



**Report on the West Control Area
Inter-Jurisdictional Allocation
Methodology**

January 2013

I. OVERVIEW

On June 21, 2007, the Washington Utilities and Transportation Commission (Commission) adopted the West Control Area Inter-Jurisdictional Allocation Methodology (WCA) for a five-year evaluation period.¹ Because PacifiCorp, d/b/a Pacific Power & Light Company (PacifiCorp or Company) is a multi-jurisdictional utility, the WCA outlines how total-company costs, revenues, and rate base balances are allocated to Washington for the purpose of establishing retail rates in Washington. This report provides an evaluation of the WCA during the five-year period established by the Commission.²

This evaluation is based on the Company's experience during the trial period. In general, the Company does not believe that the WCA is a sustainable approach to setting rates in Washington, primarily because it is incompatible with how the Company actually plans and operates its six-state system. This creates over- and under-recovery of costs that the Company actually incurs, and has resulted in a mismatch of certain costs accounted for in the auditable books and records of the Company and the costs reflected in rates. It is also significantly challenging for the Company to have Washington use a different allocation methodology than the Company's other five jurisdictions. As a result, the Company is proposing certain modifications to the WCA in its 2013 general rate case, and will request that the Commission direct Staff to actively participate in the upcoming Multi-State Process (MSP) Standing Committee activities.

This evaluation also reflects discussions with Commission Staff, Public Counsel, and the Industrial Customers of Northwest Utilities. These discussions were the result of a settlement in the Company's 2011 general rate case (docket UE-111190). In that settlement, the Company agreed not to file another rate case until January 2013 in order to engage in a collaborative process to discuss, among other things, the WCA as ordered by the Commission, challenges and concerns with the methodology, and possible modifications or alternatives. From April through October 2012, the parties convened ten meetings. Unfortunately, no consensus was reached among the parties to address the Company's continued concerns that the WCA is not a sustainable approach to setting rates in Washington.

II. DESCRIPTION OF THE WCA

As approved by the Commission, the WCA isolates the costs and revenues associated with assets located in the Company's west "control area" or "PacifiCorp West Balancing Authority Area" (PACW), and allocates to Washington a proportionate share of the costs and revenues based primarily on Washington's relative contribution to demand and energy requirements. The WCA includes loads, generation and transmission assets and wholesale contracts for facilities located in California, Oregon, and Washington. It also includes

¹ Docket UE-061546, Order 08, ¶ 43.

² In Order 06 in Docket UE-100749, the Commission indicated that a review of the WCA was due in June 2012. Docket UE-100749, Order 06, ¶ 294, n444. In PacifiCorp's 2011 general rate case, the Commission extended the five-year evaluation period from June 2012 to January 2013. Docket UE-111190, Order 07, ¶ 8 (March 30, 2012).

transmission and generation assets located outside of California, Oregon, and Washington that are electrically located in PACW. The WCA excludes all loads and assets located within PacifiCorp's East Balancing Authority Area (PACE).

The primary revenue requirement components and the associated treatment under the WCA are described below.

A. Generating Resources

The WCA includes: (1) the Hermiston and Chehalis natural-gas-fired generating plants; (2) the Jim Bridger and Colstrip Unit 4 coal-fired generating plants; (3) the Leaning Juniper, Marengo, Marengo II, and Goodnoe Hills wind generating facilities; (4) the Lewis River, North Umpqua, Klamath, and Prospect (Rogue River) major hydroelectric projects, as well as minor hydroelectric projects in California, Oregon, and Washington; and (5) wholesale contracts and sales with third parties, including the Bonneville Power Administration (BPA).

The fixed and operating costs associated with Company-owned resources are allocated to Washington using the Control Area Generation West (CAGW) allocation factor, which is developed based on Washington's relative contribution to total demand and energy requirements for California, Oregon, and Washington. The factor is weighted to reflect 75 percent demand and 25 percent energy. The fuel costs associated with the natural gas and coal facilities are allocated to Washington using the Control Area Energy West (CAEW) allocation factor, which is developed based on Washington's relative contribution to total energy requirements for California, Oregon, and Washington.³ Wholesale contracts and sales are allocated using the CAGW factor for firm contracts and the CAEW for non-firm contracts.

Generation-related costs that cannot be directly assigned to either PACW or PACE, such as certain engineering and management expenses, are allocated to Washington using the System Generation (SG) factor. This factor is developed based on Washington's relative contribution to total-company demand and energy requirements (75 percent demand, 25 percent energy).

B. Transmission Facilities

The fixed and operating costs of transmission facilities located within PACW are allocated to Washington using the CAGW factor described above.

C. Distribution Facilities

Distribution-related expenses and investments are directly assigned to the state in which located, also referred to as situs assignment. Certain distribution costs, such as

³ Costs and balances for the Jim Bridger generating plant and associated transmission are allocated using the Jim Bridger Generation (JBG) factor and Jim Bridger Energy (JBE) factor. These factors are modifications of the CAGW and CAEW factors, respectively.

administrative and engineering costs, that cannot be situs assigned are allocated using the System Net Plant Distribution (SNPD) allocation factor. This factor is developed based on each state's contribution to the total-company net electric plant in service distribution balance.

D. Administrative & General

Administrative and general (A&G) expenses are allocated using a variety of allocation factors. For example, state-specific expenses are allocated using the Situs factor, customer-related expenses (such as the Company's billing system) are allocated using the customer number (CN) factor, and general A&G expenses are allocated using the System Overhead (SO) factor. A&G costs directly attributable to generation or transmission functions are allocated consistent with the fixed and variable costs associated with those functions, as described above.

A detailed listing of each allocation factor by FERC account is contained in the WCA Allocation Manual, which has been provided in each of the Company's rate cases beginning with docket UE-090205.

III. CHALLENGES WITH THE WCA

Over the trial period, the Company has identified the following five major challenges resulting from Washington's adoption of the WCA:

A. The WCA Does Not Reflect the Actual Operations of the Company

Although the Company operates two balancing authority areas, its system is integrated and power is dispatched from a central control center. Power is purchased, sold, and transferred between PACW and PACE. Having a geographically diverse, six-state system is a benefit to customers because of enhanced flexibility in dispatching power, enhanced system reliability, peaking diversity, and greater access to wholesale markets. The WCA artificially divides an otherwise integrated system, and creates a fictitious "stand-alone west control area utility." Although there are transmission constraints between PACW and PACE that limit the transfer capability, it does not change the fact that PacifiCorp operates the two balancing authority area as a single system, which optimizes total-system costs. There is no separate optimization of PACW and PACE, as assumed under the WCA.

The Company's long-term integrated resource plan reflects this integrated system, and long-term planning and resource decisions are based on the infrastructure in the Company's six-state service territory and load requirements for the system as a whole. Accordingly, investment decisions are not made on a "west control area" basis. The planning process recognizes transmission constraints across the system in optimizing its portfolio to result in a risk-adjusted, least-cost, six-state plan. Setting rates using the WCA ignores not only how the Company actually operates the system, but also how the Company plans to serve its customers in all six states.

B. The WCA is Inconsistent with How the Company Finances its Investments

The Company finances its operation on a total-company basis. The Company's credit ratings benefit from the Company's six-state service territory:

[C]redit rating on PacifiCorp reflects an "excellent" business risk profile. . . . Our assessment of the business risk profile takes into account PacifiCorp's position as a vertically integrated electric utility with geographical, market, and regulatory diversity over its six-state service territory.⁴

The market diversity of PacifiCorp's six-state service territory is favorable from a credit perspective because it mitigates the economic and regulatory impacts of concentration in any one jurisdiction.⁵

These positive credit ratings help reduce debt costs, to the benefit of the Company's customers. Under the WCA, customers receive the full benefit of reduced debt costs, but Washington rates do not accurately reflect Washington's allocation of the costs to operate the six-state system supporting the Company's positive credit ratings. If the Company were to separately finance its operations on a state-by-state basis, it is very likely that the credit ratings of the smaller entities, such as Washington, would be lower than PacifiCorp's existing ratings resulting in higher capital costs and prices to customers.

C. The WCA is Inconsistent with how Costs are Allocated in the Company's Five Other State Jurisdictions

In PacifiCorp's five other state jurisdictions (California, Idaho, Oregon, Utah, and Wyoming), the state regulatory commissions use the same inter-jurisdictional allocation methodology—the 2010 Protocol. The 2010 Protocol is a six-state, system-based methodology that reflects the actual planning and operation of the system. With the use of the WCA in Washington, the sum of the six state allocations do not equal the whole, leading to over-allocation of PACW investments and under-allocation of PACE investments.

Parties involved in regulatory proceedings in each of these five states participate in regular MSP Standing Committee workgroup meetings to discuss emerging issues and potential refinements to the 2010 Protocol. The 2010 Protocol will be used through 2016. Accordingly, representatives from these states are beginning to discuss potential alternative allocation methodologies to replace the 2010 Protocol. During the collaborative discussions, Washington Commission Staff indicated a willingness to

⁴ Standard & Poor's Ratings Direct (October 23, 2012).

⁵ Moody's Investors Service (May 8, 2012).

participate in the MSP workgroup discussions. The Company strongly encourages participation from the other Washington parties to see if all six states can reach a consensus on an appropriate approach for use after the 2010 Protocol expires.

D. The WCA Originally Impeded the Adoption of a Power Cost Adjustment Mechanism

One of the primary reasons that the Commission previously rejected a power cost adjustment mechanism (PCAM) is the lack of accounting detail for actual net power costs (NPC) because the “computer-generated actual costs has not been shown to be reliable:”⁶

Our concern is that the computer-generated, pseudo-actual costs will themselves be only estimates including some statistical (i.e., modeling) variability (i.e., error). The Company and Staff contend that actual data, rather than assumptions, will be used in the computer model. Presumably that will reduce the modeling error and produce a more precise result. Truing-up one estimate with another more precise estimate *may* be justified, but the risk is that neither will be accurate and using two inaccurate, even if precise, estimates of cost to set cost-based rates could lead us to depart farther and farther from actual costs.⁷

As discussed above, since the WCA creates a fictitious system, the NPC under the WCA have historically not been tied to the Company’s accounting records. As noted above, the Company does not dispatch its system to optimize PACW and PACE separately. Accordingly, since the adoption of the WCA, the Company’s Commission basis reports, quarterly results of operations, and rate case filings remove actual total-company net power costs and replace them with “pseudo-actuals” calculated by the GRID net power cost model. PacifiCorp is the only electric utility in the state of Washington that has been denied a PCAM.

E. The WCA is a Hybrid of a Situs and System Methodology, which Leads to Inconsistencies

Because the WCA does not represent a true system or situs methodology, inconsistencies have developed over time causing Washington rates to depart further and further from actual costs or resulting in outcome-based proposals.

For calculation of net power costs, there are two items of significant concern. First, the WCA treats power purchase agreements (PPAs) with qualified facilities (QFs) differently than all other PACW generating resources by not reflecting the costs of PPAs with QFs located in Oregon and California even though output from these QFs serve Washington

⁶ *Wash. Utils. & Transp. Comm’n v. PacifiCorp d/b/a Pacific Power & Light Co.*, Docket UE-061546, Order 08, ¶ 59 (June 27, 2007).

⁷ *Id.*, ¶ 77.

retail load. Second, the net power costs are reduced by an imputed sale to PACE, without including the cost of the assets located in PACE that would be required to wheel power from PACW to wholesale markets located in PACE.

In addition, parties have proposed changes in how allocation factors are applied and to which costs they are applied based solely on whether the change reduces the costs ultimately allocated or assigned to Washington. This has been particularly true for A&G expenses, and has led to an inconsistent application of allocation factors among cost categories.

As a result of discussions among the parties after the Commission issued its order in the Company's 2010 rate case, several cost categories were deemed more appropriately situs assigned, including advertising, memberships, and subscription expenses. During these discussions, certain parties were reluctant to agree on further situs assignment of cost categories because of the uncertainty of the overall impact on Washington's allocated costs.

The Company has also identified inconsistencies in assumptions used in the development of WCA inter-jurisdictional allocation factors with elements of the Company's cost of service study, which uses the Commission's approved methodology. Specifically, the Company uses the peak credit method in the cost of service study, which results in demand/energy weightings of 38 percent/62 percent, but the WCA inter-jurisdictional allocation factors are derived using 75 percent/25 percent demand/energy weightings. In addition, the cost of service study uses class loads coincident with PacifiCorp's highest 100 winter and highest 100 summer hourly retail WCA peak loads in determining the demand and energy classification percentages used to allocate generation and transmission costs, but the WCA inter-jurisdictional allocation factors are based on the 12 monthly WCA coincident peaks.

IV. ALTERNATIVES TO THE WCA CONSIDERED DURING THE COLLABORATIVE PROCESS

During the collaborative process, the parties discussed two alternatives to the WCA: (1) moving to a true situs methodology; and (2) moving to a six-state system approach.

A. True Situs Methodology

In response to the Commission's statement that it expected the review of the WCA to "greatly refine the WCA to produce results that more closely represent Washington-only actual costs and revenues," the parties discussed how a true situs model could be incorporated in the Company's Washington service territory.⁸ The parties discussed identifying fixed portions of existing generation resources that could be used to serve Washington load, with specific situs assigned purchases and sales to balance Washington load and resources. This proposal is similar to the Southern Company structure, where

⁸ *Wash. Utils & Transp. Comm'n v. PacifiCorp d/b/a Pacific Power & Light*, Docket UE-100749, Order 06, n 444 (March 25, 2011).

each state utility owns and operates its own generation. It is also similar to the Company's Structural Realignment Proposal filed in docket UE-001878. Transmission costs under this proposal would be based upon the Company's Federal Energy Regulatory Commission Open Access Transmission Tariff. Distribution-related costs would remain situs assigned, while a share of A&G expenses would still need to be allocated to Washington using some type of allocation factors.

This proposal ultimately proved to be unworkable at this time, primarily due to the complexity and difficulty of reaching agreement on which generation resources, and what share of those resources, would serve Washington load. Any outcome that does not reflect the Company's actual costs to serve its Washington customers would be as unsustainable as the WCA. In addition, establishing and financing a stand-alone Washington distribution utility could increase costs to Washington customers. However, as part of the upcoming MSP Standing Committee workgroup efforts, the Company has committed to comprehensively evaluating the costs and benefits of structural separation options, which may identify a viable option for states wanting to pursue permanent structural separation or subscription options for new generation resources.

B. Six-State System Allocation Methodology

Since the Commission adopted the WCA, the Company's system operations have not significantly changed. There are, however, plans for future transmission projects across the west and emerging market initiatives that could affect the manner in which the six-state system is operated. During the collaborative process, the Company identified some potential triggers that would enhance the Company's ability to demonstrate the direct or indirect benefits to Washington customers of its integrated system-wide resources, and support a change to a system-based allocation methodology, similar to the 2010 Protocol. These triggers include:

- Increased transmission capacity between PACW and PACE.
- A change in Washington law allowing the Company to use PACE resources to comply with Washington's renewable portfolio standard.
- Operation of PacifiCorp's system under a single balancing authority area.
- Implementation of federal and regional efforts to increase market initiatives throughout the western United States.

Due to the evolving nature of these efforts, the Company believes that a six-state system allocation methodology should remain a consideration in the future in Washington.

V. RECOMMENDATIONS

The collaborative process allowed the Company to outline its concerns with the continued use of the WCA to set rates in Washington. The Company presented those concerns in this report. During the collaborative process, all parties had the opportunity to gain knowledge and share ideas about potential alternatives ranging from a true situs model to a six-state system model. Given the timing of the upcoming efforts with PacifiCorp's

other five state jurisdictions to analyze and develop alternatives to the 2010 Protocol for use after 2016, the Company believes that those efforts should also be used to address the challenges in Washington, and the Company urges the Commission to direct Staff to actively participate in the upcoming MSP Standing Committee activities. The Company also believes, however, that there are near-term modifications that can be made to the WCA to better match the Company's actual costs to the costs reflected in rates. The Company is proposing these modifications in its 2013 general rate case.