BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES & TRANSPORTATION COMMISSION, Complainant, v. PACIFICORP d/b/a PACIFIC POWER & LIGHT COMPANY, Respondent. In the Matter of the Petition of PACIFIC POWER & LIGHT COMPANY For an Accounting Order Approving Deferral of Certain Costs Related to the MidAmerican Energy Holdings Company Transition.	DOCKET NO. UE-061546 DOCKET NO. UE-060817

REPLY BRIEF OF PUBLIC COUNSEL

MAY 7, 2007

I. INTRODUCTION

1. This reply brief primarily addresses PacifiCorp's request for a power cost adjustment (PCA) mechanism. Public Counsel continues to recommend the Company proposal not be adopted. PacifiCorp has failed to show that it faces the kind of power cost volatility that would warrant adoption of a PCA. The Company wants to have its cake and eat it too, asking for a PCA with no recognition of the reduced risk to shareholders.

II. POWER COST ADJUSTMENT MECHANISM

2. Public Counsel agrees with Staff's statement of the three basic issues regarding the PCA: 1) Is a PCAM appropriate for PacifiCorp?; 2) What is the appropriate PCAM design?; and 3) How should the Commission implement its cost of capital offset policy, i.e. that 'ratepayers should receive the benefit of a reduction in cost of capital, as a power cost adjustment mechanism introduces rate instability for ratepayers and earnings stability for stockholders.'"[1] As we have argued in testimony and in our opening brief, PacifiCorp has not carried its burden of proof sufficiently to get past the first question on this list.

A. A PCA Is Not Appropriate For PacifiCorp

3. Both PacifiCorp and Staff challenge Public Counsel's view that PacifiCorp does not face sufficient volatility in power costs to warrant a PCA. No party disputes that PacifiCorp has lower exposure to hydro variability than either Puget Sound Energy (PSE) or Avista. However, PacifiCorp's brief as initially filed took issue with Mr. Johnson's statement that 17.9 percent of PacifiCorp's load is met by hydro generation, arguing that "[i]n fact, hydro generation meets 30

[1] Opening Brief on Behalf of Commission Staff (Staff Brief), ¶ 44 (footnote omitted).

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percent of the Company's WCA load requirements."[2] Mr. Johnson obtained the 17.9 percent number from the testimony of PacifiCorp witness Mark Widmer.[3] When asked to confirm this figure at the hearing, Mr. Widmer stood by his 17.9 percent number.[4]

4. As noted, however, PacifiCorp's brief initially cited a 30 percent figure to challenge Mr. Johnson's accuracy, citing page 51 of Mr. Widmer's rebuttal.[5] This testimony is no longer in the record. On March 22, 2007, just prior to the hearing, PacifiCorp filed a revised version of Mr. Widmer's testimony deleting the "30 percent" assertion. PacifiCorp has now filed a corrected version of its opening brief striking the inaccurate reference.

5. Staff's brief also takes issue with the 17.9 percent figure. However, while pointing to higher figures for winter and summer peaks, Staff cites a figure of 18 percent hydro on an annual basis, essentially identical to Public Counsel's testimony.[6] Mr. Johnson's testimony, therefore, is uncontested on this point by either Staff or the Company. PacifiCorp has modeled its PCAM after the ERM, even though PacifiCorp's 17.9 percent hydro is only a little more than one third of Avista's level.[7]

6. PacifiCorp also argues that the 17.9 percent figure is meaningless in any event because it does not take into account that when hydro production declines due to adverse weather, PacifiCorp is exposed to more expensive incremental power.[8] This is a somewhat mystifying statement in light of PacifiCorp's own testimony. When asked to "provide some background on why the Company is requesting a PCAM in this proceeding, PacifiCorp witness Widmer stated:

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[2] Initial Post-Hearing Brief of PacifiCorp d/b/a Pacific Power & Light Company (PacifiCorp Brief), ¶ 38.
[3] Exh. No. 81, p. 26:28-27:6 (Widmer)(emphasis added).
[4] Widmer, Tr. 214:6-17.
[5] PacifiCorp Brief, ¶ 38.
[6] Staff Brief, ¶ 56.
[7] Exh. No. 241, p. 6 (Graph 1: Hydro Production as Percentage of Annual MWh Load)(Johnson).
[8] PacifiCorp Brief, ¶ 37. PacifiCorp cites Staff testimony to support this point, but does not point to any of the Company's own evidence.

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> We are requesting a PCAM to protect the Company and customers from the net power cost volatility related to the west control area. *This volatility has been due in large part to the generation volatility of owned and contracted hydro generation. For the test period, normalized hydro generation produces 17.9 percent of the Company's west control area load requirements.* Of course, other factors such as market price volatility, weather conditions, forced outages for generation and transmission facilities, planned outages and the economy also affect the volatility of power costs.[9]

PacifiCorp cannot now argue this is meaningless data when the Company itself cites the figure to show that hydro generation is "in large part" the cause of its power cost volatility.

7. Staff's brief tries to make a similar argument by contrasting Avista with PacifiCorp, asserting that "if Avista experiences a decline in hydro generation, it can increase generation from one of its thermal generating units that are not being fully utililized" whereas PacifiCorp must rely on "fully-loaded" short term contracts."[10] It not at all clear that the record supports this claim. Staff witness Alan Buckley indicates that PacifiCorp too can look to its thermal plants if hydro declines, but he refers to these as much more expensive.[11] Of course, as Mr. Buckley noted, for any utility replacing hydro power with thermal plants, the replacement power is by definition more expensive because hydro production is essentially "free."[12] This does not equate to volatility if the Company is able to use thermal plants that are under company ownership, control and operation. That is far different from relying on short term contracts in the market. Mr. Buckley's testimony shows that, in fact, both PacifiCorp and Avista appear to be similarly situated in that they can both look to their own thermal plants to deal with hydro decline. Neither the PacifiCorp nor the Staff brief has cited anything in the record to show what these incremental costs are or how Avista's costs compare to those of PacifiCorp.

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[9] Exh. No. 81, p. 26:28-27:6 (Widmer)(emphasis added).
[10] Staff Brief, ¶ 61.
[11] Exh. No. 265, p. 3:18-23 (Buckley).
[12] *Id.*

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8. Finally, Staff accuses Public Counsel of being inconsistent by pointing to the minimal level of hydro exposure which PacifiCorp faces on a company-wide basis, citing Public Counsel's position in the last rate case opposing PacifiCorp's use of a company-wide cost analysis in the Revised Protocol. Public Counsel's position is not inconsistent. The company-wide figure of 0.2 percent hydro exposure is provided here to show a contrast to the exaggerated assertions of PacifiCorp regarding its level of risk. The context is different. The point is raised to aid in an accurate assessment of PacifiCorp's level of hydro volatility and risk, not for the development of a cost allocation methodology.

B. If A PCA Is To Be Approved, PacifiCorp's Modified PCAM Position Is Unacceptable; The Staff or ICNU Proposals Are Preferable

9. If the Commission decides that a PCA is appropriate for PacifiCorp, the Commission must decide on the design of the PCA and must implement its cost of capital offset policy. As Public Counsel stated in its opening brief, should the Commission decide to approve a PCA, the Staff and the ICNU proposals are preferable choices to the PacifiCorp plan.

10. The opening round of briefs reveals the wide gap between the positions of Staff and PacifiCorp. Staff's brief provides a careful and detailed description of the Staff proposal which addressed the variety of issues raised by the PCA filing. PacifiCorp takes pains, for its part, to create the appearance of compromise by agreeing to certain parts of Staff's PCA.[13] Upon review, however, it is apparent serious deficiencies remain in the PacifiCorp position. The PacifiCorp position boils down to this – the Company will only accept a PCA if it rejects Staff's water year adjustment, allows inclusion of fixed production costs or authorizes a PCORC filing, and most importantly, makes no downward adjustment to the rate of return. PacifiCorp also

[13] PacifiCorp Brief, ¶ 24.

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insists upon the use of "pseudo-actual" costs in the mechanism. Public Counsel urges the Commission to see past PacifiCorp's false compromise, and refrain from approving PacifiCorp's watered down version of Staff's PCA.

C. PacifiCorp's Cost of Capital Should Be Adjusted Downward If It Is Authorized To Implement a PCA

11. Public Counsel again voices its support for the appropriately firm positions of both Staff and ICNU in support of an adjustment to cost of capital in the event a PCA is approved. This is a critical issue and it is squarely presented in this case. As the first heading in Staff's brief on PCAM states "a PCAM is appropriate for PacifiCorp, *so long as the Commission adjusts the rate of return to compensate ratepayers for shouldering significant risk.*"[14] PacifiCorp's approach is avoidance, delay, or the pretense that "the Company's ROE implicitly includes a cost of capital adjustment."[15]

12. PacifiCorp argues that the Commission need not decide the cost of capital issue here because the issue was not decided when the PSE and Avista PCAs were adopted. This inaccurately states the situation in these cases.

13. PacifiCorp asserts that the "Avista ERM was implemented without making any adjustment to reduce Avista's allowed cost of capital."[16] This misrepresents the history of the Avista ERM.[17] Avista did not have a fully developed power cost adjustment mechanism until

[14] Staff Brief, p. 15 (emphasis added).
[15] PacifiCorp Brief, ¶ 49.
[16] PacifiCorp Brief, ¶ 51.
[17] The tortuous history of Avista's efforts to deal with power cost deferrals and the development of the precursor ERM is summarized in the order adopting the initial ERM. *WUTC v. Avista Corporation*, Docket No. UE-011595, Fifth Supplemental Order, ¶¶ 9-18. There are a few salient points to note here. The precursor to the current ERM, adopted in 2002, was not a fully developed PCA mechanism. For example, it was designed to deal only with normal variability in power costs, not with extraordinary volatility. *Id.*, ¶ 38. In Avista's 2005 general rate case, the Commission rejected piecemeal changes to the ERM proposed by Staff and Avista which would have made large reductions in the deadband. Public Counsel had opposed the modification on the ground that it shifted more

its current ERM mechanism was adopted in June 2006 in a special docket outside a rate case.[18] The order in the ERM docket approved and adopted the agreement of the parties (Avista, Staff, Public Counsel and ICNU) to adopt a complete power cost adjustment mechanism. Because the ERM docket was not a rate case, however, the order (by adoption of the agreement) specifically provided that "the cost of capital impact of the ERM" would be addressed in Avista's next general rate case.[19] That rate case was filed in April 2007 and will address the rate of return impact of the Avista ERM in the coming months.

14. PacifiCorp also does not fairly represent the history of the PSE PCA. The PCA was adopted as a result of a comprehensive two-stage settlement. In the first stage, resolving the interim rate relief request, the parties reached an agreement on capital structure and cost of capital.[20] They also agreed to continue to negotiate general rate case issues including a power cost adjustment mechanism. Subsequently, in the comprehensive general rate case settlement, the parties developed and agreed to the detailed PCA mechanism in use today.[21] The PacifiCorp brief says this PCA was approved with no reference to cost of capital issues.[22] This is misleading. The Commission had before it supporting testimony on the PCA from PSE, Staff and Public Counsel stating that the PCA reflected and was consistent with the Commission's

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risk to ratepayers without any compensating benefits, in violation of Commission policy. *WUTC v. Avista Corporation*, Docket No. UE-050482, Order 05, ¶ 67. The Commission noted that a comprehensive review of the ERM had been planned since the inception of the mechanism, and deferred any changes in the mechanism to that review. *Id.*, ¶ 74. The Commission also stated "Concerns about the balance of risk between the Company and its ratepayers under the ERM deserve further consideration. On the basis of a more fully developed record, we may determine that adjustments to the deadband and other features of the ERM will result in a more effective balance of risks than is currently in place." *Id.*, ¶ 73.

[18] *In the Matter of the Petition of Avista Corporation d/b/a Avista Utilities for Continuation of the Company's Energy Recovery Mechanism with Certain Modifications*, UE-060181, Order 03, Order Approving Settlement Agreement (*ERM Settlement Order*).

[19] *ERM Settlement Order*, ¶ 10, Settlement Agreement, Section 7(1).

[20] *WUTC v. PSE*, UE-011570, et al., (*2001 PSE GRC)* Ninth Supplemental Order, Appendix A, Settlement Stipulation, pp. 6, 8.

[21] *WUTC v. PSE*, UE-011570, et al., Twelfth Supplemental Order, ¶¶ 22-29.

[22] PacifiCorp Brief, ¶ 42.

directive that the risk shift be reflected in cost of capital. As the Staff, Public Counsel, and PSE witnesses explained, in the PSE settlement this was achieved by designing the PCA so as to fairly balance risk in light of the previously agreed ROE, which included a cost of capital reduction [23]

15. PacifiCorp also makes a brief reference to the most recent PSE rate case order which slightly increased PSE's ROE. In that decision, however, the Commission essentially maintained the status quo with respect to this issue, while reaffirming the principle that return should take the PCA into account. The Commission rejected a number of PSE's proposed modifications to the PCA and observed:

> PSE's proposal in this proceeding, by contrast, would result in a substantial transfer of risk from PSE to ratepayers without a corresponding ratepayer benefit. A central purpose of the PCA the Commission approved for PSE, and similar mechanisms approved or considered for other companies, is to protect the companies against extreme variations in power costs caused by such factors as the extraordinary market events that occurred during 2001 and 2002, serious drought, or other circumstances that are beyond the companies' ability to foresee and control. PSE, in its proposal, seeks to modify the mechanism to share with customers the risk of normal variations in hydropower. This would mark a new and much expanded role for the PCA. We do not find such an expanded purpose to be in the public interest.
>
> Finally, we observe that a PCA designed to insulate the Company from fifty percent of the cost risk of normal variations in hydro *should necessarily be accompanied by an adjustment to the return on equity*. The record in this proceeding does not include substantial competent evidence upon which we might determine the magnitude of the adjustment to return on equity that would be required to account for such a reduction in risk.[24]

[23] *2001 PSE GRC*, Testimony of Merton R. Lott, Exh. No. ___ (MRL-2T)(Staff), p 13:5-13 (June 2, 2002); Testimony of Jim Lazar, Exh. No. ____(JL-T)(Public Counsel), p 1:24-22:2, p. 4:7-11. PSE Witness William Gaines stated that a cost of capital reduction had been agreed to consistent with the Commission PCA principles. Testimony of William Gaines, Exh. No. ___ (WAG-10T)(PSE), p. 4:1-6 (June 7, 2002).

[24] *WUTC v. PSE*, Docket No. 060266, ¶¶ 20-21 (emphasis added).

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16. In summary, neither the PSE nor the Avista experience provides support for PacifiCorp's argument that it should be able to implement a PCA without any adjustment to its rate of return.[25]

D. No PCORC Should Be Adopted or Approved In This Docket

17. In some parts of the brief, the company appears to be indirectly requesting pre-approval of a PCORC. PacifiCorp says it is willing to trade its claim for new long term variable resource costs and wholesale transactions for authorization to file for a PCORC.[26] The Company makes a similar proposal with respect to Staff's proposal to remove the fixed production cost component of its proposed PCA, indicating that its "acceptance" of the proposal "should be conditioned on the Company being authorized to file a power-cost only adjustment mechanism."[27] Public Counsel repeats its recommendation made in the opening brief that no PCORC should be approved or pre-approved in this docket. A record on this issue has not been developed by the parties.[28]

III. INTERJURISDICTIONAL COST ALLOCATION

18. Public Counsel adopts ICNU's Reply Brief on interjurisdictional cost allocation. This is a key aspect of the case. Resolution of the interstate cost question for Washington has been a long time in coming. The Commission now has the opportunity on this record to bring some degree of closure to the debate. While the WCA has surface appeal, Staff, ICNU and Public

[25] PacifiCorp also argues that no cost of capital reduction should be adopted because "the WCA is relatively untested and there is some uncertainty about its impact and the financial results that it will produce." PacifiCorp Brief, ¶ 53. Public Counsel raised this same concern about implementing the PCA at all at this time. Public Counsel Brief, ¶ 23.

[26] PacifiCorp Brief, ¶ 24.

[27] *Id.*, ¶ 25.

[28] Initial Brief of Public Counsel (Public Counsel Brief), ¶ 26.

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Counsel have all identified a basic defect: the failure to compensate Washington for benefits provided from the WCA to the eastern control area. Staff's remedy for this, a proposed "eastern market bubble" is inadequate.[29] Randy Falkenberg, on behalf of Public Counsel and ICNU has proposed other adjustments to the WCA to make it consistent with the directives of the 2005 rate case order.[30]

IV. LOW INCOME ASSISTANCE

19. Both PacifiCorp and the Energy Project propose increasing low income bill assistance. PacifiCorp's proposal is a reasonable way to get the existing program "caught up" to account for rate increases since it was created. It is a matter of concern that PacifiCorp's existing program has not kept pace with the Company's rate increases, particularly because of the socio-economic demographics of the PacifiCorp service territory.[31] However, PacifiCorp's proposal does not address the issue of the program's overall level of funding, currently 0.24 percent of gross operating revenues.

20. Public Counsel supports the Energy Project's recommendation for an increase in PacifiCorp's Low-Income Bill Payment Assistance Program (LIBA) at least to the range of that provided by Avista (as a percentage of revenues). This would increase the surcharge by 17 cents, from its current level of 23 cents to 40 cents per month. The testimony of Charles Eberdt

[29] Initial Brief of ICNU, ¶¶ 29-31.

[30] Staff's brief finds it "surprising" that Public Counsel (together with Industrial Customers of Northwest Utilities (ICNU)) makes recommendations that would actually result in a rate decrease for PacifiCorp. Staff Brief, ¶ 2. There should be nothing surprising in such a recommendation. Indeed, in the last PacifiCorp rate case, in testimony filed only a year and a half ago, both Staff and ICNU recommended a rate decrease for PacifiCorp. Staff's recommended cut was larger than ICNU's. *WUTC v. PacifiCorp*, Docket No. UE-050684, Order 04, ¶ 14. There is no presumption in favor of rate increases.

[31] Energy Project's Post-Hearing Brief, p. 2.

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provides a reasonable justification for the Energy Project proposal.[32] Low income assistance was one of the topics addressed by customers who wrote to the Commission and Public Counsel of their concern with the increase.[33] Sandra Richard of Yakima, for example, wrote:

> Even tho [sic] I had OIC energy assistance it was not enough to cover everything. I got all but $50.00, there was no more funds anywhere in the Valley. They turned me off in January with the weather setting at 4 [degrees] F. My mobile is entirely electric so I have no way to eat except out of a can. I sat here for 1 month for a lousy $50.00, that is wrong.[34]

PacifiCorp has stated that the Company does not object to the recommendations of the Energy Project and will implement the level selected by the Commission.[35]

V. CONCLUSION

21. For the foregoing reasons, Public Counsel recommends that Commission not approve the PacifiCorp request for a power cost adjustment mechanism. If the Commission decides to approve a PCA, it should only do so if it also reduces PacifiCorp's cost of capital and requires the Company to resolve the "pseudo-actual" costs issue. Public Counsel joins in the recommendations of ICNU with respect to interjurisdictional cost allocations and net power cost, and supports an increase in low income bill assistance.

22. RESPECTFULLY SUBMITTED this 7th day of May, 2007.

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[32] Exh. No. 231 (Eberdt).
[33] Public Counsel Brief, ¶¶ 31-37.
[34] Exh. No. 1 pp. 5-6.
[35] PacifiCorp Brief, ¶¶ 121-122.

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