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10. As an additional basis for rejecting the Settlement Agreement, Mr. Falkenberg urged adoption of those of his proposed adjustments that were ***not*** included in the Settlement Agreement, which total about $7.7 million. *Exh. No. 425* (*Falkenberg*). These additional adjustments should not be adopted, for the reasons set forth in Section III.E.3 below.

11. Public Counsel, for its part, appears to agree with point 5 above—that any rate relief should be deferred until January 1, 2006—but did not offer other testimony in opposition to the Settlement Agreement, other than rejection for the reason that the Settlement Agreement failed to incorporate Mr. Lazar's proposed "hydro situs" proposal for interjurisdictional cost allocations and certain remaining adjustments offered by Public Counsel witness Dittmer. Mr. Lazar's "hydro situs" proposal is discussed in Section III.C.5 below, while Mr. Dittmer's unadopted adjustments are presented in Section III.D.3 below.

C. The Commission Should Adopt the Settlement Proposal Regarding Interjurisdictional Allocation Issues.

1. Background on the Multi-State Process.

12. Mr. MacRitchie's direct testimony describes PacifiCorp's nearly four-year quest to resolve a number of long standing issues arising from its status as a multistate utility subject to the jurisdiction of six regulatory commissions. *Exh. No. 61 at 3:9 – 7:11.* The process known as MSP commenced in March 2002, when the Company made a set of filings requesting that the Company's state commissions initiate investigations and endorse a collaborative process to address interjurisdictional issues facing PacifiCorp. These filings were broadly supported by the Company's state commissions.[11] *Id. at 4:10-14.* The Company had three fundamental objectives with respect to the MSP:

1. To establish interjurisdictional cost allocation mechanisms that would permit it to continue to plan and operate its generation and transmission system on an integrated basis,

[11] The Commission supported the MSP but preferred not to open a docket in connection with it. *Docket No. UE-020319, Order Denying Petition and Authorizing Participation in Multi-State Discussions*. Key staff members in California monitored the proceedings and received relevant documents.

23. The suggested approaches of Messrs. Lazar and Falkenberg would obviously substantially delay the Company's ability to obtain timely rate relief in these proceedings. There would also be a disincentive to reach consensual agreement if resolution of allocation issues were a prerequisite to a rate change. Also, as testified to by Mr. Braden, achieving "open and free discussions" would be more difficult in a litigation context. *TR. 646:12-15.*

24. Concerns were raised that the approach recommended in the Settlement Agreement might create inappropriate incentives for the Company to delay filing a new rate case if a different allocation method is more beneficial to Washington consumers than the Protocol. However, Mr. Braden discounted this possibility, observing that the Company's need to recover escalating costs and its desire to resolve allocation issues would overwhelm any benefit from delaying the implementation of a new allocation method in Washington. *TR. 651:10-18.*

25. Concerns were also raised that if there is not a definitive resolution of allocation issues, problems could arise if the Company were to seek interim rate relief or deferred accounting orders. The possibility of such circumstances was acknowledged, with the understanding that until a permanent allocation method is established in Washington, the Company would be at some risk. *TR. 372:1-9(Schooley), 647:19 – 648:14 (Braden), 656:6 – 657:6 (Braden), 684:2-19 (Schooley), 686:19 – 687:16 (Schooley).*

26. The approach advocated in the Settlement Agreement will afford the Company an ability to promptly establish compensatory rates in Washington. This approach is also best adapted to permitting the Commission to consider MSP outcomes in other states and most conducive to achieving a consensual resolution among the Company and Washington parties.

3. The Original Protocol Provides a Reasonable Basis for Establishing Rates for Purposes of This Proceeding.

a. The Original Protocol Is the Only Allocation Method Supported and Fully Evaluated in the Record.

27. Staff's "control area" approach was not independently developed, but was instead based upon adjustments to a Company response to a Staff data request that asked the Company to

and Oregon—and no later than December 1, 2004—formal discussions would be initiated. *TR. 764:24 – 765:3 (Buckley).* On April 1, 2005, a fairly extensive status report would be presented to the Commission, including recommendations for further proceedings. *Id. at 765:16 – 766:4; TR. 776:4-18 (Kelly).* This timeline permits the process to be informed by the MSP outcomes in PacifiCorp's other jurisdictions.[18]

4. ICNU's Proposed Changes to the Revised Protocol are Unworkable and Unreasonable.

36. ICNU's proposed changes to the Revised Protocol not only embody Mr. Falkenberg's "higher standard" as discussed in Section II above, but suggest that the Commission dramatically depart from traditional cost of service regulation, as described below.

a. Mr. Falkenberg's Proposal to Specially Allocate the Reserve and Load-Following Benefits of the Company's Hydroelectric Resources Is Unreasonable.

37. There are three principal reasons that it would be inappropriate to provide for a special allocation of hydro load following and reserve benefits to Washington under either the Protocol or the Revised Protocol:

1. The Protocol and the Revised Protocol describe methods for allocating costs, not "benefits." *Exh. No. 110 at 23:2-19 (Duvall).*

2. It would be unreasonable to provide for a special allocation of benefits arising from one category of resources, while ignoring "benefits" derived from other resource categories.[19]

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[18] The results presumably would be incorporated in the Company's next general rate case, which is expected to be filed during 2005. *TR. 211:19-212:2* (*Furman*); *TR. 330:6-9* (*Omohundro*).

[19] Under either the Protocol or the Revised Protocol, Utah customers pay a disproportionate share of the costs of thermal plants, which also provide ancillary benefits to the system such as Automatic Generation Control. Yet Mr. Falkenberg is not proposing a special allocation of these benefits. *Exh. No. 110 at 23:11-17 (Duvall)* Furthermore, if the MSP became a contest of "interjurisdictional benefit allocation," there is a broader argument available to Utah parties. If one assumes that the hydro resources are being used to provide service to customers in the Northwest, it might be concluded that sales for resale (particularly on the eastern side of the Company's system) are being made from thermal resources. Since Utah customers are supporting a disproportionate share of the costs of such thermal resources, might they not reasonably claim a disproportionate allocation of special sales revenues instead of the system allocation provided for in the Protocol and the Revised Protocol?

apparent $403,000 *benefit* to Washington consumers from faster Utah load growth in 2006. *Exh. No. 420C at 1.*

46. Notwithstanding the foregoing, Mr. Falkenberg proposes that in order to "protect" Washington consumers from costs shifts from faster load growth in Utah, all of the Company's new resource additions should be reflected in rates based upon their short-term market value, rather than cost. While acknowledging that the Commission's long-standing policy has been to establish rates based upon cost, Mr. Falkenberg suggests that that his proposal has precedent in the Commission's 1983 treatment of the Company's interest in Colstrip Unit 3. *Exh. No. 401C at 73:5 – 74:11.* As is apparent from the Commission's 1983 order, *Exh. No. 448*, however, what Mr. Falkenberg described as a "market-based" approach was actually a cost-based one—the referenced Black Hills contract was "based on the fully-distributed costs of Colstrip 3" and, in fact, Colstrip 3 was used as the resource for purposes of calculating costs in the Company's tariff filing for cost-based rates at FERC, *Exh. No. 448 at 8, 15.* Thus the precedent cited by Mr. Falkenberg is inapposite.

47. More importantly, Mr. Falkenberg's proposal would deny Washington customers the benefits of long-term least-cost planning. Faced with the prospect of being able to recover only short-term market prices, rather than cost, no utility would take on the risk of long-term resource commitments. Because PacifiCorp's other states expect the Company to make long-term resource commitments, Mr. Falkenberg's proposal would totally undermine the purpose and benefits of the MSP.

5. Public Counsel's "Hydro Situs" Approach Unrealistically Seizes Inexpensive Hydro Power Benefits for Washington, Includes a Calculational Error Due to a Misunderstanding of the Company's Proposal, and Is Not Worthy of Further Consideration.

48. Mr. Lazar presented his "Washington-centric" proposal that, by allocating all of the Company's hydropower in Washington to the Washington jurisdiction, would produce a $25 million rate reduction for the Company's Washington customers. *Exh. No. 32 at 2:6-10*