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Memorandum

To: Public Service Commission

From: Division of Public Utilities
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Date: November 24, 2003

Subject: Initial Comments and Issues of the Division of Public Utilities, Docket 02-035-04, *In the Matter of the Application of PacifiCorp for an Investigation of Inter-Jurisdictional Issues,* PacifiCorp's Motion for Ratification of Inter-Jurisdictional Cost Allocation Protocol

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The following document constitutes the initial comments and issues of the Division of Public Utilities. These comments and issues are preliminary only and not intended to be all-inclusive.

Based on the Division's initial review of the Company's filed Cost Allocation Protocol, it is our understanding that PacifiCorp is proposing a modified dynamic approach to resolve the issues identified during the Multi-state Process (MSP). We understand the key modifications requested are as follows:

- A hydro endowment inclusive of the Mid-C contracts
- An "opt-out" provision for Oregon regarding the first new coal resource acquisition
- Utilization of a weighted allocation factor for seasonal resources
- A coal endowment to the East based on the cost of the Huntington coal-fired facility
- A defined process for evaluation of modifications to the proposed protocol

The Division believes it is important to restate that in the evaluation of the proposal filed by PacifiCorp, we will utilize the set of evaluation criteria as specified in the Utah party memo dated July 11, 2003 and also attached to the Utah party memo dated September 10, 2003. At this time, we are concerned about whether or not the proposal as it stands promotes the key principles of continued system operation and planning, only reasonable costs shifts to Utah customers (no greater then fair share), and durability. Moreover, it has been and continues to be our understanding that the primary purpose of the MSP, and hence the need for an ultimate solution, is the Company's need to improve its level of costs recovery certainty to promote efficient acquisition of resources as required. At this time, we believe that any analysis of a proposed solution requires a restatement of the guiding objective and an evaluation of whether or not the solution meets the objective.

We appreciate that PacifiCorp has endeavored to incorporate a number of elements of the Utah party's earlier dynamic proposal and also its evaluation criteria. In particular, we recognize that the Company is attempting to maintain numerous elements of a dynamic approach and mitigate cost shifts to the East via a coal endowment. However, we do have some significant concerns, including but not limited to the following: (1) The inclusion of the Mid-C contracts as part of the hydro endowment; (2) timing of the costs and benefits across jurisdictions resulting from the proposed allocation changes; (3) development of the coal endowment, including utilization of the principle of environmental cost shifts to justify the coal endowment; (4) impact on future planning and other risks associated with making fixed resource decisions today; (5) the treatment of special contracts and Qualifying Facilities (QFs); and (6) sustainability of the protocol in the absence of clearly defined criteria and principles for the proposed resource allocations.

The Hydro-Endowment

We have expressed on numerous occasions an understanding that the Pacific Northwest concern over hydro resources goes beyond that of cost allocation and recognize the unique socio-economic considerations regarding such resources. Moreover, we can understand how this rationale applies to Company owned resources but fail to see how it applies to resources for which contracts are used to secure output, since it would seem that the specific socio-economic concerns would have to be assessed via the party(ies) owning the resource(s) and not PacifiCorp. In the event that contracts are not renewed or the output levels are adjusted, we would expect that PacifiCorp would acquire alternate resources or contracts in the most cost-effective manner as required to meet its loads. Thus it is not clear to us, that there is an implied guarantee that hydro resources would generate the replacement power.

Timing of Costs and Benefits

We also remain concerned about future cost shifts. It does appear that the shifts to Utah ratepayers may fall within a fair share allocation; however, the timing of costs and benefits is problematic and speculative. The length of the time horizon in the studies provides little assurance that the future benefits will occur as forecasted. Should the West refuse to accept certain hydro costs in the future, there may be adverse consequences for the East. For example, the East may find that its future costs are significantly higher than projected as a result of either cost shifts or renewed cost allocation risks to the Company.

Coal Endowment

Regarding the coal endowment, we are still unclear on the principles and criteria used to develop this as an offset to the hydro endowment. For example, we are concerned that the coal endowment is based on a principle in which may be implicit the notion that the East may ultimately be responsible for any and all cost associated with coal-fired facilities. As such, this could gravely impact the sustainability of the Protocol. Thus, we question whether a coal endowment represents a sustainable option. We believe that a more appropriate offset would be to situs assign the cost of QFs. Such an adjustment is in alignment with the justification for the situs assignment of DSM costs i.e. the state makes the decision as to the costs. Another example is that hydro resources are associated with key local issues impacting cost and resource decisions, as are QFs. While, QF decisions may be based in part on PURPA, we believe that the interpretation and application of PURPA ultimately resides with states.

Future Risk

We also are concerned that fixed resource decisions today may impede future system planning. For example, it is not clear that the coal opt out for Oregon will not lead to a situation of "over-planning" for the system, or pursuit of less than cost effective resources for the system. Additionally, the resource mix for the East will change under the situation that the majority of the hydro is allocated to the West. As the fuel mix on the East becomes more coal intensive under the proposed protocol, the cost effectiveness analysis for the East changes. With a "heavy coal" resource mix, the risk to the East of accepting another coal facility may be too substantial, resulting in a different resource plan with potentially higher costs than would have emerged in the absence of the protocol.

Special Contract and QF Assignments

We do understand that other jurisdictions are concerned about load growth in Utah, in particular the cost consequences of such growth. In response to this, the Utah parties made a concerted effort to evaluate whether or not Utah does pay its fair share of new generation. To date, studies performed in the MSP indicate that costs shifts to Utah are generally sufficient to cover the costs of growth and mitigate impacts to other jurisdictions. Additionally, the Division has made a concerted effort over recent years to promote policies and encourage the Company to implement programs designed to manage growth in a more cost-effective manner, including using situs assigned resources. To this end, we have actively pursued evaluation of interruptibility options, development of additional demand side management programs, and evaluation of the avoided costs of QFs greater than one megawatt.

We believe that resource allocations supportive of efforts to locally address the issue is key to managing Utah's load growth. At this time, we are not certain that treatment of special interruptible contracts in the proposed protocol, nor the treatment of QFs effectively assigns the costs and benefits of such programs. Our understanding of the protocol is that for special interruptible contracts the full contract loads are situs assigned, although that load may never be realized depending on the terms of interruption. The power costs savings associated with the interruption are then system assigned. We are concerned that this approach may not incent the acquisition of all cost-effective interruptibility options.

As stated above, we believe that the situs assignment of QFs is generally aligned with the principle of accepting cost impacts of local decisions making. While PURPA mandates that PacifiCorp purchase power from QFs, the pursuit of QF opportunities and the ultimate price paid for those resources is a state specific decision, based on perhaps both energy and other economic considerations. Thus, we are not certain that under the Protocol the appropriate price signals would be given to states and may possibly violate the principle of "cost causation."

These future decisions, such as the situs assignment of QFs, must contain sufficient flexibility to address major changes, including the repeal of PURPA and the elimination of an obligation to purchase QF power.

Sustainability of the Protocol

Finally, we believe that it is essential to have a fully developed, consistent, and principled set of criteria as the basis for any changes in cost allocation practices and that this is key to the sustainability of any solution. We are concerned that sustainability may not hold if principles utilized to make resource allocation decisions are not aligned. For example, the protocol appears to use inconsistent or incomplete criteria for both the coal endowment and the hydro endowment. We cannot accept a coal endowment simply on the premise that it provides an offset to a hydro endowment. Analysis to date leads us to believe that state specific QF assignment is the better alternative.

Concluding Comments

We are open to further discussions regarding our concerns and consider that such a discussion would be useful. We believe that continued cooperation, coordination, and communication remain key in the development of a long-term sustainable resolution of the Company's cost allocation problems. We appreciate consideration of our concerns as expressed throughout the MSP process and attention to our issues expressed at this time.