we understand the basis of ICNU's argument, we do not agree with it. First, when we ratified the RP in January 2005, we also ratified the contractual effective date of June 1, 2004. This intent has been carried out in this rate case, as PacifiCorp made its filing in November 2004 using the RP. Second, we do not read Section XIII D, the Interdependency Clause, in the same manner as ICNU. This clause provided an "out" to any state commission that ratified the RP prior to action by other state commissions, and later learned that either another state commission decided not to ratify the RP, or chose to modify the terms of the RP. Contrary to ICNU's assertion, the Interdependency Clause does not establish an effective date different than that of June 1, 2004. Third, the title of Section II, Proposed Effective Date, does not modify the language contained in the section. Rather, June 1, 2004, was the "proposed" effective date, which in reality became the effective date once the protocol was ratified by this and other state commissions.

We hold that the effective date of the RP is June 1, 2004. Therefore, the four QF contracts at issue must be treated as new contracts. Under the terms of the RP, the costs will be allocated system-wide and not assigned on a situs basis.

CONCLUSIONS

1. PacifiCorp is a public utility subject to the Commission's jurisdiction.

2. The stipulations, attached as Appendices A, B, C, D and E, should be adopted, subject to the changes made by later filed stipulations, and subject to the income tax adjustment described above.

3. Based on the record in this case, the PacifiCorp rates that result from the stipulations adopted and the conclusions reached in the body of this order are fair, just and reasonable. A results of operations spreadsheet is attached as Appendix H.

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[25] ICNU did not sign the RP, and contested its ratification by this Commission.

ORDER

IT IS ORDERED that:

1. Advice No. 04-018, filed by PacifiCorp on November 12, 2004, is permanently suspended.

2. The stipulations attached as Appendices A, B, C, D, and E are adopted in their entirety, subject to the changes made by later filed stipulations, and subject to the income tax adjustment described above.

3. PacifiCorp will file revised tariffs consistent with the findings of fact and conclusions of law in this order, to be effective no earlier than October 4, 2005.

Made, entered, and effective SEP 2 8 2005.

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.