

Agenda Date: March 27, 2002
Item Number: 2A

Docket: UE-020319
Company Name: PacifiCorp, dba as Pacific Power & Light Company
Staff: Ken Elgin, Case Strategist

Recommendation

Deny PacifiCorp's request that the Commission open a docket and investigate issues related to the Company's operation as a multi-state utility.

BACKGROUND

On March 11, 2002, PacifiCorp filed a petition asking that the Commission open a docket to investigate several issues facing the Company as it operates as a multi-state utility. In general, these issues involve: 1) interstate cost allocations and cost recovery, 2) open access requirements in Oregon (Oregon SB1149) and 3) long-term resource planning. The petition requests that the Commission issue an order and participate in PacifiCorp's proposed multi-state process ("MSP" or "Process"). The petition also asks the Commission to obtain comments from interested parties to address the following specific issues the Company has identified in its petition:

- What statutory and rule changes are required to provide PacifiCorp a reasonable opportunity to recover its costs?
- What changes are required in the way the Commission calculates the Company's cost-of-service to accommodate divergent state policies directing the Company to acquire specific new resources?
- Alternatives for allocating costs among its jurisdictions in an equitable manner;
- Alternatives for reallocating resources in the event of sudden and dramatic shifts in loads, i.e., load loss, in a particular jurisdiction;
- Alternatives for allocating PacifiCorp's future additions to generation and transmission;
- Alternatives for different state jurisdictions to prescribe the types of new generation PacifiCorp must acquire;
- Consequences of different cost allocation methodologies to each jurisdiction for both existing and future resource additions; and
- Policies this Commission and other commissions should adopt to provide PacifiCorp a reasonable opportunity to recover its costs.

PROPOSED MULTI-STATE PROCESS

In order to analyze the issues listed above, the Company proposes a two-stage process for the MSP. The first stage involves a dialogue and the development of a record on the issues set forth above by the parties in the six states where PacifiCorp provides electric service. The first phase of the Process seeks to develop a consensus among these diverse interests on these issues. The second stage of the Process involves a state-specific proceeding. While not explicitly stated, the second stage would culminate in a Commission decision regarding the ratemaking treatment of the issues raised by PacifiCorp in its petition.

The Company proposes the first phase of the process to be managed by an independent Special Master. On March 18, 2002, the Commission received a letter from the Company identifying the Company's choice of Robert I. Hanfling as the Special Master. The letter states that nominations were solicited from parties participating in its contested Structural Realignment Proposal ("SRP") in various states, but it does not specify from whom it received nominations.¹ By April 8, 2002, any jurisdiction or combination of jurisdictions that represents at least 25% of its retail revenues ("opposing percentage") may object to the designee. If there is an objection to the individual selected as Special Master, the Company will suspend the MSP schedule, and it will attempt to find an acceptable nominee or terminate the MSP altogether. Once the Special Master is nominated, all interested parties must notify PacifiCorp of plans to participate in the MSP. There is no limitation on the parties that may participate in the Process during the first phase. By April 5, 2002, all interested parties must forward briefing papers describing the information they believe should be considered by the Special Master prior to the MSP.

At the conclusion of the first phase of the MSP, the Special Master will file a report with each jurisdiction. This report will contain the following information: 1) a description of any consensus achieved among the parties and whether there are any objections to the consensus view (Staff would note that the term "consensus" generally denotes a complete agreement); and 2) recommendations from the Special Master on issues where consensus was not achieved based upon the record the Special Master develops. PacifiCorp proposes that the Special Master have the authority to determine how the record should be developed if there are any dissenting opinions to the "consensus" opinion.

The petition sets out an aggressive schedule during 2002 for the MSP. PacifiCorp proposes that the first phase of the Process begin with initial meetings on April 10-12, 2002, in Boise, Idaho, followed by two workshop/settlement meetings during May, 2002, and a final settlement conference June 10-11, 2002. On June 25, the Special Master will report on any unresolved issues and describe specific plans to develop a record on

¹ The Company did not seek any input from Staff in the selection process, nor is it expected that this agency would have any ability to influence the process since Washington is at most 10% of PacifiCorp's system revenues.

unresolved issues. Filings are due by July 15 on unresolved issues, and responsive filings on any unresolved issues are due August 2. The week of August 12 is reserved for proceedings and settlement discussions on the unresolved issues. The initial draft report by the Special Master is scheduled for distribution on September 6 with comments from all the parties due one week later, on September 13. On September 20, the final report will then be filed with each state commission. During the initial phase of the MSP, the Company or any jurisdiction(s) representing an opposing percentage may terminate the process.

The second phase of the proposed process would begin in Washington with all interested parties filing comments on the Special Master's final report. This report is proposed to be filed with the Commission on September 20, 2002. These initial comments would be due to the Commission on October 2, 2002. Thirty days after the filing of the final report the Commission would convene a formal pre-hearing conference for a state-specific investigation. PacifiCorp proposes that the record developed by the Special Master be accepted in any formal proceeding with this Commission, subject to any party's right to rebut the report. The petition is silent on the specific action the Commission is to take with respect to either the final report or the parties' comments filed in response to the report. Given the fact that the Company seeks to have some final determination on the issue of cost allocations, it is anticipated that, at some later time, PacifiCorp will request an order including specific findings and conclusions of law regarding the appropriate ratemaking treatment for common and joint production, transmission and any other costs the Company deems significant.

The petition requests that the Commission consider its proposed MSP at its next regularly scheduled open meeting, March 27, 2002, and seek comments from interested parties at that time. On March 18, 2002, ICNU filed its petition to intervene, and on March 19, 2002, the Commission issued a notice to the parties of record in PacifiCorp's pending SRP² seeking comments on the proposed MSP.

PacifiCorp asserts in its petition that it is a public service company providing electric service to customers in a six-state area. It owns significant generation and transmission assets supplemented with substantial purchases of both generation and transmission in order to provide electric service in a cost effective manner. The Company states that it operates its system on an integrated basis. The petition generally describes the rate setting process, including the need to develop a method for the allocation of its common and joint production costs. PacifiCorp states absent a consensus among all the jurisdictions regarding joint cost allocations, the Company is denied an opportunity to recover its costs. Due to differences in the manner in which the various jurisdictions allocate a significant portion of the Company's costs, PacifiCorp claims that it is

² The parties are Public Counsel, ICNU, The Energy Project and Northwest Energy Coalition. The Company's SRP is PacifiCorp's initial effort to solve the issues raised in this petition. The SRP proposes to transfer its generation and transmission assets to an unregulated company within PacifiCorp's holding company. The SRP would also create six separate distribution companies all within PacifiCorp's holding company structure. PacifiCorp's SRP filing in this State is being adjudicated in Docket No. UE-001878.)

currently facing a substantial under-recovery of its costs. The petition identifies several specific issues it seeks to have resolved by the Commission in this process:

- The lack of consensus regarding the allocation of existing generation and transmission costs;
- The lack of consensus regarding the responsibility of benefits and costs associated with significant load shifts, e.g., direct access or industrial load loss;
- The lack of consensus regarding the responsibility for the cost of new resources acquired by PacifiCorp for load growth;
- The lack of consensus regarding the specific types of resources the Company should acquire to meet load growth; and
- The lack of assurances that any consensus that may be reached on cost allocations will be maintained over the life of the new resources.

DISCUSSION

Commission Staff believes that there is no need for the Commission to devote its scarce resources³ to this process in order to resolve the issues identified in the petition. Our recommended course of action is driven by two significant events, which the Company did not discuss in its petition: Pacific Power & Light Company's ("Pacific Power") decision to acquire Utah Power & Light Company ("Utah Power") in 1988, and the decision by the Utah Commission in 1999 to adopt the "rolled-in" methodology for interstate cost allocation. These two events are the cause of the problems identified by the Company in its petition and are critical for a full evaluation of the Company's petition.

In 1987, Pacific Power filed an application under Chapters 80.08 and 80.12 RCW for approval to acquire, through a pooling of interest, the assets of Utah Power. (Cause No. U 87-1338-AT-"Acquisition") During the hearings in that case, several significant issues were addressed. In general terms, these issues were generally:

1. The integration of Pacific Power's low cost resource system, which included significant hydro-based power supply, and Utah Power's high- cost thermal system;
2. Issues surrounding interstate cost allocations for a larger, more diverse, utility with two operating divisions, each with very different cost structures;
3. Issues related to the acquisition of new resources for the combined utility;
4. Equitable sharing of merger benefits; and
5. Issues related to whether the merged company would move to creating a generation and transmission company.

³ At this time the Commission and the parties that have an interest in the outcome of the MSP are all involved in two major contested rate proceedings. These cases are subject to statutory suspension periods and must be completed during the same time frame the Company proposes that the Commission engage in this investigation.

As Staff reviewed the record of the proceeding, it noticed the striking similarity between the issues presented by PacifiCorp in its current petition and the contested issues Staff and other parties raised when evaluating Pacific Power's request to acquire Utah Power. Furthermore, during that proceeding Pacific Power, made significant commitments to resolve these issues all of which are the same issues the Company seeks to examine now.

While not set forth in its petition, Staff believes the reason PacifiCorp is pursuing an aggressive schedule within this new process is the Utah Commission's unilateral decision to base PacifiCorp's revenue on a "rolled-in" interstate cost allocation methodology. The effect of the Utah Commission's rolled-in decision is the cause of PacifiCorp's current cost recovery problems. That decision seizes the benefits of Pacific Power's low-cost resource system for Utah ratepayers. In addition, as Utah's load increases faster than the loads in other states, the amount of this "subsidy" from the Pacific Power system to the customers in Utah is expected to grow over time. In Cause No. U 87-1338, the Commission expressed its concern about the impact of merging Utah Power's high-cost system with Pacific Power's low-cost system, and the Commission did not accept the rolled-in allocation methodology. The Merger Order states, "The Commission continues to be concerned about the effects on Pacific's ratepayers of merging with a higher cost system, and believes the integration of the power supply function for the two companies should be done in a manner consistent with Pacific's least-cost planning process, now getting underway. In the meantime, the Commission views Pacific's current average system costs as the appropriate basis for rates." (Order @ 14)

Since the time of the order approving the acquisition, Staff has consistently voiced its concerns to the Company and other participants in the allocation committee (described below) that the rolled-in methodology is unacceptable until it can be shown that there are no adverse impacts to Washington ratepayers. Based upon the issues as framed by the petition, Staff simply cannot agree to participate in a process in which it is likely that Washington customers will lose. Staff is also concerned with participating in a process that excuses PacifiCorp from honoring the commitments PacifiCorp made to Washington regulators in order to obtain merger approval.

What follows is a brief explanation of the issues in the 1988 acquisition proceeding. This will provide context for Staff's concerns. In order to obtain a favorable ruling and overcome the issues of the parties in the Acquisition proceeding Pacific Power made several commitments to the Commission. These commitments, Staff believe, were critical in the Commission's authorizing Pacific Power's acquisition of Utah Power. Pacific Power's policy witness, Mr. Frederick Reed, specifically addressed the issue of cost allocations. He testified, "Pacific will initiate action to reconvene the jurisdictional allocation committee within six weeks after the final approval of the merger, and that committee is the appropriate forum for resolving the allocation issue, including allocation of power supply costs and benefits." (Ex. T-43, page 1, lines 16-20)⁴ The commitment

⁴ The allocation committee had just completed work to develop new interstate allocation factors. The Commission had recently accepted the results of that effort in a Pacific rate case, Cause No. U 86-02.

to reconvene the joint allocation task force addressed PacifiCorp's other commitments to ensure that Washington customers would receive a fair share of ongoing benefits from the acquisition. Staff and other parties were also concerned about the complexity of cost allocations for a bigger, more complex company and the increased regulatory burdens as a result of the acquisition. To allay those concerns, Mr. Reed stated in his rebuttal testimony that, "[t]he merger will not significantly increase the regulatory burden of the state and federal regulatory commissions." (*I.*, at 1, line 29; at 2, line 1) In order to accommodate our current resource constraints and enforce PacifiCorp's prior commitments, in early February Staff suggested that the Company reconvene the interstate allocation task force (PITA). The Company rejected this suggestion.

Finally, Staff wants to point out the Company's commitment that Washington customers would be held harmless for the integration of the Utah operations into the calculation of PacifiCorp's system revenue requirements in the event Utah moves to rolled-in allocations. In response to questions from the bench on this very issue Mr. Reed testified, "But I will hasten to add that through the allocation process we [PacifiCorp] will insure and I'm sure you [the Commission] will insure that there's no cross subsidization whereby a Washington customer or any Pacific Power and Light customer is helping to subsidize that price reduction. If there is a subsidy required, it's going to be a subsidy by the shareholder." (TR 733)

Staff has completed another analysis in order to determine whether the Commission should proceed with the proposed MSP. This analysis combines the concept of equitable sharing of benefits from the combined system and the asserted under-recovery issue for PacifiCorp's system. If the relative rates in each of the six states have exhibited a similar pattern over time, that positive correlation would suggest an equitable sharing of merger benefits for all PacifiCorp customers. Such a correlation would support further investigation in order to resolve the cost recovery issues identified in the petition.

The analysis, however, does not support such a conclusion. Rather, it shows that Utah ratepayers received a disproportionate share of the benefits from Pacific Power's acquisition of Utah Power. It also shows that the Company's efforts in the MSP are misplaced, and that the responsibility for the Company's substantial under-recovery of its costs lies with its Utah operations.

The analysis provided in Attachment A is a simple comparison of rates in the various jurisdictions since Pacific Power's acquisition of Utah Power. The hypothesis is simple: if there is a sharing of acquisition benefits, the rates in each of the six states where the Company operates should be positively correlated. Staff used data reported by PacifiCorp to the Energy Information Agency since 1989, the first full year of the combined Pacific Power and Utah Power operations. The first four pages are, respectively, the average residential, commercial, industrial rates, and average rate for all customers. Page 1 shows the significant decrease for residential customers in Utah and the corresponding increases in all other states. Since 1989, the average residential rate in Utah decreased almost 2 cents per kWh-from just under 8 cents per kWh to about 6 cents

per kWh. Commercial rates in Utah experienced similar reductions of approximately 2 cents per kWh through 2000. Industrial customers in Utah also experienced substantial reductions over time. Rates in all other jurisdictions were not reduced in any similar way. (California was not considered in the analysis due to legislative changes mandating open access.)

Pages 5 through 8 of Attachment A show the percentage change in rates since 1989. The charts on these four pages use 1989 as the base year (100%) for each of the categories listed above. The last page is significant. It shows the percentage change for the average rate of all customers in each state. It demonstrates that rates in Utah are negatively correlated to the rates in the other five states. The average rate for Utah customers between 1989 and 1998 declined to 90% of 1989 levels declining further in 1999 to 80% of 1989 levels.⁵ No other jurisdiction experienced similar rate reductions. Indeed, the data suggest other jurisdictions are making up the lost revenues from the Company's Utah operations.

There is an additional relevant point regarding this data. PacifiCorp's Idaho operations were part of the pre-acquisition Utah system. The data show that the rates in Idaho are 110% of 1989 levels. One would expect that any allocation methodology that is "fair" and shares benefits equitably would produce similar relative costs for customers in both Utah and Idaho.

There are additional issues for Staff regarding process. First, Staff is concerned with the development of a record elsewhere that may be used in Washington with ratemaking consequences. It is arguable that these issues may only be raised in a proceeding where the Company's proposed rate changes are noticed to the public. There are issues related to whether the outcome from the MSP and an Order by this Commission in this Docket may be used in a future proceeding where the Commission determines rates. Finally, Staff is concerned about the request for the MSP to consider future statutory changes in order to provide PacifiCorp with a reasonable opportunity to recover its costs. PacifiCorp may submit any proposed statutory changes to the Legislature if it believes there is need to amend the statutes to resolve its problems. That is the proper forum for considering any statutory changes since such proposals potentially impact all companies the Commission regulates under Title 80. Finally, the proposed process is "stacked" to favor large jurisdictions. Staff is very uncomfortable with the provisions of the MSP providing the two largest jurisdictions, Utah and Oregon, significant power over many aspects of the process such as the ability to reject the selection of the Special Master and the ability to terminate the process at any time.

To summarize, the Commission is being asked to participate in a process that will likely result in an outcome adverse to the interests of Washington ratepayers. The Company's ability to recover its costs is not related to anything this Commission can do other than increase rates to Washington ratepayers in order to pick up the costs Utah no longer

⁵ The latest drop in rates for Utah in 1999 is the result of the Utah Commission's rolled-in decision.

supports in rates. Staff has consistently participated in the PITA process in an effort to achieve a consensus regarding a reasonable methodology for cost allocations consistent with the Company's prior commitments when it chose to acquire Utah. This new and different process cannot overcome the unilateral decision by Utah to adopt the rolled-in methodology to capture the benefits of Pacific's low cost resource system for Utah ratepayers. Furthermore, the analysis of relative rate levels between jurisdictions provides no support for the Commission to participate in a process where one state may receive a disproportionate share of benefits from a consolidation. Staff is unable to find any reasonable basis for recommending the Commission participate in the process requested in the Company's petition.

For the reasons stated above, Commission Staff recommends that the Commission deny the Company's request to participate in the MSP. The Commission's current statutes, policies, and rules do not need to be investigated or amended to address the issues the Company identifies in its petition. The Company's rates in Washington meet the statutory test under RCW 80.28.010, and current rates meet the long-standing constitutional tests of the U.S. Supreme Court in the *Hope & Bluefield* cases. In fact, rates in Washington for PacifiCorp are the result of a negotiated settlement that created a five-year rate plan. The Company has the affirmative obligation under current rules to acquire least-cost resources, and our current rate case procedures provide the opportunity for the Company to recover the costs of these newly acquired resources. The Company and its shareholders accepted the risks that a "regulatory gap" could exist when they proposed to acquire Utah. Unfortunately, that risk became a reality. However, the Commission should not now be asked to participate in a time-intensive process at this time where the likely outcome would be that Washington ratepayers be held responsible for risks PacifiCorp's shareholders specifically acknowledged and accepted. Accountability lies with PacifiCorp. Staff is willing to continue discussions through less time-consuming processes and is willing to continue the work of PITA, consistent with merger commitments, with an effort to produce a cost allocation methodology for use at the end of PacifiCorp's rate plan in 2005.

Therefore, Staff recommends that the Commission deny PacifiCorp's petition for the Commission to participate in the proposed Multi-State Process.

Attachments

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