

TABLE OF CONTENTS

Introduction.....	1
Argument	3
I. The Commission Should Make Adjustments to PacifiCorp’s Net Power Cost Model to Appropriately Account for the Cost of Power in the Test Period	3
A. The Thermal Availability Factors Used in the NPC Model Should be Adjusted to Reflected Operation of the Units	4
B. The Scheduled Maintenance Factors Incorporated in the NPC Model Should be Adjusted to Reflect the Maintenance Life Cycle of the Generating Facilities	5
C. The Commission Should Reject the Overstated “Normalized” Costs Contained in PacifiCorp’s Net Power Cost Model	6
D. The NPC Model Should Reflect PacifiCorp’s Operation as an Integrated System	9
II. The Commission Should Adopt Modifications to PacifiCorp’s Claimed Net Power Costs to Account for the Proper Sharing of Risk.....	10
A. PacifiCorp’s Wholesale Power Marketing Strategy Became Demonstrably More Aggressive the Mid-1990s.....	11
B. The Increased Wholesale Market Participation Was Driven by Two Separate Strategies.....	13
C. Ultimately PacifiCorp’s Strategy Led to Higher Costs, Which PacifiCorp Is Now Attempting to Pass Through to Ratepayers	14
D. The Benefits Ascribed by PacifiCorp to the Revenue Credit Are Illusory	17
E. PacifiCorp Knowingly Adopted a Strategy Fraught With Risk, and It Should Bear the Risk and the Consequential Costs.....	17
F. Revenues Should Be Imputed to Long-Term Wholesale Contracts to Properly Shift the Consequences of Risk to Where It Belongs	21
G. The Impact of Losses on Short-Term Transactions Should Be Removed from Net Power Costs.....	23

III.	A Commission Decision to Hold PacifiCorp Accountable for the Costs Created by Its Wholesale Marketing Strategy Will Not Unreasonably Impact PacifiCorp’s Financial Position	25
	A. The Commission Must Balance the Company’s Capital Costs With Fairness to Ratepayers	26
	B. PacifiCorp Credit Ratings Are Also Impacted by Many Other Decisions and Events	26
	C. PacifiCorp Has Overstated the Current Financial Ratios, and Painted an Unnecessarily Pessimistic Picture of Its Status.....	27
	D. PacifiCorp Has Grossly Overstated the Impact the Adoption of the Intervenor Recommendations Would Have on Its Credit Rating	28
IV.	Development of a Mechanism for recovery of the Cost of Demand Side Management Programs Is Not Appropriate at This time	29
	Conclusions and Recommendations	30

Peter J. Mattheis
Shaun C. Mohler
BRICKFIELD, BURCHETTE, RITTS & STONE, P.C.
1025 Thomas Jefferson Street, N.W.
800 West Tower
Washington, D.C. 20007
Telephone: (202) 342-0800

Glen E. Davies
PARSONS, DAVIES, KINGHORN & PETERS, P.C.
185 South State Street
Suite 700
Salt Lake City, UT 84111
Telephone: (801) 363-4300

ATTORNEYS FOR NUCOR STEEL, A DIVISION OF NUCOR CORPORATION

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application)	Docket No. 01-035-01
of PacifiCorp for an Increase in)	
its Rates and Charges)	POST-HEARING BRIEF OF
)	NUCOR STEEL, A DIVISION
)	OF NUCOR CORPORATION

Pursuant to Utah Admin. Code Rule R746-100-10 and the Commission’s Order from the bench (Tr. at 1370, ll. 17-19), Nucor Steel, a Division of Nucor Corporation (“Nucor”), hereby submits its Post-Hearing Brief in the above-captioned proceeding.

INTRODUCTION

Beginning in the mid-1990s, PacifiCorp management made a decision to vigorously participate in the developing wholesale electric market. By 1997, PacifiCorp was selling more energy in the wholesale market (59,143,145 MWh) than it was to its native load customers (46,148,733 MWh). Cross Ex. 8. This decision to participate in the wholesale market at a level

beyond what was necessary to meet retail needs, exacerbated by subsequent management decisions and strategies as well as market changes, ultimately led to the increases in net power costs that are at issue in this docket.

PacifiCorp has attempted to creatively craft a case that insulates management decision-making, shields its shareholders from significant exposure to market risks, and places into rates more than the full amount of the reasonably expected future power supply costs. PacifiCorp argues that the high net power costs it seeks to recover in this case are solely related to the service provided to retail customers. Ex. UP&L 3R (Watters Rebuttal) at 3, ll. 8-11. The evidence in the case belies this interpretation. PacifiCorp adopted a business strategy that included substantial economic risk, incurred heavy costs, and is now attempting to pass these costs through to ratepayers via a creative determination of test year net power costs. Nucor and Utah Association of Energy Users Intervention Group (“UAE”) witness Dr. Richard Anderson, along with every other non-PacifiCorp witness to examine net power costs, including witnesses representing the Division of Public Utilities (“Division” or “DPU”), the Committee for Consumer Services (“Committee” or “CCS”) and other large customers, concluded that ratepayers were being asked to bear far too great a portion of test year net power costs.

The ratepayers should not serve as insurance against management strategies gone awry. To correct PacifiCorp’s net power costs, the Commission should first make adjustments to the Net Power Cost Model (“NPC Model”) inputs to better reflect the expected operation and maintenance of PacifiCorp’s generating units and to better reflect the going-forward market prices. The Commission should also make an adjustment to the NPC Model to reflect the true operation of PacifiCorp’s system. The Commission should then make adjustments to protect

ratepayers from the consequences of the Company's risky wholesale marketing strategy by removing losses created by the reliance on the short-term market to supply long-term wholesale obligations, and losses from short-term market speculation.¹ These corrections and adjustments will not have an unreasonable impact on the Company's ability to cost-effectively raise capital, and represent a fair balancing of management accountability and the interests of ratepayers.

Finally, with regard to demand side management ("DSM") issues, the Commission should indicate strong support for cost-effective DSM programs and direct PacifiCorp to bring forward those programs that are cost-effective and reasonable for deliberation before the Commission. Consideration of appropriate DSM expenditures and mechanisms for recovery of those expenditures are best left until specific programs are brought before the Commission for consideration.

ARGUMENT

I. The Commission Should Make Adjustments to PacifiCorp's Net Power Cost Model to Appropriately Account for the Cost of Power in the Test Period

The inputs to PacifiCorp's NPC Model result in overstated net power costs by incorporating availability and maintenance factors that overemphasize recent operations, and by utilizing "normalized" market prices that do not reflect actual test period prices and overstate prices expected for the rate-effective period. Moreover, PacifiCorp's NPC Model itself does not accurately reflect PacifiCorp's operation as an integrated system. In order to properly "smooth out" the fluctuations in the NPC Model, and to better reflect expected operations, the inputs to

¹ Nucor will address in this brief certain adjustments recommended by various witnesses in this proceeding. Nucor does not intend, by its silence as to other adjustments, to suggest that those adjustments not addressed herein are without merit.

the model should be adjusted, and the model itself should be adjusted to account for the actual integrated operation of the Company.

A. The Thermal Availability Factors Used in the NPC Model Should Be Adjusted to Reflect Expected Operation of the Units

The Commission should adopt changes in the thermal availability factors used in the NPC Model as suggested by CCS/DPU witness Randall Falkenberg.² The suggested adjustment would result in a reduction in net power costs of approximately \$45.6 million on a total company basis, or \$16.9 million on a Utah jurisdictional basis. Tr. at 1114, ll. 6-7 (Falkenberg).

PacifiCorp's NPC Model uses a four-year rolling average of thermal availability based upon scheduled and unscheduled outage rates for PacifiCorp thermal generators from 1996-99. Ex. UP&L 5S (Widmer Suppl. Direct) at 8, ll. 8-14; Tr. at 483, l. 5 (Widmer). The purported purpose of using a four-year average is to "smooth out generation levels so that you don't see fluctuations . . . from year to year." Tr. at 483, ll. 10-13 (Widmer). PacifiCorp specifically decided to use a four-year average simply because that is what it has used since the UP&L/PP&L merger. Tr. at 485, ll. 8-10 (Widmer).

Messrs. Falkenberg and Herz both suggest using a six-year thermal availability factor instead of a four-year factor in the NPC Model. Ex. DPU 9SR (Falkenberg Surrebuttal); Ex. USEA 1 (Herz Direct) at 18. A lower thermal availability, on average, will increase net power costs. Tr. at 484, ll. 2-4 (Widmer). The high outage rates from 1996 through 1999, however, do not appear to be representative of outages going forward. Tr. at 1123, l. 4 (Falkenberg).

PacifiCorp has expressly stated in data responses in a recent Oregon proceeding that “[w]hile there have been some large outages in the past few years, these are felt to be single occurrences and not indicative of a declining trend.” Ex. DPU 9.2 at 1. PacifiCorp’s four-year thermal availability factor should therefore not be used in the NPC Model. Instead, a thermal availability factor based upon a longer six-year period will better “smooth out” fluctuations by properly de-emphasizing the declining thermal availability that was the result of large, single occurrence outages.

B. The Scheduled Maintenance Factors Incorporated in the NPC Model Should Be Adjusted to Reflect the Maintenance Life Cycle of the Generating Facilities

The Commission should adopt changes to the NPC Model to reflect suggestions made by Mr. Herz with respect to scheduled maintenance. Scheduled generator maintenance in the NPC Model should better reflect maintenance over the maintenance life cycle. The suggested adjustment would result in a reduction in net power costs of approximately \$58 million on a total company basis, or \$21 million on a Utah jurisdictional basis. Tr. at 1060, ll. 9-11 (Herz).

PacifiCorp’s NPC Model uses a four-year average of maintenance hours for each PacifiCorp generating unit from 1996-99. Ex. UP&L 5S (Widmer Suppl. Direct) at 8, ll. 8-14. Once again, the professed purpose of using a four-year average is to “smooth” annual fluctuations in unit operation and performance. *Id.* at 8, ll. 11-14.

Mr. Herz proposes a six-year scheduled maintenance factor instead of a four-year factor for use in the NPC Model. Ex. USEA 1 (Herz Direct) at 21, ll. 17-18. The six-year alternative is

² United States Executive Agencies (“USAE”) witness Joseph Herz proposed the same adjustment, with a corresponding reduction in net power costs of \$58 million on a total company basis (\$21 million on a Utah

superior because PacifiCorp's generating units and system are long-term investments that should be maintained for the benefit of ratepayers, and therefore the NPC Model should reflect the cost of maintenance over the maintenance life cycle of those facilities. Ex. USEA 1 (Herz Direct) at 21, ll. 7-13. Mr. Herz' observation that, based on PacifiCorp's responses to data requests in this proceeding, the cycle for major overhauls for the generating units at issue is five to six years, not four, stands un-refuted. See Tr. at 1067, ll. 3-5 (Herz). In addition, PacifiCorp's historical data shows that the maintenance hours for 1997 and 1998 were exceptionally high when compared to historical figures. Ex. USEA 1.4. Thus, the Commission's adoption of a longer six-year average scheduled maintenance factor will more closely model PacifiCorp's actual maintenance practices and serve to smooth out the two abnormal spikes in maintenance hours that occurred in recent years.

C. The Commission Should Reject the Overstated "Annualized" Costs Contained in PacifiCorp's Net Power Cost Model

The proposed "annualized" net power cost figures submitted by PacifiCorp in this proceeding are contrary to the historic test year methodology adopted by the Commission. The Commission should adopt the use of actual net power costs from the test period as proposed by Mr. Falkenberg. Mr. Falkenberg's adjustment would result in a reduction in net power costs of approximately \$149.7 million on a total company basis, or \$55.3 million on a Utah jurisdictional basis. Tr. at 1113, ll. 21-23 (Falkenberg).³

jurisdictional basis). Tr. at 1060, ll. 6-7 (Herz).

³ Utah Industrial Energy Consumers ("UIEC") witness Alan Chalfant also recommends utilizing actual net power costs. If the Commission accepts Mr. Chalfant's calculations rather than Mr. Falkenberg's, the adjustment would result in a reduction in net power costs of approximately \$37.7 million on a Utah jurisdictional basis. Tr. at 1014, ll. 23-25 (Chalfant).

In its NPC Model, PacifiCorp utilizes “annualized” market price adjustments to account for short-term firm and non-firm price increases. Ex. UP&L 5R (Widmer Rebuttal) at 6, ll. 9-10. More specifically, in the “*expectation* that higher market prices will continue, prices for the period October 1999 through May 2000 were annualized to reflect prices incurred by the Company during the period June-September 2000.” Ex. UP&L 5S (Widmer Suppl. Direct) at 10, ll. 9-12 (emphasis added). PacifiCorp contends that this “annualization” practice is consistent with historical ratemaking treatment that the Company has received in the State of Utah. Ex. UP&L 5R (Widmer Rebuttal) at 6, l. 11.

PacifiCorp’s stated methodology, however, does not comport with the Commission’s rules. Rule R746-407, the Commission’s rule on “Annualization of Test-Year Data,” provides in relevant part:

An item of test-year data may be annualized in the determination of a utility's rates if it meets the following criteria:

* * *

D. The change must be known to occur at a specific moment or moments in time.

E. The effects of the change must be measurable.

F. The change must occur on or before the effective date of a final Commission order setting rates.

G. The change must be expected to be ongoing after final rates become effective.

Utah Admin. Code R746-407-3 (“Annualization Rule”). The four months of test year data that PacifiCorp seeks to annualize over the other eight months of the test year does not satisfy the above-referenced criteria required by the Commission’s Annualization Rule. The price increases experienced by PacifiCorp in June-September 2000 are not traceable to any single event, but

instead were the result of a fluctuating market. PacifiCorp cannot (1) identify a specific known moment or moments in time where the “change” occurred, (2) measure the effects of the “change,” or (3) delineate where the “change” begins, continues, or ends. PacifiCorp witness Mark Widmer even goes so far as to admit that short-term contracts vary not only month to month, but also “moment to moment.” Tr. at 481, ll. 3-14 (Widmer). This is not a case where PacifiCorp’s prices increased “X” amount because of one or more specific event(s) in time (*e.g.*, by Commission Order or the termination of a long-term contract).

PacifiCorp’s proposed changes to the test year market data are also inconsistent with past practices. Mr. Widmer admits that “[t]his is the first time that we [PacifiCorp] have annualized prices in this method,” Tr. at 472, ll. 18-19 (Widmer), and that it is not consistent with the way PacifiCorp has done power costs for short-term firm in any Utah proceeding. Tr. at 482, ll. 18-22 (Widmer).

Moreover, these annualized prices are not likely to be any more reflective of market prices in the rate effective period than test year prices. Market prices have already declined significantly off levels used to annualize prices. *See, e.g.*, Cross Ex. 3 (Revised). In addition, “with the implementation by the Federal Energy Regulatory Commission of price caps in the western wholesale market (an event that transpired after Mr. Falkenberg’s direct testimony was filed), it is likely that future wholesale prices will not reflect the values created by the Company’s normalization process.” Ex. UAE/Nucor 1R (Anderson Rebuttal) at 1; *see also* Ex. UIEC 2R (Chalfant Rebuttal) at 5-6. In sum, PacifiCorp’s annualization of the test-year data at issue in this case was inappropriate under Commission rules, unsupported by precedent, overstated, and should be rejected.

As an appropriate alternative, Nucor supports Mr. Falkenberg's suggested use of actual net power costs from the test period in the NPC Model. The NPC Model already utilizes the actual net power costs for June-September 2000. Tr. at 471, ll. 15-17 (Widmer). To use the actual transaction prices for the other eight months would be consistent with the Commission's Order in the last case and would remove the projected "hypothetical" losses that PacifiCorp has incorporated into the test year through the annualization process. Tr. at 1116, ll. 8-16 (Falkenberg).⁴ Leaving PacifiCorp's excessive, "annualized" market prices in retail rates on a going-forward basis (potentially for years to come) will require retail ratepayers to pay rates based on wholesale prices that are unlikely to be reflective of the future.

D. The NPC Model Should Reflect PacifiCorp's Operation as an Integrated System

The Commission should correct the NPC Model so that it realistically accounts for PacifiCorp's operation as an integrated system as suggested by CCS/DPU witness Philip Hayet. The suggested adjustment would result in a reduction in net power costs of approximately \$13.6 million on a total company basis, or \$5 million on a Utah jurisdictional basis (assuming the Commission adopts all of Mr. Falkenberg's modeling adjustments). Ex. DPU 10SR.2 (Hayet Surrebuttal); Tr. at 1093, ll. 18-20 (Hayet).

PacifiCorp's NPC Model, as originally filed, admittedly balanced the Pacific and Utah divisions of the Company's system independently from one another. Ex. UP&L 5R (Widmer Rebuttal) at 49, ll. 11-12. Following Mr. Hayet's identification of the inappropriateness of this approach, *see* Ex. DPU 10 (Hayet Direct) at 11-12, 15-17, PacifiCorp developed a transmission

⁴ For an example of how PacifiCorp incurs "hypothetical" losses that are built into the test year due to the annualization process, *see* Tr. at 1118-19 (Falkenberg), describing the Cheyenne Contract that expired in

model with integrated system operation in time for its rebuttal filing, Ex. UP&L 5R (Widmer Rebuttal) at 50-51. The results of PacifiCorp's new model, however, do not accurately reflect the benefit of the integrated system.⁵ Based upon evidence presented by Mr. Hayet in the course of this proceeding, *see* Ex. DPU 10SR (Hayet Surrebuttal) at 3-11; Tr. at 1086-93 (Hayet), the benefit of the integrated operation of the system has been demonstrated to be \$28.8 million on a total company basis, Ex. DPU 10SR.3 at 3. When all of Mr. Falkenberg's other modeling adjustments are added in, the total adjustment related to integrated system transmission modeling is lowered to the \$13.6 million figure referenced above. *See* Ex. DPU 10SR.2.

II. The Commission Should Adopt Modifications to PacifiCorp's Claimed Net Power Costs to Account for the Proper Sharing of Risk

The Company supported its wholesale activities with a business model based on capturing the differential between short-term and long-term prices. Many witnesses in this proceeding described the eventual consequences of this strategy – it created the risk that rising market prices would result in significant cost exposure. The strategy was not concocted to benefit ratepayers, was not controlled by ratepayers, and was not approved by this Commission. The ratepayers should, therefore, not be asked to serve as insurance to protect the Company from its own decisions. The ratepayers should be insulated from the negative consequences of the Company's decision to chase profits in the wholesale market. To provide this protection, the Commission should adjust net power costs to (1) remove the impact of the Company's strategy of serving long-term, firm wholesale commitments out of the short-term market; and (2) remove the impact of the Company's losses from its short-term marketing activities.

Despite PacifiCorp's attempts to characterize the intervenors' arguments as attacking the prudence of PacifiCorp actions, the prudence of PacifiCorp's long-term sales agreements are not at issue here, nor is the prudence of the sale of Centralia.⁶ What is at issue is the manner in which PacifiCorp chose to fulfill its obligations to supply its wholesale customers, whether the decisions it made created significant exposure to the risk of market price increases, and whether the costs that inured from that strategy should now be passed through to ratepayers. PacifiCorp seeks, but should not be given, *carte blanche* to serve its wholesale contracts in whatever manner it chooses, and to attempt to play the market without oversight,⁷ with all of the associated risks placed squarely on retail ratepayers. The Commission should not require ratepayers to backstop the Company's forays into market speculation.

A. PacifiCorp's Wholesale Power Marketing Strategy Became Demonstrably More Aggressive in the Mid-1990s

It is undisputed that beginning in 1996, PacifiCorp significantly increased its activity in the wholesale market. Tr. at 163, l. 18 (Watters); Cross Ex. 8. PacifiCorp's intent to more

⁵ The limited benefits related to integrated system operation shown by PacifiCorp's revised model are counter-intuitive, given that a primary reason for the merger was the ability to achieve the benefits of an integrated system. *See* Ex. DPU 10SR (Hayet Surrebuttal) at 3-4.

⁶ As PacifiCorp witness Stanley Watters noted, the Centralia case was not about whether the wholesale business strategy of the Company created risks that ought to be assigned to ratepayers or shareholders. Tr. at 308, ll. 4-11 (Watters).

⁷ PacifiCorp already seems to operate in an environment with little after-the-fact accountability as to the success or failure of its wholesale marketing efforts. PacifiCorp currently assumes that any short-term purchase is prudent because the transaction would not have been made if not in line with the Company's forward price curves. Tr. at 981, l. 21 to 982, l. 1 (Widmer). The comparison of the transaction price to the price curve is the sum total of the Company's performance evaluation. Tr. at 968, ll. 10-15 (Widmer). However, because the forward price curves are not retained by the Company (Tr. at 979, l. 22 to 980 l. 1 (Widmer)), this Commission can never replicate the review done by the Company – the validity of the curves cannot be examined, nor can it be determined whether the purchase prices were actually in conformance with the price curves. Tr. at 980, ll. 11-20 (Widmer).

aggressively participate in the wholesale market was amply documented by the Company. As early as its 1994 Annual Report, PacifiCorp laid out its plan for the future:

There are a rapidly growing number of business opportunities in the Wholesale Transactions and Transmission area, but only for companies that are fast, flexible and innovative.

* * *

Through 1995, PacifiCorp expects to emerge as a national presence in marketing, brokering and trading. The company will sell both electricity commodities and services, and will aggressively pursue new markets.

Ex. CCS 7 (Yankel Direct) at 17.⁸ This shift in focus was confirmed in the Company's RAMPP-4 Report,⁹ dated November 1995:

In the past, wholesale sales were a minor part of PacifiCorp's total revenues. The company used the revenues to help offset retail prices. However, several changes are occurring: 1) wholesale is becoming a larger part of the company's total business, 2) wholesale prices are declining, and 3) that part of the business carries increasing risks and potential rewards.

The wholesale part of the business is growing rapidly and the company is looking at wholesale sales as a major business activity. Wholesale marketing will increasingly evolve as a separate business with its own strategies, rewards and risks.

Ex. UP&L 4R.1 at 12; Ex. CCS 7 (Yankel Direct) at 18.

This purposeful move to step up wholesale activity is confirmed by the sales and purchases data. Wholesale sales exploded from 16,375,820 MWh in 1995 to 59,143,145 MWh in 1997, an increase of 261%. Wholesale purchases followed virtually the same path. Cross Ex.

⁸ Likewise, the Company's 1996 Annual Report stressed the Company's developing wholesale market activity, and in particular short-term market activity. *See* Ex. UAE/Nucor 1 (Anderson Direct) at 12.

8. While sales have declined off of that peak in recent years, they remain well above pre-1996 levels, evidencing a continuing intent to pursue market-based strategies.

B. The Increased Wholesale Market Participation Was Driven by Two Separate Strategies

This shift in focus manifested itself in two separate strategies. First is the Company's decision to serve long-term, firm wholesale commitments out of the short-term wholesale market. Dr. Anderson, DPU witness Rebecca Wilson and CCS/DPU witness Anthony Yankel addressed the impact of this strategy and proposed remedies to protect ratepayers. The second risk-creating strategy was the Company's decision to attempt to generate profit through short-term wholesale market transactions. This strategy backfired, as demonstrated by UIEC witness Mr. Chalfant and DPU/CCS witness Mr. Falkenberg.

Beginning in the mid-1990s, PacifiCorp elected to enter into long-term sales commitments without sufficient generation or long-term purchase arrangements in place to supply the new load, thereby gambling on short-term market prices to cover long-term "open" positions. *See* Ex. UAE/Nucor 1 at 12-13; *see also* Ex. CCS 7 (Yankel Direct) at 3; Ex. DPU 13SR (Compton Surrebuttal) at 1, 7-9. PacifiCorp's own statements confirm this strategy. In an April 2001 handout from "PacifiCorp's Power Cost Workshop," PacifiCorp witness Stanley Watters explained that the Company's "trading activities . . . increased to take advantage of market liquidity and maintain a market presence" and "sales were system sales backed by the overall portfolio of resources including market purchases." Ex. UAE/Nucor 1.7 (RMA-7) at 13. Likewise, RAMPP-5 described the Company's "strategy of relying increasingly on the wholesale

⁹ PacifiCorp admitted that the RAMPP reports represent the policies of the Company at the time the RAMPP

market to acquire the resources needed to meet the commitments made in long-term wholesale sales contracts.”¹⁰ Cross Ex. 10; Tr. at 179, ll. 18-25 (Watters); Ex. DPU 8 (Wilson Direct) at 14.

C. Ultimately PacifiCorp’s Strategy Led to Higher Costs, Which PacifiCorp Is Now Attempting to Pass Through to Ratepayers

Dr. Anderson demonstrated that PacifiCorp had a significant level of exposure to short-term market prices during the test year. Ex. UAE/Nucor 1.11 (RMA-11). Mr. Yankel concluded that “all of the risk of these Post-1995 sales is placed upon the retail customers. . . .” Ex. CCS 7 (Yankel Direct) at 22. In his surrebuttal testimony, DPU witness Dr. George Compton presented additional evidence that PacifiCorp exposed retail customers to unreasonable market price risk. As Dr. Compton’s analysis demonstrated:

PacifiCorp’s apparent strategy (at least as it developed after 1995) was to have *insufficient* long-term capacity to meet even its projected peaks. Instead of only relying on risky, short-term markets to accommodate *unanticipated* needs, the Company relied on short-term markets to meet a significant portion of its projected needs as well. In other words, short-term market price risk was expressly built into its strategy.

Ex. DPU 13SR (Compton Surrebuttal) at 1 (emphasis in original, footnote omitted). Dr. Compton further noted that “[t]he Company entered into intermediate- to long-term wholesale firm sales contracts after 1995, but did not add a sufficient magnitude to its long-term resources to meet those obligations plus the growth in its native load. Ex. DPU 13SR (Compton Surrebuttal) at 1, footnote 1. Dr. Compton went on to demonstrate that PacifiCorp’s level of

documents are issued. Tr. at 143, ll. 9-12 (Watters); Tr. at 411, ll. 10-11 (Hedman).

¹⁰ Similarly, in an August 1997 letter related to RAMPP-5, PacifiCorp’s Manager of Integrated Resource Planning noted that the new RAMPP-5 would need to recognize “the increasing volume of wholesale

reliance on the short-term market was significant.¹¹ Cross-examination Exhibit 11 shows that prior to 1996, PacifiCorp was a net seller in the short-term wholesale market. Beginning in 1996, PacifiCorp became a net purchaser in the short-term wholesale market, and even though overall wholesale sales have been declining since 1997 (*see* Cross Ex. 8), PacifiCorp has relied even more heavily on purchases in the short-term market, reaching a peak kilowatt-hour market exposure in 2000 (*see* Cross Ex. 11).

The only empirical evidence Mr. Watters offers to refute the notion that PacifiCorp had significant exposure to the short-term market is Table 1 and Supplemental Table 1. Ex. UP&L 3.9 and Ex. UP&L 3.9R. Effectively, Mr. Watters suggests that the growth in short-term wholesale activity is created by short-term sales backed by short-term purchases. Tr. at 165, ll. 7-15 (Watters). After “netting out” short-term transactions, the remaining purchases are explained away as being necessary to cover “temporary imbalances,” Tr. at 181, ll. 5-6 (Watters), and as demonstrating that the Company reasonably matched its resources and its commitments. Ex. UP&L 3R (Watters Rebuttal) at 13. Commenting on this explanation, Dr. Compton testified that, “[s]uch an inference would be grossly in error in our present context.” Ex. DPU 13SR (Compton Surrebuttal) at 2 (emphasis in original). Likewise, CCS witness Mr. Yankel refuted the Company’s explanation:

[O]ver the course of a year these short-term firm purchases and sales do tend to cancel one another out, but this is not true on an hourly or daily basis. The Company is buying large quantities of short-term firm at some times while selling large quantities at other times.

transactions and the company’s goal to rely on the wholesale market to meet those needs.” Ex. UAE/Nucor 1.9 (RMA-9) at 2.

¹¹ UIEC witness Mr. Chalfant utilized an hour-by-hour analysis to likewise determine that the Company placed significant reliance on the short-term power market. Ex. UIEC 2 (Chalfant Direct) at 7-8.

Ex. CCS 7SR (Yankel Surrebuttal) at 5; *see also* Ex. DPU 8 (Wilson Direct) at 13. Apart from the problem of comparing a net figure to a gross figure (*see* Tr. at 299, l. 9 to 303, l. 12 (Watters); 335, ll. 3-25 (Watters); Ex. CCS 7SR (Yankel Surrebuttal) at 4), Table 1 suffers further from the assumption that all short-term sales are offset by short-term purchases. Tr. at 1295, ll. 11-14 (Watters). Even Mr. Watters admitted that on an hour-to-hour basis, short-term sales would be made out of any available Company resource. Tr. at 337, ll. 2-8 (Watters); Tr. at 1295, ll. 15-20 (Watters). Similarly, despite Mr. Watters' notion of the "netting" of short-term sales, Mr. Widmer testified that PacifiCorp is unlikely to be buying and selling the same product in the same hour. Tr. at 939, ll. 5-8. As demonstrated at the hearing and through the testimony of other witnesses, Table 1 and Supplemental Table 1 are simply not credible evaluations of the Company's actual exposure in the short-term market.

In contrast, as described above, other witnesses have offered credible evidence that PacifiCorp was exposed to price risk in the short-term wholesale power markets. Dr. Compton concluded:

[I]n the year 2000, the Company's strategy of relying upon short-term purchases to meet firm wholesale plus retail commitments had huge consequences with respect to net power costs. By not acquiring sufficient long-term resources to meet reasonably projected firm peak requirements (or by not more quickly reducing its off-system, wholesale commitments), PacifiCorp subjected itself to extraordinary short-term market price risk.

Ex. DPU 13SR (Compton Surrebuttal) at 8. Beginning in 1996, the excess of PacifiCorp's resources (owned capacity plus exchanges) over its native firm demand (at the summer coincident peak hour) began to be whittled away. Ex. DPU 13.1SR. By the summer of 2000, PacifiCorp's resources were just barely sufficient to meet peak native firm load – all of the

Company's wholesale commitments had to be met out of the short-term market. Ex. DPU 13SR (Compton Surrebuttal) at 3-5.

D. The Benefits Ascribed by PacifiCorp to the Revenue Credit Are Illusory

PacifiCorp has asserted that Utah ratepayers have received \$1.3 billion in benefits as a result of the revenue credit in place since 1992. Ex. UP&L 3.2R. Comparing the pricing under the long-term agreements to the pricing that would have been available under short-term agreements does not in any way measure a "benefit" to ratepayers. The \$1.3 billion calculation is no more than a comparison of an actual strategy with an imprudent strategy, and thus of no value to a determination of the benefits actually provided to ratepayers. *See* Tr. at 296, ll. 5-10 (Watters); *see also* Ex. DPU 8SR (Wilson Surrebuttal) at 6. Nor does comparing the pricing under the long-term wholesale agreements to the avoided costs at the time measure a "benefit" to ratepayers. Mr. Watters claims that the contracts identified by Ms. Wilson for revenue imputation actually provided a net benefit to the ratepayers by comparing the price of the contract to the avoided costs at the time the sale was made. Ex. UP&L 3R (Watters Rebuttal) at 25. However, as noted by Ms. Wilson, the Company clarified in a data response that "[t]he level of avoided costs do not provide [a] direct benefit to ratepayers." Ex. DPU 8SR (Wilson Surrebuttal) at 6, *quoting* PacifiCorp response to DPU Request 28.32.

E. PacifiCorp Knowingly Adopted a Strategy Fraught With Risk, and It Should Bear the Risk and the Consequential Costs

It is indisputable that PacifiCorp was well aware of the risks associated with its increased wholesale activity. As the Company stated in its RAMPP-4 Report:

The greater the company's activity in the wholesale market, the greater the potential rewards and the greater the risks. Those who bear the risks should also benefit from the rewards. The company would prefer to not expose retail customers to the higher risk/reward situation. Equity capital is a better place for such activities. The company will experience upward pressure on retail rates if it cannot maintain the current level of wholesale contribution. Changing conditions in the wholesale markets mean the company must take on greater risk to achieve the same level of wholesale contributions. However, the company continues, for now, to use the retail credit approach for wholesale sales. These are transition times, and that approach may change in the future as other changes occur, some expected and some unforeseen. These changes could include alternative regulation, deregulation, and restructuring. (PacifiCorp's RAMPP-4 Report, dated November 1995, at pp. 12-13.)

Ex. UP&L 4R.1 at 13; Ex. CCS 7 (Yankel Direct) at 18. PacifiCorp management is now attempting to pass on the consequences of that risk to ratepayers. Nucor is particularly troubled by the Company's apparent indifference to this risk. With increasing market risk (Tr. at 331, ll. 1-2 (Watters)) and volatility (Tr. at 330, ll. 2-4 (Watters)) and a significant level of wholesale sales and purchases, a business concerned about the risks inherent in the situation would be expected to perform significant market analysis. But PacifiCorp performed no such analysis:

The company has not performed an analysis of supply and demand in the WSCC region. The company has only analyzed its own load and resource mix. (PacifiCorp response to DPU Data Req. 13.1.)

Ex. DPU 8.5. The Company has instead relied on its ability to shift market risks and costs onto the backs of ratepayers. Because PacifiCorp management is responsible for the strategy to participate heavily in the short-term market, it should be held accountable for the consequences of its decision.¹²

¹² PacifiCorp has long recognized that it is the decision-maker that should bear the risk associated with decisions:

The revenue credit methodology that has been employed by the Company since the UP&L/PP&L merger initially succeeded in properly assigning risks:

The mechanisms implemented were intended to address risks of nature and the risks associated with market sales out of excess generation and market purchases necessary to serve retail load. These were the “market risks” existent in the energy environment of the early 1990s. Between rate cases, the Company absorbed the outcomes of its successes and failures in managing these risks. The production cost model “smoothed out” certain risks of nature. The revenue credit approach permitted the Company to enter into wholesale sales transactions when, in the Company’s judgment, revenues exceeded variable costs over the life of the contract. These mechanisms were not, however, designed nor adequate to deal with long-term business risks associated with the aggressive participation in wholesale markets initiated by Company management in 1995.

Ex. UAE/Nucor 1 (Anderson Direct) at 7. The Commission adopted the Revenue Credit Method as a means of accounting for wholesale transactions. Ex. UAE/Nucor 1 (Anderson Direct) at 6-8; Ex. DPU 8 (Wilson Direct) at 8-9; Ex. CCS 7 (Yankel Direct) at 11-12. At the time that the Revenue Credit Method was being introduced, the Company took the position that it was designed to benefit retail customers and also designed to place economic responsibility and exposure on the Company.¹³ Ex. DPU 8 (Wilson Direct) at 7, *citing* prefiled Direct Testimony

The Company believes in placing the risk of management practices on those that make the business decisions – management – not customers. (Testimony of Mr. Verl Topham, UPSC Docket No. 90-035-06, p. 13).

Ex. UAE/Nucor 1 (Anderson Direct) at 5.

¹³ Likewise, in Docket No. 99-035-10, PacifiCorp witness Mr. Widmer recognized that customers should not bear the risks associated with net power costs:

The use of normalized net power costs stabilizes the prices paid by the Company’s retail customers and places the risks and responsibility of managing energy costs, over which the customer has no control, on the Company. (Prefiled Direct Testimony of Mark Widmer, UPSC Docket No. 99-035-10, at 2.)

Ex. DPU 8 (Wilson Direct) at 12.

of Gregory Duvall, UPSC Docket No. 90-035-06, at 5-6.¹⁴ The Commission believed that retail ratepayer protection was one of the goals of the Revenue Credit Method:

Though the Company is not required to seek Commission approval of such sales, we must, as a matter of statutory responsibility, make sure that retail customers are not harmed by them. (Order, UPSC Docket No. 90-035-06 at 50.)

CCS Ex. 7SR (Yankel Surrebuttal) at 3.

The Company undertook a strategy that led to increased participation in volatile wholesale markets, which in turn led to increased costs – costs that the Company seeks to shift to ratepayers. This Commission must address whether the level of wholesale activity is necessary to serve retail load, and whether it is appropriate for the ratepayers to serve as the backstop to the Company’s aggressive marketing strategy. CCS witness Mr. Yankel concluded:

It is unfair and unreasonable to ask retail customers in Utah to continue to subsidize PacifiCorp’s flawed business strategy of failing to hedge their wholesale power contracts.

Ex. CCS 7 (Yankel Direct) at 4. Nucor submits that Mr. Yankel is correct – it is PacifiCorp that is responsible for the risks that have been created, and it is PacifiCorp that should therefore absorb the costs resulting from the decision to incur those risks.

F. Revenues Should Be Imputed to Long-Term Wholesale Contracts to Properly Shift the Consequences of Risk to Where It Belongs

¹⁴ PacifiCorp witness Gregory Duvall testified that a reasonable net power cost estimate:

stabilizes the prices paid by the Company’s retail customers and places the risks and responsibility of managing energy costs, over which the customer has no control, on the Company. (Prefiled Direct Testimony of Gregory Duvall, UPSC Docket No. 90-035-06, at 5-6.)

Ex. DPU 8 (Wilson Direct) at 7.

In order to protect ratepayers from the risks associated with the wholesale marketing strategy adopted and followed by PacifiCorp, the Commission should, at a minimum, impute revenues to the six contracts¹⁵ identified by Dr. Anderson, up to at least the level of cost that was incurred to serve the contracts.¹⁶ As demonstrated above, by entering into long-term firm wholesale contracts without available sources of supply, the Company was committing itself to a strategy of supplying these contracts out of the short-term market. Because the contracts were served out of the short-term market, revenue should be imputed to the contracts at least equivalent to the short-term market prices in effect in the test period.¹⁷ Mr. Falkenberg has recommended using actual, short-term market prices in the net power cost model. Tr. at 1113, ll. 18-20 (Falkenberg); Ex. DPU 9 (Falkenberg Direct) at 24-25. In developing its net power costs, on the other hand, the Company utilized the average of the last four months of the test period as the proxy for short-term wholesale power costs. Ex. UP&L 7 (Widmer Direct) at 10.

¹⁵ Similar to Dr. Anderson, Ms. Wilson imputed revenue to thirteen or fourteen long-term firm wholesale contracts. Ex. DPU 8R (Wilson Rebuttal) at 4-5. Mr. Yankel proposed to impute revenue to eight long-term wholesale contracts, and to make adjustments related to five other contracts. Tr. at 846-47 (Yankel); Ex. CCS 7 (Yankel Direct) at 23-26, 30-34.

¹⁶ PacifiCorp has argued that imputing revenue to long-term power supply agreements based on the cost of serving those agreements (as suggested by Dr. Anderson, Mr. Yankel, and Ms. Wilson) is inappropriate due to the Commission decision in Docket No. 99-035-10. Tr. at 136, ll. 15-19 (Watters); Ex. UP&L 3 (Watters Rebuttal) at 6. However, the Commission's May 24, 2000 Order in 99-035-10 did not resolve the issue as to how to treat long-term firm wholesale contracts. The Commission explicitly stated in its Order that the revenue imputation applied in that proceeding "is reasonable *for the purposes of revenue imputation in this Docket.*" Order at 48 (¶ II.F.3.) (emphasis added). The Commission found that, with respect to risk related to the Company's performance in the wholesale market, "[s]ome form of establishing the appropriate degree of risk to be borne by firm retail ratepayers remains." Order at 37 (¶ II.F.1.a.) Moreover, the Commission ordered the formation of a forum to consider issues associated with retail versus wholesale cost responsibility. Order at 11-12 (¶ II.B.2.) This is hardly consistent with the notion that retail versus wholesale cost responsibility issues had been definitively decided.

¹⁷ In contrast, DPU witness Ms. Wilson applied imputed revenues to long-term, firm wholesale contracts using PacifiCorp's average embedded cost. Ex. DPU 8R (Wilson Rebuttal) at 6-7. Ms. Wilson noted that the selection of the value for revenue imputation "is a matter of judgment." Ex. DPU 8 (Wilson Direct) at 18.

If the Commission adopts Mr. Falkenberg's actual net power costs for use in the test period (as Nucor believes it should), the amount of Nucor's recommended total company adjustment associated with the six contracts is \$75,617,009 (\$28,086,879 for the Utah jurisdiction). Ex. UAE/Nucor 1R.3 (RMA-3R); Ex. UAE/Nucor 1R (Anderson Rebuttal) at 3. If the Commission rejects Mr. Falkenberg's adjustment, Nucor's recommended total company adjustment is \$172,864,635 (\$64,208,149 for the Utah jurisdiction (using an SG factor of 37.1436%)). Ex. UAE/Nucor 1 (Anderson Direct) at 29.

Dr. Anderson's proposed adjustment mitigates, but does not entirely eliminate, the subsidy provided by retail customers related to PacifiCorp's wholesale marketing strategy. The imputation of revenues to six long-term, firm wholesale contracts (as recommended by Dr. Anderson) is a conservative approach, and actually continues to impose a significant amount of the cost of PacifiCorp's failed wholesale strategies on ratepayers. If revenue is imputed to all ten of PacifiCorp's post-1995, long-term, firm wholesale contracts in order to ensure that they at least cover the cost of service, the imputation would amount to \$374,577,911 on a total company basis (using the Company's estimate of market prices), or \$140,841,295 for the Utah jurisdiction (based on an SG factor of 37.1436%).¹⁸ Ex. UAE/Nucor 1 (Anderson Direct) at 30.¹⁹

The result achieved by imputing revenues is a far less beneficial result for the ratepayers than could have been achieved had PacifiCorp been satisfied to simply market its excess power

¹⁸ DPU witness Ms. Wilson did, in fact, impute revenues to all of PacifiCorp's post-1995, long-term, firm wholesale contracts. Because she imputed revenues utilizing average embedded costs as opposed to market prices, her recommended adjustment to rate base was similar to Dr. Anderson's.

¹⁹ The other witnesses that imputed revenues to long-term wholesale contracts likewise took a conservative approach. Mr. Yankel notes that his proposed adjustment is conservative and could have been much higher. Ex. CCS 7 (Yankel Direct) at 27-28, 29. Likewise, Ms. Wilson noted that her approach continues

in the short-term market, and limit purchases in the short-term market to those truly necessary to serve retail load. As described by Dr. Anderson, had PacifiCorp adopted that strategy, which it did in fact employ until the mid-1990s, PacifiCorp would have been able to take advantage of the rapidly escalating market power prices, and could have achieved total benefits from wholesale sales of \$1,096,783,948. Ex. UAE/Nucor 1 (Anderson Direct) at 32. Even if these benefits were divided 50/50 between ratepayers and shareholders, the revenue requirement adjustment would be \$548,391,974 on a total company basis and \$203,692,521 on a Utah jurisdictional basis (37.1436% SG factor). Ex. UAE/Nucor 1 (Anderson Direct) at 32.

G. The Impact of Losses on Short-Term Transactions Should Be Removed From Net Power Costs

In addition to removing from test period net power costs the impact of relying on the short-term market to supply long-term sales, the Commission should also remove from test period net power costs the losses incurred by the Company in its short-term market transactions. UIEC witness Mr. Chalfant's hour-by-hour analysis of short-term market activity discloses that PacifiCorp incurred substantial losses chasing profits in the short-term markets.²⁰ Ex. UIEC 2 (Chalfant Direct) at 12-14. Mr. Chalfant prepared a model that examined, on an hour-by-hour basis, the Company's participation in short-term power markets.²¹ Simplified, Mr. Chalfant's model does the following for each hour of the test period:

to share the consequences of the risk between ratepayers and shareholders. Ex. DPU 8 (Wilson Direct) at 18-19.

²⁰ DPU witness Mr. Falkenberg also removed losses on short-term firm transactions from test period net power costs, by utilizing a monthly average pricing methodology. Ex. CCS 5 (Falkenberg Direct) at 25-26.

²¹ Mr. Watters' argument that the Company is close to load and resource balance on an average energy basis is meaningless – it is the hourly balance that matters, and Mr. Chalfant and Dr. Compton demonstrated that the Company does not operate “in balance,” but rather relies heavily on the short-term market to supply retail and long-term wholesale commitments. Ex. UIEC 2 (Chalfant Direct) at 12-14; Ex. DPU 13SR (Compton Surrebuttal) at 5-8.

- (1) Calculates PacifiCorp Total Requirements
(Native load plus long- and intermediate-term sales plus exchange commitments)
- (2) Calculates PacifiCorp Net Requirements
(Total Requirements less generation, long- and intermediate-term purchases and positive exchanges)
- (3) If the Net Requirements are Negative:
PacifiCorp has power to sell
These sales are credited to customers (who paid for the resources out of which the energy is being sold)
The credits are based on the average short-term price during the hour
- (4) If Net Requirements are Positive:
PacifiCorp must make short-term purchases
The lowest-priced short-term purchases are assigned to Net Requirements
Remaining short-term purchases were made to cover short-term sales
- (5) The cost of these purchases is compared to the corresponding cost of sales
This determines the gain or loss in the hour from short-term transactions

Utilizing this hour-by-hour analysis, Mr. Chalfant calculated a net loss for the test period of \$32.5 million total Company, \$12.0 million for the Utah jurisdiction (using a 37.1436% SG factor). Ex. UIEC 2 (Chalfant Direct) at 12-14; Ex. UIEC 2.2 (Revised AC2) at Schedule 2; *see also* Tr. at 999, ll. 20-25 (Chalfant). This net loss was incurred by PacifiCorp as a direct result of its decision to attempt to profit by participating in the short-term market. The Commission should remove the effects of this resulting net loss from the test period.

III. A Commission Decision to Hold PacifiCorp Accountable for the Costs Created by Its Wholesale Marketing Strategy Will Not Unreasonably Impact PacifiCorp's Financial Position

The Commission has statutory obligations to both ratepayers and the utilities that it regulates. As more thoroughly documented and discussed *supra*, PacifiCorp embarked on an aggressive wholesale marketing strategy that was accompanied by significant risk, and that ultimately led to higher power costs and significant losses for the Company. In the present case,

various intervenors recommend that the Commission modify PacifiCorp's "adjusted" net power costs to reflect a lower cost that, in turn, supports a lower revenue requirement. In rebuttal, PacifiCorp witnesses Judi Johansen and Karen Clark contend that the Commission's decision in this proceeding regarding the amount of net power costs that PacifiCorp may include in its retail rates will affect PacifiCorp's (1) liquidity and ability to obtain financing at reasonable rates, (2) access to capital markets, and (3) debt ratings. Ex. UP&L 1R (Johansen Rebuttal) at 2, ll. 14-22; Ex. UP&L 2R (Clark Rebuttal) at 1-2; Tr. at 684-85 (Clark). As a result, the Commission must now appropriately balance PacifiCorp's actions and accountability with the utility's need to have adequate, cost-effective access to the capital markets. Based upon the evidence presented during the course of this proceeding, a Commission decision to hold PacifiCorp accountable for the consequences of its wholesale marketing strategy will not unreasonably impact PacifiCorp's financial position.

A. The Commission Must Balance the Company's Capital Costs With Fairness to Ratepayers

Every Commission decision that increases a utility's revenues will be taken into account and viewed favorably by ratings agencies. Standing alone, decisions to raise rates will improve a utility's credit ratings, thereby lowering its cost of capital. However, the Commission must balance this with its overarching statutory obligation to set rates that are just and reasonable. *See* Utah Code Ann. § 54-4-4. While the Commission may consider a utility's financial condition or changes reasonably expected in the utility's revenues, expenses, or investments, *id.*, the Commission is not responsible for protecting and insulating management from the effects of its poor judgment, and should not fashion Utah ratepayers into a safety net to protect utilities from actions of other state commissions. The Company's interest (and the ratepayers related interest)

in credit ratings and low capital costs does not trump the Commission's statutory obligation to set just and reasonable rates.

B. PacifiCorp Credit Ratings Are Also Impacted by Many Other Decisions and Events

The Commission's final decision in this particular proceeding is but one of many factors that may affect PacifiCorp's credit ratings. Credit ratings are issued by agencies such as Moody's, Standard & Poor's, and J.P. Morgan, who's fundamental purpose is to make recommendations to investors with full disclosure of the risks inherent thereto. Tr. at 102, ll. 13-16 (Johansen). These credit rating agencies must therefore continually monitor and analyze a multitude of quantitative and qualitative factors when establishing the ratings for a company.²² Such factors include, but are not limited to, a company's business structure, practices, and finances,²³ as well as market conditions, competitive position, regulatory environment, and any events that may affect that company's creditworthiness.²⁴ Obviously, in establishing credit ratings for regulated utilities such as PacifiCorp, a principal consideration for the agencies are any and all regulatory determinations by this Commission that may directly or indirectly affect the utility. Thus, while the Commission's decision in this proceeding will certainly be taken into account by the credit rating agencies, as PacifiCorp witness Ms. Johansen stated, the credit rating agencies will focus on "the overall treatment that [PacifiCorp] get[s] from the regulators." Tr. at 100, ll. 1-2 (Johansen).

²² Interim Testimony of Karen K. Clark, at 5.

²³ Credit rating agencies engage in a "very thorough review of a company and the way its runs." Tr. at 103, ll. 14-15 (Johansen).

²⁴ Interim Testimony of Karen K. Clark, at 5-6.

C. PacifiCorp Has Overstated the Current Financial Ratios, and Painted an Unnecessarily Pessimistic Picture of Its Status

PacifiCorp would have the Commission believe that the utility is in dire financial straits and that matters will only get worse. As evidence, PacifiCorp points to its alleged depressed cash flows and resultant liquidity position. Ex. UP&L 2R (Clark Rebuttal) at 3-5. In addition, PacifiCorp witness Ms. Clark provided “key financial ratios” that purportedly show the effect of the depressed cash flows.²⁵ Both DPU witness Judith Johnson and UIEC witness Michael Gorman, however, demonstrated that once the ratios are properly adjusted to exclude certain inappropriate adjustments made by PacifiCorp (*e.g.*, the inclusion of hypothetical debt),²⁶ the ratios are well within the Company’s historical range.²⁷

Moreover, PacifiCorp’s credit ratings as of April 2001 were said to reflect “its strong competitive position, portfolio of low-cost generating assets, extensive transmission network and association with ScottishPower,” Cross Ex. 19 at 3, and a Moody’s Investors Service report from early 2001 noted that “PacifiCorp’s ratings continue to benefit from its affiliation with its financially strong parent, ScottishPower (senior unsecured debt at A1),” Cross Ex. 22 at 1. None of the aforementioned characteristics have drastically changed in the last few months. PacifiCorp’s present credit rating should therefore continue to benefit from these factors regardless of the Commission’s decision in this proceeding.

²⁵ Ex. UP&L 2R (Clark Rebuttal) at 7, Table 1. Ms. Clark contends that during the Interim proceeding, the two “funds from operations” ratios were deemed the most significant. *Id.* at 6-7.

²⁶ *See* Ex. DPU 12.1; Ex. UIEC 1SR (Gorman Surrebuttal) at 5-8; Ex. UIEC 1SR.1; Ex. UIEC 1SR.2; Tr. at 694-97 (Johnson).

²⁷ Ex. DPU 12.2; Tr. at 693, ll. 8-12 (Johnson).

D. PacifiCorp Has Grossly Overstated the Impact the Adoption of the Intervenor Recommendations Would Have on Its Credit Rating

Lastly, PacifiCorp claims that if the Commission adopts any of the Intervenor's recommended power cost adjustments, its access to capital markets will be impaired and its credit rating would likely be downgraded, which would then lead to higher costs for capital. Tr. at 684-85 (Clark).

The rumors of PacifiCorp's demise have been greatly exaggerated. First, the credit rating will not affect the availability of capital, only the cost of the capital. Second, as Mr. Gorman suggested, if the Commission allows the Company to recover all of its expenses, as adjusted by the Intervenor to reflect PacifiCorp's normalized power costs for the test year, and earn its authorized return on equity, the credit rating agencies should find that sufficient to maintain PacifiCorp's current credit rating (assuming other jurisdictions do likewise). Tr. at 709, ll. 8-25 (Gorman). As stated previously, the Commission's statutory obligation in this proceeding is to determine and fix just and reasonable rates for electric service. The Commission will satisfy this obligation by allowing PacifiCorp to recover its costs plus its authorized rate of return; the Commission should do no more.

IV. Development of a Mechanism for Recovery of the Cost of Demand Side Management Programs Is Not Appropriate at This Time

The Utah Energy Office of the Utah Department of Natural Resources ("UEO"), through witnesses Jeff Burks and Dr. David Nichols, recommends demand side management ("DSM") programs that PacifiCorp could initiate. Tr. at 590, ll. 1-4; *id.* at 591, ll. 23-24; *see generally* Ex. UEO 2 (Nichols Direct) at 9-19. UEO expressly did not ask the Commission to order PacifiCorp to institute such programs. Tr. at 591, ll. 21-22. Rather, UEO witness Dr. Nichols agreed that,

“the best thing this Commission can do in the DSM arena is to indicate strong support for cost-effective DSM programs and direct [PacifiCorp] that they expect them to bring forward those programs that are cost-effective and reasonable for implementation in this state.” Tr. at 603, ll. 7-16 (Nichols).²⁸ Nucor concurs in this recommendation. Without a specific DSM program before the Commission for consideration, the development of a mechanism for recovering the costs of such a program is premature and would be more appropriately addressed when specific programs are brought before the Commission for consideration.

CONCLUSIONS AND RECOMMENDATIONS

If PacifiCorp is permitted to pass through the costs that resulted from its risky wholesale strategies, as well as costs related to NPC Model inputs designed to inflate net power costs, the ratepayers will be required to pay for excessive power costs into the foreseeable future. PacifiCorp will memorialize in rates its NPC Model biases, its failed short-term strategies, and its undue reliance on the short-term market to supply wholesale load commitments. The Commission must take the appropriate steps to make sure that the ratepayers are not required to act as management’s insurance policy. The Company is effectively requesting the freedom to participate in the power markets as it sees fit, with little or no oversight. This should not be permitted. Specifically, as addressed above, the Commission should:

- (1) Adjust the thermal availability factors in the NPC Model (\$45.6 million adjustment on a total Company basis);
- (2) Adjust the scheduled maintenance factors in the NPC Model (\$58.0 million adjustment on a total Company basis);

²⁸ The UEO also proposes that PacifiCorp commit \$35 million to fund the first year of a multi-year DSM initiative. Tr. at 517, ll. 3-5; Ex. UEO 1 (Burks Direct) at 5, ll. 17-19. This recommendation does not require any action by the Commission in this proceeding.

- (3) Utilize actual test period short-term market prices in the NPC Model (\$149.8 million adjustment on a total Company basis);
- (4) Correct the NPC Model so that it accurately reflects PacifiCorp's operation as an integrated system (\$13.6 million adjustment on a total Company basis);
- (5) Impute revenue to six long-term wholesale contracts using actual short-term market prices (as recommended in #3 above) (\$75.6 million adjustment on a total Company basis);
- (6) Remove from net power costs losses incurred during the test period from the Company's short-term trading activity (\$32.5 million adjustment on a total Company basis); and
- (7) Indicate its strong support for cost-effective DSM programs and direct PacifiCorp to bring forward those programs that are cost-effective and reasonable for consideration by the Commission.

Even with these adjustments the ratepayers still share to a very significant degree in PacifiCorp's planned wholesale market exposure. However, this represents as reasonable a balance between competing interests as can presently be achieved.

WHEREFORE, for the reasons set forth above, the Commission should adopt the recommendations set forth herein, and take such other precautions as it deems necessary to protect ratepayer interests.

DATED this 21st day of August 2001.

Respectfully submitted,

Peter J. Mattheis
Shaun C. Mohler
BRICKFIELD, BURCHETTE, RITTS & STONE, P.C.
1025 Thomas Jefferson Street, N.W.
800 West Tower

Washington, DC 20007
(202) 342-0800
(202) 342-0807 -- Facsimile

Glen E. Davies
PARSONS, DAVIES, KINGHORN & PETERS, P.C.
185 South State Street, Suite 700
Salt Lake City, UT 84111
(801) 363-4300