BEFORE THE WASHINGTON STATE
UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Petition of PACIFICORP for an Order Approving Deferral of Costs Related to Declining Hydro Generation	DOCKET NO. UE-05______ PETITION FOR ACCOUNTING ORDER

I. INTRODUCTION

1. Over the last five years, PacifiCorp has experienced hydro generation conditions far worse than those reflected in its Washington rates. Each year, PacifiCorp has been forced to turn to market purchases or to more expensive thermal generation to make up its hydro generation shortfall. As a result, since 2000, the Company has incurred increased power costs of almost $600 million on a system wide basis and suffered significant financial harm.

2. In 2005, PacifiCorp appears to be facing its sixth consecutive year of a low hydro generation trend. In Washington, Governor Gregoire recently declared a statewide drought emergency given the low level of snow pack in the mountains—about 26 percent of normal—and the record-low flows that are being seen in many rivers across the state. If 2005 mirrors the conditions PacifiCorp has experienced over the last three years, PacifiCorp's actual hydro generation will be approximately 80 percent of what is reflected in rates. This will result in PacifiCorp incurring increased system power costs of approximately $58 million.

3. Pursuant to WAC 480-07-370(b), PacifiCorp applies to the Washington Utilities and Transportation Commission ("Commission") for an order authorizing the Company to defer from the date of this Petition forward its increased power costs caused by continuation of the current low hydro trend. PacifiCorp seeks deferral of these costs to track and preserve them for later incorporation in rates, to be considered as part of the Company's next Washington general rate case proceeding, anticipated to be filed in Spring 2005. PacifiCorp requests that the deferral continue through the conclusion of that general rate proceeding. As part of that proceeding, the

Company expects to address the rate treatment of current low-hydro trend and power cost volatility through a proposed power cost adjustment mechanism, or PCA mechanism. It is anticipated that deferral of hydro impacts can be discontinued at the conclusion of that proceeding and replaced with a PCA mechanism that would address hydro variability thereafter.

II. BACKGROUND

4. PacifiCorp is an electrical company and a public service company in the state of Washington under RCW 80.04.010, and is subject to the jurisdiction of the Commission with respect to its rates, services, and accounting practices. PacifiCorp also provides retail electricity service in the states of California, Idaho, Oregon, Wyoming, and Utah.

5. This Petition is filed pursuant to RCW 80.01.040(3), which authorizes the Commission to regulate in the public interest the rates, service, facilities, and practices of electrical companies; RCW 80.04.090, which authorizes the Commission to prescribe the forms of account to be kept by public service companies; and WAC 480-100-203, pertaining to the accounting requirements applicable to electric utilities in the state of Washington.

6. Communications regarding this Petition should be addressed to:

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In addition, PacifiCorp respectfully request that all data requests regarding this matter be addressed to:

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III. THE BASIS FOR REQUESTING DEFERRED ACCOUNTING

A. Description.

7. This Petition seeks authorization to defer for later recovery in rates costs associated with a low hydro generation trend. Since 2000, the Company has experienced systematically declining hydro generation due primarily to low water availability. Every year, the Company has been forced to make market purchases and rely on more expensive thermal generation to compensate for the shortfall, a proposition that has been very expensive given the level of wholesale market prices during this period. As demonstrated in Exhibit A, the downward trend in hydro generation has continued despite year-to-year fluctuations in actual hydro conditions.

8. The Company has historically normalized its hydro availability in its net power costs using the 40-year rolling average normalization method previously adopted by the Commission. Under this approach, the Company's modeling of hydro does not account for the year-to-year dependencies and trends regarding hydro availability on a timely basis, given the 40-year averaging technique. This lack of timeliness is particularly true for the analysis with respect to the Company's share of output from the mid-Columbia hydro projects, which are based on data from BPA that extend only through 1978.

9. Because the Company's normalized hydro generation levels reflected in its rates do not fully incorporate the impact of the current downward trend in hydro generation, the

premise that cost swings above and below the average level set in rates will ultimately balance out is faulty. This failure in risk/reward symmetry associated with the current low hydro trend is exacerbated as underlying market conditions present continued volatility and hydro availability steadily declines for non-weather related reasons.

10. PacifiCorp has suffered a significant financial impact from the current low hydro trend. Exhibit A estimates those losses since 2000 using a calculation method that: (1) compares the difference in actual hydro generation with that reflected in rates; and (2) quantifies the costs of replacement market purchases and increased thermal generation. The annual losses fall in the following range:

2000	$152 million
2001	$309 million
2002	$35 million
2003	$43 million
2004	$59 million

The losses exceed one-half billion dollars on a system basis.

11. As Exhibit A also demonstrates, forecasting 2005 losses using an average derived from the last three years of the low hydro trend projects losses in the range of another $58 million. Under the Revised Protocol allocation methodology adopted by the Commission for reporting purposes in the Company's most recent Washington general rate case (Docket No. UE-032065), Washington receives the benefits and pays the costs of a significant percentage of the Company's hydro generation, approximately 16 percent, or in this case $9.5 million. Exhibit B shows derivation and application of the relevant allocation factors to the projected costs sought to be covered by this Petition.

B. Basis for Deferral.

12. The Company submits that these circumstances warrant the use of deferred accounting for excess net power costs associated with poor hydro conditions. The Commission

has consistently approved the use of deferred accounting as a regulatory tool for addressing variations in power costs due to extraordinary events. During the 1980s, for example, Puget Sound Power & Light Company implemented an Energy Cost Adjustment Clause, or ECAC, which provided dollar-for-dollar recovery of power cost variations due to, among other things, abnormal hydro conditions. *See, Cause No. U-81-41, Second Supplemental Order at pp. 17-18, Appendix A.*[1] During the 1990s, Puget implemented a Periodic Rate Adjustment Mechanism, or PRAM, which used deferred accounting to track the difference between projected and actual "resource" costs (which included a hydro adjustment mechanism). *See, Docket No. UE- 901183-T, Third Supplemental Order at pp. 11-17*. More recently, in Docket No. UE-000972, Avista was authorized to defer certain power supply costs associated with poor hydro conditions and the Western energy crisis. *See Avista Corporation, Order Granting Deferral of Power Cost Expenses Pending Demonstration of Prudence issued August 9, 2000*. The Company submits that a six-year trend of low hydro availability is the kind of extraordinary event for which deferred accounting treatment is appropriate. Moreover, the magnitude of the harm in this case is so significant that it should satisfy whatever materiality threshold the Commission may choose to apply.

13. The tracking of actual hydro generation costs produces an appropriate match between costs borne by and benefits received by customers, because customers will be charged rates based on the actual cost of power needed to serve them. While PacifiCorp's hydro resources are a relatively low cost resource, their generation output is variable and unpredictable. Current normalization models and the ever-increasing cost of replacement power result in the inability of the Company to recover the impacts associated with this variability.

14. A PCA mechanism would ensure that, in the future, current rates more accurately capture the actual underlying cost of the generation resource. Until the issues associated with a

[1] According to the Commission's order in that proceeding, "[t]he major fluctuation in net power cost faced by Puget as a result of varying stream flows and varying unit resource energy costs are a circumstance for which deferred accounting appears to be uniquely appropriate." *Second Supplemental Order at p. 17*.

PCA mechanism can be addressed in the Company's upcoming rate case, this deferral is required in the interim to match the benefits of the Company's hydro resources with their actual costs.

C. Treatment of Hydro Costs by other Washington Utilities

15. PacifiCorp is the only investor-owned electric utility in Washington without a power cost recovery mechanism to capture the impacts associated with poor hydro conditions. Puget Sound Energy (PSE), for its part, has a PCA mechanism under which PSE will recover 99% of its excess net power costs associated with poor hydro conditions, once PSE reaches a cumulative $40 million cap, an event that is expected to occur this year. *Docket No. UE-040640, Order No. 06 issued February 18, 2005, at ¶ 99*. Thus PSE will be in a position to recover virtually all of the power cost impacts of abnormal hydro conditions in 2005 through its PCA mechanism. Avista has an Energy Recovery Mechanism, or ERM, under which Avista's exposure to excess net power costs is limited to $9 million annually. *Docket No. UE-011595, Fifth Supplemental Order*. Under the ERM, Avista is authorized to defer 90% of the excess power costs above $9 million. This mechanism provides Avista with recovery of a significant portion of the power cost impacts associated with poor hydro conditions.

16. In PacifiCorp's most recent rate proceeding, Commission Staff witness Buckley proposed an adjustment to PacifiCorp's hydro normalization methodology in recognition that hydro recovery mechanisms were in place for Washington electric utilities. According to Mr. Buckley's testimony, "two of the three regulated electric utilities now have some form of power cost adjustment mechanism." *Docket No. UE-032065, Ex. T-581 at 125*. With the likelihood that a hydro adjustment mechanism would also be implemented for PacifiCorp that "would address the more significant variations in water conditions throughout the region," it would be "incorrect to include the power supply costs associated with all water year conditions in the determination of the base power supply costs." *Id*. Mr. Buckley therefore proposed a hydro normalization methodology that excluded the "more extreme stream flow conditions" inasmuch as the Company would presumably obtain rate relief in those circumstances. *Id. at 126*. Under

his proposed methodology, 14 years with the “more extreme stream flow conditions” were excluded from the 40 years proposed to be used by the Company, resulting in a proposed reduction of $3.0 million to the Company’s Washington-allocated net power costs. *Id. at 127*. This hydro normalization adjustment (in the amount of $4.597 million Total Company) was adopted by Staff and the Company as part of the calculation of $1.93 million of power cost adjustments million included in the Settlement Agreement. *Docket No. UE-032065, Order No. 06, Attachment B to Appendix A.*

17. Mr. Buckley went on to address the procedure that should apply in the event an “extreme year” occurs prior to the implementation of a hydro adjustment mechanism for the Company:

> In the event an extreme year occurs that adversely affects power costs between now and the next general rate case, the Company can make a filing to recover those costs. The adoption of this water year methodology is also appropriate under any scenario. Whether through a hydro adjustment mechanism or through a separate filing requesting relief from drought conditions, it may be in the best interests of customers to see the cost effects of stream flow variations.

Id. at 126. That is precisely what the Company is proposing by this Petition: a separate filing requesting relief from current drought conditions, in the form of a deferral that would preserve the power cost impacts of these poor hydro conditions for later recovery in rates. This is the type of relief that Mr. Buckley contemplated in proposing his hydro normalization adjustment, which was adopted by the parties for purposes of reaching the revenue requirement recommendation in the Settlement Agreement. Failure to provide this relief would clearly result in an under-recovery of power costs for the Company, as the effect of including this adjustment was to build into rates a *higher* level of hydro generation under the premise that relief of the type requested here would be available. On a longer term basis, the Company proposes to address recovery of hydro-related impacts through a PCA mechanism, to be considered as part of the Company’s upcoming general rate filing. As noted by Mr. Buckley’s testimony, implementation of a PCA mechanism would bring the Company into line with the other two regulated electric utilities in Washington.

D. Cost Allocation Issues.

18. In the Settlement Agreement adopted by the Commission in its Order No. 06 in Docket No. UE-032065, the parties did not reach agreement on an inter-jurisdictional cost allocation methodology to be used on a going-forward basis. While the revenue requirement in that proceeding was calculated on the basis of the Protocol methodology, the Settlement Agreement further provides that "the Company will use the Revised Protocol as the basis for its routine regulatory filings with the Commission, including filing requirements under Chapters 480-100 WAC and 480-1246 WAC." *Settlement Agreement at 4*. Whether or not a petition for deferred accounting qualifies as a "routine regulatory filing," PacifiCorp proposes to use the Revised Protocol as the basis for recording deferrals of excess net power costs. As observed by the Commission its order in that case:

> Looking forward, the Settlement Agreement's use of Revised Protocol for reporting at least tacitly acknowledges progress toward an allocation methodology that will work in Washington as well as in other states where PacifiCorp provides service.

Order No. 16 at ¶ 51. Under the requirements imposed by the Order for expeditiously resolving the issue of inter-jurisdictional cost allocation methodology, the Company is required to present a detailed status report to the Commission on or before April 1, 2005, followed by a filing no later than October 31, 2005 in which this issue is resolved. That filing can take the form of either a general rate proceeding or an independent proceeding devoted to the cost allocation issue. *Id. at ¶ 95*.

19. As noted above, the Company intends to file a general rate case in Spring 2005 which will include a proposal to resolve inter-jurisdictional cost allocation in Washington. That general rate proceeding will thus provide the forum in which the inter-jurisdictional cost allocation issue is resolved on a going-forward basis. In this Petition, the Company is proposing that another issue in the general rate proceeding will be the rate treatment of excess net power costs deferred in accordance with the accounting authorization requested here. Because the inter-jurisdictional cost allocation issue will be resolved contemporaneously with the

consideration of the amortization of deferred amounts in rates, the absence of an agreed upon cost allocation methodology does not preclude granting the requested deferrals. Rather, any amounts deferred by the Company under the Revised Protocol will be reconciled with the cost allocation methodology ultimately adopted by the Commission in the upcoming rate proceeding prior to any amortization in rates. If a different methodology that allocates fewer excess net power costs to Washington is adopted, for example, the Company's deferred amounts would be reduced accordingly prior to amortization in rates.

20. This very issue was considered in the Company's recent general rate case hearings, in the examination of Staff witness Schooley by Chairwoman Showalter:

> Q. [J]ust in order to establish one [a deferred account], don't you need to know in what account or what box or what state to put certain dollars?
>
> A. Ideally, I would say so, but if you looked at it from the system-wide basis and said, yes, on a system-wide, this event occurred and we will allow it to be recovered in rates in the future, under protocol or even modified accord or revised protocol, methods that are allocating system resources will allocate different portions to Washington, and the amortization of that would be one thing.
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> If we do go to a control area, it does become more problematic as to say, yes, that was an unfortunate event and you may recover those costs, but we're not allocating any of them to Washington. I can see the dilemma that raises, but I don't know really how to handle that unless we have the circumstances before us. Hopefully nothing will happen by the time we can resolve this.
>
> Q. So it what you're saying that it is not essential to have a methodology, as long as you start the account running, and then you figure it out later?
>
> A. Yes, and presumably the Company would be asking the other states for the same thing. . . . It does seem like it's not incumbent to have a specific allocation process to identify, on a Company-wide basis, expenses that may be deferred.

Docket No. UE-032065, Tr. 685:24 – 687:6.

21. The Company's proposal in this proceeding is consistent with this approach: defer excess net power costs in accordance with the Revised Protocol methodology, and then revisit the calculation of these deferrals according to the inter-jurisdictional cost allocation

methodology adopted by the Commission as part of the upcoming general rate case to determine the amounts that will be amortized in rates.

E. Proposed Accounting.

22. During the period of deferral, PacifiCorp proposes to account for replacement power costs associated with the continuation of the current low hydro trend in the following manner. Excess net power costs will be credited to Account 555, thereby decreasing the recorded power supply expenses, and debiting Account 182.3. Deferred income taxes would be recorded by debiting Account 410.10, and crediting Account 283. The amortization of the balance in Account 182.3 would be accomplished by crediting Account 182.3 and debiting Account 555. Deferred income taxes would be amortized by debiting Account 283 and crediting Account 411.10. PacifiCorp requests that it be allowed to accrue interest on the unamortized balance at a rate equal to its weighted average cost of capital, 8.39%, most recently approved by the Commission in Docket No. UE-032065.

F. Estimate of Amounts.

23. As explained above, Exhibit A projects these excess net power costs to be in the range of $58 million for calendar year 2005. On a Washington- allocated basis, Exhibit B demonstrates excess costs in the range of $9.5 million. Because of the variability of hydro generation, however, the actual costs could be higher or lower than this projection.

IV. CONCLUSION

24. PacifiCorp respectfully requests that the Commission authorize the Company to defer, commencing as of the date of this filing, its increased power costs caused by the continuation of the current low hydro trend, as described in detail in this Petition. The Company

requests that the Commission convene a prehearing conference on this Petition in the near future to establish the process and schedule to be followed in this proceeding.

DATED: March 18, 2005.

PACIFICORP

By ______________________________

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Exhibit A

Summary of Past and Projected Hydro Generation Losses

Exhibit B

Allocation Summary