United States Executive Agencies
Issues Regarding Proposed Interjurisdictional Cost Allocation Protocol
PacifiCorp - Utah
Docket No. 02-035-04

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BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application of PACIFICORP for an Investigation of Inter-Jurisdictional Issues	Docket No. 02-035-04 **USEA'S PRELIMINARY ISSUES LIST**

The United States Executive Agencies (USEA) have evaluated PacifiCorp's proposed Interjurisdictional Cost Allocation Protocol (Protocol or MSP Solution). The Protocol embodies PacifiCorp's effort to address many complex costing issues related to its operation in six retail jurisdictions. In general, the Protocol details how PacifiCorp's generation, transmission, and distribution costs will be allocated and/or assigned to each retail jurisdiction. In addition, the Protocol describes mechanisms and procedures for dealing with such allocation issues on a going-forward basis. While PacifiCorp's effort is commendable, the proposed Protocol raises numerous issues that should be carefully evaluated and resolved before the Utah Public Service Commission ratifies and implements the Protocol.

In evaluating the Protocol, USEA focused on a simple question: Will Utah's ratepayers be adversely and unfairly affected if the Commission ratifies and implements the Protocol? At the present time, we are unable to answer this question definitively. Moreover, we are unsure whether we—and more importantly, the Commission—will be able to answer this question satisfactorily after a lengthy rulemaking or adjudicatory proceeding addressing the Protocol's political, regulatory, economic, and engineering elements. Nevertheless, in response to the Commission's November 13, 2003, scheduling Order in this case, USEA has identified seven important issues that the Commission should address in its consideration of the proposed Protocol.

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1. Is the Protocol necessary to ensure the continued development of reliable and cost-effective supply resources?

2. What is the magnitude of the potential ratepayer impacts on Utah retail customers if the Commission ratifies the Protocol?

3. What are the potential financial consequences if the Protocol is not ratified?

4. Is the Protocol necessary to prevent a long cycle of adjudicative proceedings regarding rate/revenue adjustments and resource acquisitions?

5. Do the Protocol's cost allocation methodologies reasonably reflect PacifiCorp's cost of serving retail customers in Utah?

6. Would ratifying the Protocol restrict or limit Utah's choice of cost allocation methodologies for retail customers?

7. How should the cost of serving Special Contract customers be determined?

In the sections below, we briefly discuss each of these issues.

Issue 1. Is the Protocol necessary to ensure the continued development of reliable and cost-effective supply resources?

In its Motion for Ratification (at page 2), PacifiCorp says:

> Ratification will afford PacifiCorp assurance that it will have a reasonable opportunity to recover prudent investments in new generation and transmission facilities and required improvements to existing facilities. This, in turn, will ensure that the Company's customers continue to receive safe and reliable electricity service at reasonable prices.

In our opinion, this statement goes much further than simply seeking multistate agreement on a set of uniform jurisdictional cost allocation procedures. More specifically, the Protocol seeks not only to allocate costs using uniform multistate procedures, but also to isolate parochial regional interests that may encourage state regulators to retain permanently PacifiCorp's pre-merger regional investment positions, supply resource conditions that are not viewed favorably by other states, and limit PacifiCorp's recovery of prudent investment costs. These goals may be laudable. However, the issue in our mind is whether the Protocol is necessary to achieve these goals. PacifiCorp's motion presents no evidence that it has been prevented from recovering prudent investment costs, or that it will be prevented from doing so in the future. Moreover, the likelihood that all six state regulatory agencies will ratify the proposed or an amended Protocol seems remote. Before committing Utah to a lengthy, time-consuming, and expensive attempt to find multistate agreement on complex regulatory issues, the Commission should carefully evaluate both the need for the effort and the likelihood of success.

Issue 2. What is the magnitude of the potential ratepayer impacts on Utah retail customers if the Commission ratifies the Protocol?

PacifiCorp's witnesses Duvall and Taylor present the results of numerous analyses that purportedly demonstrate the Protocol's minimal impact on revenue requirements for its Utah retail jurisdiction. These results are generally stated either as percentage deviations in Utah's revenue requirements under the Protocol relative to the current rolled-in allocation methodology or as changes in net power costs (expressed as dollars per MWh) under the Protocol relative to such costs under the rolled-in methodology. PacifiCorp's witnesses conclude that because these deviations are relatively small, the Protocol would have no significant short- or long-term impacts on Utah's ratepayers.

On the basis of our examination of Mr. Duvall's and Mr. Taylor's exhibits, we believe that between 2005-2010 the Protocol would increase Utah's revenue requirements by more than $70 million (assuming an average annual Utah revenue requirement of $1.2 billion over the period). We do not find this increase insignificant. Moreover, we are not prepared to wait for the Protocol's expected reductions in Utah's revenue requirements between 2011-2018 as shown in PacifiCorp's analysis.

A related issue arises. What happens if PacifiCorp files a rate case in 2006 (or a similar year) when Utah's revenues requirement under the Protocol is more than 2 percent higher than it would be under the current rolled-in methodology (Taylor Exhibit _(DLT-5)? This higher percentage would remain built into PacifiCorp's rates until its rates were adjusted in another rate case. In our view, the Protocol appears to give PacifiCorp an incentive to seek rate increases while Utah's revenue requirements (relative to the rolled-in methodology) are going up, but not to seek rate decreases when Utah's revenue requirements are going down (for example, in 2011-2018). If Utah's ratepayers are to bear higher rates from 2002-2010 under the Protocol, then we should also be guaranteed the benefits of lower rates from 2011-2018 as implied by PacifiCorp's exhibits.

Issue 3. What are the potential financial consequences if the Protocol is not ratified?

PacifiCorp states that it (MacRitchie at page 12):

> …anticipates the needed addition of more than 5,000 megawatts of new generation or demand-side management at a cost that will approach the amount invested in PacifiCorp's existing generation fleet. Additionally, we face billions of dollars of investment associated with hydro relicensing and clean air requirements over this same time period. The Company will need to obtain significant new debt and equity financing to undertake these investments. Ratification of the Protocol will permit PacifiCorp's senior management to assure our Board of Directors and external investors that the Company has a reasonable opportunity to recover 100 percent of these prudent investments.

Similarly, PacifiCorp asserts (MacRitchie at page 9):

> Consensus on an MSP Solution affords PacifiCorp greater confidence to make long-term commitments to these resources that involve hundreds of millions of dollars.…Additionally, our projections of PacifiCorp's need for new generation, particularly on the east side of our system, are materially greater than they were three years ago. Again, these factors make it critical for us to be in a position to make major, long-term financial commitments with reasonable confidence in our ability to recover 100% of our prudently incurred costs.

As we noted in Issue 1 above, we are not convinced that existing regulatory procedures would prevent PacifiCorp from recovering its prudent investment costs. We believe that PacifiCorp needs to provide more careful analysis regarding this issue. However, we are concerned about PacifiCorp's contention that it may seek less-than-optimal resource acquisitions if the Protocol is not ratified. For example, PacifiCorp says (MacRitchie at page 13):

> Faced with a continued lack of consensus among our states regarding responsibility for new resources, we would undoubtedly somehow assure that there is continuity of service. However, we may be forced to do so in a manner that poses a higher level of risk for our customers and shareholders by relying upon ***shorter- term commitments*** that create exposure to price volatility and ***do not necessarily represent the least-cost approach*** to meeting our customers' expected load growth. Additionally, the ***cost of external financing would be greater due to the uncertainty of returns***. (emphasis added)

We are concerned by PacifiCorp's statement regarding the potential consequences of not ratifying the Protocol. This is a serious issue that deserves close scrutiny and evaluation.

Issue 4. Is the Protocol necessary to prevent a long cycle of adjudicative proceedings regarding rate/revenue adjustments and resource acquisitions?

One likely outcome of PacifiCorp's projected load growth and sizable resource deficits is a long cycle of adjudicative proceedings dealing with its resource acquisitions (both planned and realized) and associated rate adjustments to recover the costs of new investments. The costs of such proceedings to Utah regulators and consumers will be heavy. In examining the Protocol further, we recommend that the Commission address potential ways in which the burden of these proceedings could be minimized. Moreover, while some elements of the Protocol address this issue (for example, provisions dealing with the *First New Major Coal Resource*), we are not convinced that the Protocol's potential regulatory benefits outweigh the additional revenue requirement burden its imposes on Utah ratepayers in the next few years.

Issue 5. Do the Protocol's cost allocation methodologies reasonably reflect PacifiCorp's cost of serving retail customers in Utah?

In testimony accompanying its Motion, PacifiCorp lays out a detailed summary of the Protocol's cost allocation methodologies and cost assignment procedures. Reviewing PacifiCorp's description of the process that led it to select these methodologies and procedures leads to one conclusion—they were selected largely to accommodate widely divergent views on how costs should be allocated and/or assigned to retail jurisdictions. We recognize that compromise is necessary to gain consensus among parties that hold such divergent views. However, the Commission must determine whether reaching consensus means having to abandon sound costing principles. For example, we are not convinced that the 12 CP methodology properly allocates PacifiCorp's cost of System and Regional resources. Each of the Protocol's major allocation methodologies should be carefully examined to determine whether Utah's ratepayers are treated fairly. Multistate consensus should not come at the expense of Utah's consumers.

Issue 6. Would ratifying the Protocol restrict or limit Utah's choice of cost allocation methodologies for retail customers?

PacifiCorp states the following (Taylor at page 3):

> The MSP Solution only deals with the allocation of costs among States. The procedures for allocation of costs among customer classes will continue to be determined independently by each State.

We do not dispute PacifiCorp's assertion. However, if the Commission ratifies the Protocol, some parties will inevitably argue that cost allocation methodologies consistent with those in the Protocol must be used in Utah retail cost allocations. Even PacifiCorp in its current rate case in Utah has used many of the Protocol's cost classifications and allocations to distribute its costs among retail customer classes. Yet, as we noted in Issue 5 above, many of the factors that led PacifiCorp to choose specific cost classifications and allocations for the Protocol were driven by PacifiCorp's desire to achieve multistate consensus—not to reflect the cost responsibility of a particular customer class in Utah. In examining the Protocol, the Commission should explicitly address whether the Protocol's cost classifications and allocations reflect a reasonable jurisdictional allocation of PacifiCorp's costs. However, the Commission should also make clear that the Protocol's cost classifications and allocations may not reflect a reasonable basis for determining class cost responsibility in Utah.

Issue 7. How should the cost of serving Special Contract customers be determined?

Concerning how the Protocol addresses discounts embodied in Special Contracts, PacifiCorp says (Kelly at page 19):

> If the discount represents reasonable compensation for the Customer Ancillary Service Contract attributes of a Special Contract, it should be allocated to all States as a System Resource. However, if the discount is overly generous because the State approving the contract wishes to subsidize the industrial customer for economic development purposes, the subsidy amount should be assigned on a situs basis as a State Resource. In other words, States should be free to use electric rates as a means of subsidizing local economic development, but the costs of such subsidies should not be supported by customers in other States.

Moreover, PacifiCorp states (Taylor at page 20):

> As applied to Special Contracts, the cost of serving contract customer loads, and their State approved retail service revenues, will be included in the local State's revenue requirement on the same basis as would apply to the cost of serving any other retail customer. Any payments made (or discounts provided) for the Customer Ancillary Service Contract attributes, such as operating reserves, system integrity interruption, or economic curtailment, will be treated as a Resource acquisition by the Company and included as a purchased power costs allocated among all States.

Utah has several Special Contracts that would be affected by the Protocol. Our concern is whether the Protocol understates the systemwide benefits provided by these contracts, thereby potentially causing excessive costs to be allocated to Utah. The Commission should carefully examine this issue to ensure that the Protocol does not excessively allocate costs to Utah by its treatment of Special Contracts.

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was sent by email this 20th day of November, 2003, to the following at their e-mail addresses:

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