

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NOS. UE-991255, UE-991262, UE-991409
APPLICATIONS TO SELL THE CENTRALIA POWER PLANT

EXHIBIT NO. 702

WITNESS: Nancy Hirsh, NW ENERGY COALITION

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COMMISSION

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**BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON**

UP168

In the Matter of the Application of PacifiCorp)
for an Order Approving the Sale of its)
Interest in (1) the Centralia Steam Electric)
Generating Plant, (2) the Ratebased Portion)
of the Centralia Coal Mine, and (3) related)
facilities; for a Determination of the Amount)
of and the Proper Ratemaking Treatment of)
the Gain Associated with the Sale; and for)
an EWG Determination.

**DIRECT TESTIMONY OF
BOB JENKS FOR THE
CITIZENS' UTILITY BOARD**

1 I am Bob Jenks. My qualifications are listed in CUB Exhibit 2. My testimony will cover the
2 proper method to allocate the net proceeds from the sale of PacifiCorp's share of Centralia, the
3 shortcomings of the "depreciation reserve methodology" and PacifiCorp's method of estimating the
4 benefit provided to customers, and the environmental considerations appurtenant to the sale.
5

6 I. 100% of the Net Proceeds of the Sale of Centralia Belong to the Customer

7 A. Why customers get 100%.

8 Before I explain why 100% of the net proceeds of the sale of Centralia belong to PacifiCorp's
9 customers, I must clear the air of PacifiCorp's confusing and misleading rhetoric on the subject over
10 the past few years. The net proceeds of the sale of this unit are not profits to be equitably shared

1 between shareholders and customers; the net proceeds are not a windfall; the principle that gives
2 100% of the net proceeds to customers is not a penalty to a low-cost utility; any sharing of the net
3 proceeds, including the "depreciation reserve methodology", is not a balancing of the interests of
4 customers and shareholders-- it is not a reasonable compromise.

5 Simply put, any sharing of the net proceeds of the sale with shareholders grossly undermines
6 historical ratemaking, essentially allows for shareholder rates of return that was greater than allowed
7 and is a customer ripoff of epic proportions that will cause rates to be much higher than they would
8 otherwise be.

9 Most parties and the Commission are aware of our arguments that all the net proceeds of the
10 sale of Centralia belong to customers. We have said it many times in many ways: Our arguments are
11 based on historical and current regulatory policy. Customers have paid for the investment in the plant
12 and the front-loaded profit to the utility in the expectation that the resource would be dedicated to
13 customers for the life of the asset. If we don't sell the asset, the output value of the resource accrues
14 to customers. The net proceeds of the sale simply reflect the output value of the remaining life of the
15 plant as against market prices. Shareholders will have recovered the lion's share of their expected
16 profit in the plant from customers and the overall proceeds of a sale go first to pay off the remaining
17 book value. Shareholders can now take the cash payment up to the book value and invest that money
18 in the stock market or other markets and earn a much higher return than the regulated rates of return
19 they are wont to complain about. Of course, they could lose money in the market, too, an outcome
20 that is virtually impossible in the regulatory world where the Company has customers to underwrite
21 both investment and profit.

1 In UE 102 the Commission adopted a transition cost sharing mechanism that allocated 95%
2 of the costs to customers and a 5% mitigation share to the Portland General Electric. Order No. 99-
3 033, p. 38, Jan. 27, 1999. The Commission went on to say "we note that it is symmetric: PGE will
4 receive 5 percent of any net transition benefits (where the sale price exceeds the book value) and
5 could thus receive more than the book value of the investment."

6 We agree with the Commission's underlying principle that the sharing of the transition
7 costs is a symmetry of a sharing of transition benefits. The principle of transition benefits is
8 exactly the same in determining who gets the proceeds from a simple sale of a generating asset.
9 We do depart from the Commission's reasoning in UE 102 where it applies to a mitigation share.
10 The auction for Centralia had already occurred prior to the Company's filing. If the Commission
11 finds the past auction was proper and in the public interest, there is no need for a forward-looking
12 mitigation incentive. Therefore we ask the Commission to allocate 100% percent of the Centralia
13 proceeds to customers.

14 Any transfer of the net proceeds of the sale of the Centralia plant to shareholders deprives
15 customers of their expected value in the lifetime of the resource and increases the rate of return
16 for shareholders beyond the authorized amount.

17
18 **B. Why PacifiCorp's "depreciation reserve methodology" must be rejected.**

19 Perhaps there is no better way to explain the correct allocation of net proceeds than by
20 studying PacifiCorp's proposed "depreciation reserve methodology". PPL/13/Eakin/3.
21 PacifiCorp has come up with a theory, without policy rationale or justification, that is couched in

1 terms that "sound fair". It is in fact a regulatory rip-off designed to transfer millions of dollars to
2 shareholders. Quite simply, the theory attempts to share the net proceeds of an asset sale in
3 proportion to the amount customers have paid the company in return of investment. It ignores
4 the fact that in regulatory policy, we have priced assets relatively flatly year to year and
5 shareholders receive much of their profit in the early years of an asset's life, and in a rising market
6 customers receive much of their value at the back end of an asset's useful life.

7 Allocating the proceeds from the sale of a plant based on PacifiCorp's methodology will:

- 8 1. Allow a company to increase its rate of return above what is authorized;
- 9 2. Undermine the least cost planning process that looked at customer benefits over the lifetime of
10 an asset;
- 11 3. Turn prudent investments into imprudent investments; and
- 12 4. Cause rates to go up as a result of the sale of the asset and transfer value from customers to
13 shareholders.

14
15 We decided that a visual would be instructive. In CUB's graph, presented below, we
16 have created an imaginary generation asset and its depreciation schedule. The asset cost is
17 \$500,000,000 and its expected useful life is 30 years. The authorized rate of return is 10%. We
18 have picked imaginary O&M costs (15 mills) and an imaginary beginning market price (21.1
19 mills); both costs and the market grow at the same annual rate of 2%. For the purposes of this
20 exercise, actual market prices or forecasts are irrelevant.

CUB/1
Jenks/5

	year	depreciation	rate of return at 10%	operating cost (cents/kwh)	depreciation and return (cents/kwh)	total cost (cents/kwh)	market price (cents/kwh)
1							
2							
3							
4	1	16,666,667	48,333,333	1.50	1.30	2.80	2.11
5	2	16,666,667	46,666,667	1.53	1.27	2.80	2.15
6	3	16,666,667	45,000,000	1.56	1.23	2.79	2.20
7	4	16,666,667	43,333,333	1.59	1.20	2.79	2.24
8	5	16,666,667	41,666,667	1.62	1.17	2.79	2.28
9	6	16,666,667	40,000,000	1.66	1.13	2.79	2.33
10	7	16,666,667	38,333,333	1.69	1.10	2.79	2.38
11	8	16,666,667	36,666,667	1.72	1.07	2.79	2.42
12	9	16,666,667	35,000,000	1.76	1.03	2.79	2.47
13	10	16,666,667	33,333,333	1.79	1.00	2.79	2.52
14	11	16,666,667	31,666,667	1.83	0.97	2.80	2.57
15	12	16,666,667	30,000,000	1.87	0.93	2.80	2.62
16	13	16,666,667	28,333,333	1.90	0.90	2.80	2.68
17	14	16,666,667	26,666,667	1.94	0.87	2.81	2.73
18	15	16,666,667	25,000,000	1.98	0.83	2.81	2.78
19	16	16,666,667	23,333,333	2.02	0.80	2.82	2.84
20	17	16,666,667	21,666,667	2.06	0.77	2.83	2.90
21	18	16,666,667	20,000,000	2.10	0.73	2.83	2.95
22	19	16,666,667	18,333,333	2.14	0.70	2.84	3.01
23	20	16,666,667	16,666,667	2.19	0.67	2.85	3.07
24	21	16,666,667	15,000,000	2.23	0.63	2.86	3.14
25	22	16,666,667	13,333,333	2.27	0.60	2.87	3.20
26	23	16,666,667	11,666,667	2.32	0.57	2.89	3.26
27	24	16,666,667	10,000,000	2.37	0.53	2.90	3.33
28	25	16,666,667	8,333,333	2.41	0.50	2.91	3.39
29	26	16,666,667	6,666,667	2.46	0.47	2.93	3.46
30	27	16,666,667	5,000,000	2.51	0.43	2.94	3.53
31	28	16,666,667	3,333,333	2.56	0.40	2.96	3.60
32	29	16,666,667	1,666,667	2.61	0.37	2.98	3.67
33	30	16,666,667		2.66	0.33	3.00	3.75
34		total return:	676,666,667		average cost	2.85	2.85
35							
36		10-year return:	408,333,333		10-year ave. cost	2.79	2.31
37							
38							

1 Over the expected life of this plant, the output will cost customers the same as buying
2 from the market. This plant represents a marginal resource and would be prudent to build.

3 The point of this visual is to show how the profits to the utility are front-loaded in the
4 early years, and the benefit to the consumer, having a dedicated resource that produces power
5 below the market price, emerge in the latter years of a resource. In other words, in a rising
6 market, by pricing the regulated resource relatively flatly year to year, customers are paying more
7 than market prices early and enjoying below-market rates later. All other things being equal, at
8 the end of the 30-year life, shareholders have made back their entire investment plus a fairly
9 certain 10% profit and customers have recovered the full value of their investment by receiving
10 below-market power from the resource in the latter years of its life.

11 But what happens if the company sells the plant after 10 years for 1.5 times book value
12 and uses the "depreciation reserve methodology" to allocate the proceeds of the sale?

13 Looking at the amounts paid to the utility in rate of return in year one through 10, one can
14 see that after 10 years the shareholders have received more than 60% of their expected profit on
15 the investment from customers. Meanwhile, customers have paid an average of 20.8% higher
16 rates for the output than would be provided by the market. While customers have paid 60% of
17 the Company's expected profits associated with the plant, customers have only paid for one third
18 of the depreciation of the plant. Because the "depreciation reserve methodology" looks at the
19 amount of plant paid off, shareholders would get two-thirds of the net gain from selling the plant.

20 Adding the two-thirds of the gain to the profits shareholders have already received raises
21 their 10-year return to \$519.4 million, or an average rate of return of 12.7%, 270 basis points

1 above the authorized rate of return. While the shareholders are earning above the authorized rate
2 of return for the previous 10 years, the shareholders are also made whole for their investment in
3 the plant from the sale proceeds and the Company can invest this money any way it wants ranging
4 from a low risk utility earning 10% to a high-risk enterprise earning twice as much.

5 Meanwhile, the one-third of the net proceeds going to customers would lower their
6 average price of power produced at the plant during that 10-year period, but only to 2.63 cents,
7 which is still 13.9% above the average market price during the same period. And ratepayers are
8 deprived the additional below-market output in the plant expected in the latter years. Therefore,
9 ratepayers pay above market rates for the first 10 years and as a 10-year resource it would have
10 failed a least cost planning prudence test, even though it was initially a marginal resource over a
11 30-year period.

12 Fundamentally, the "depreciation reserve methodology" allows a utility to rob its
13 customers of the value they have paid to receive. Because shareholder benefits accrue in the early
14 years and ratepayer benefits tend to accrue in the latter years of a resource, such a methodology
15 provides an incentive for utilities to sell an asset after shareholders have received most of their
16 profits, but before the customers' value is realized. If the plant were to continue to operate, the
17 future below-market benefits would flow to customers.

18 In a sense, this issue is little different from other revenues received by the company. How
19 does it effect the Company's rate of return? PacifiCorp's proposal on how to allocate the net
20 proceeds on the sale of Centralia is really a request by the Company to raise its rate of return
21 beyond that justified by its costs and currently allowed by the Commission.

1 C. PacifiCorp is not even delivering the benefit to customers that they say they are sharing.

2 While claiming to share the above-book value associated with selling the plant to
3 customers based on the "depreciation reserve methodology", a close look at Ms. Eakin's
4 testimony shows that the company is not actually doing this. PPL/13/Eakin/4, lines 3-13. The
5 company proposes to use the customer share of the gain to write off generation-related regulatory
6 assets, beginning in the year the transaction closes. This will lower the revenue requirement at the
7 next rate case. Until the next rate case, due to regulatory lag, shareholders would actually pocket
8 the ratepayers' share of this gain. We will address whether the recently filed rate case is a valid
9 filing in another forum.

10
11 D. Keep vs. Sell

12 PacifiCorp witness Weaver takes us through the exercise of comparing the net present
13 value of the revenue requirement associated with selling the plant against the net present value of
14 keeping the plant assuming that the plant is retrofitted with scrubbers. PPL/9/Weaver. Dr.
15 Weaver's conclusion is that the sale of the plant creates a higher benefit than keeping it. Id. at 5.
16 However, among the exercise's constants is the assumption that the net proceeds of the sale be
17 allocated between customers and shareholders using the "depreciation reserve methodology". Id
18 at 4. Dr. Weaver argues that even applying the "depreciation reserve methodology" to the net
19 proceeds, the sale of the plant is better than keeping it, and therefore the sale of the plant is in the
20 public interest.

21 We do not agree. A sharing of net proceeds from the sale of Centralia along the lines

1 suggested by PacifiCorp is not in the public interest under any scenario. Adoption of the
2 PacifiCorp allocation proposal would be a break from past established regulatory policy, would
3 establish terrible regulatory precedent and would transfer value from customers to shareholders
4 illogically. We can do without this "benefit".

5
6 **II. The Environment**

7 We think it is altogether fitting to consider the environmental history and future of
8 Centralia in determining the disposition of the plant in a way that serves the public interest. While
9 the ownership of the plant would transfer to a Canadian corporation, the plant itself, of course,
10 stays here in the Northwest and with it stays its environmental impact.

11 Centralia has been called the largest single source of air pollution in the Northwest. It
12 emits enormous amounts of carbon dioxide, nitrogen oxides, and sulfur dioxide. The sale of the
13 plant creates an opportunity for PacifiCorp and its customers to buy replacement power from
14 cleaner, less polluting sources.

15 We think it is appropriate to dedicate a reasonable portion of customers' net proceeds
16 from the sale of Centralia to buy down the cost, if necessary, of cleaner replacement power. The
17 testimony of Nancy Hirsh of the NW Energy Coalition discusses such a proposal. We are not
18 prepared at this time to suggest how much of the net proceeds should be dedicated toward
19 cleaner replacement power, but we do think that this is an appropriate topic for settlement
20 discussions and a proper subject of consideration for the Commission.