REPORT
of the
SPECIAL CONTRACTS TASK FORCE
To the Utah PSC

December 17, 1999

BACKGROUND

In 1992 an earlier Task Force made recommendations to the Utah Public Service Commission [PSC] regarding criteria for accepting Special Incentive Contracts. Those recommendations are as follows:

- Electricity sales resulting from the contract would not otherwise occur in the absence of such a contract. In other words, the Customer would not locate, expand, or remain in the Company's service territory, or would substantially reduce its purchases from the Company in the absence of such an incentive contract.
- Contract prices must be greater than all incremental capacity and energy costs over the term of the contract and must make a contribution to the fixed costs otherwise borne by tariff customers.
- Contract prices, terms and conditions must be based on reasonable considerations so that customers receiving like service under substantially similar circumstances qualify for like contracts.
- Customers receiving economic incentive price contracts must be of sufficient size to justify the cost of administering the contract.

Those recommendations were never formally acted on by the PSC, but were used in evaluating several proposed Special Incentive Contracts [SIC] between then and 1998. In the hearings in the 1997 PacifiCorp [PC] rate case [Docket No. 97-035-01], Ken Powell, a witness for the Utah Division of Public Utilities [DPU] recommended formal adoption of the criteria, with more specificity added to two of the criteria. Rodger Weaver, witness for PC, advocated adoption of the 1992 proposed criteria without modification. He recommended that if the PSC decided further modification was needed, that a task force be convened to consider the issue. In the same case, George Sterzinger, a consultant witness for the Committee of Consumer Services, recommended a different rate-making treatment of the SICs where shareholders were required to absorb a part of the lost revenues from SICs.

The PSC did not act on either of those recommendations, but referred those issues, along with a question on the propriety and need for confidential treatment of the SICs to a new Task Force. That Task Force, with Ken Powell as the Chairperson, met many times and produced a number of study documents. The membership of that Task Force is shown in Appendix A. While the Task Force was not able to reach a consensus on the issues, the majority of the Task Force were able to agree on a number of conclusions and recommendations. Those are presented here, along with information on the pros and cons that led to those conclusions and an indication of who supported them and who did not.

CONCLUSIONS AND RECOMMENDATIONS

1. CRITERIA

The Task Force recognized that there are two different types of cases where Special Contracts have been used rather than having the customer take service under standard tariffs: 1) If the customer has special load characteristics that make the customer sufficiently different from other customers in the class, and 2) If the customer has an economic incentive to provide his own service or take service from an alternative provider at rates below the tariff rate.

If the customer has special load characteristics, the rates for that customer would reflect the appropriate cost structure for serving that customer, and can be handled with normal procedures. As such, we believe they are not properly included within the scope of this Task Force. The Special Economic Incentive contracts, on the other hand, requires special criteria. The recommended criteria for them is as shown on the following page. Note that CCS objects to any drawing of conclusions or the issuance of a report and will respond separately to the PSC.

2. Ratemaking Treatment

The current rate-making treatment is appropriate under current allocation methodologies, given the review conducted herein. If at some future time the PSC adopts a mechanism where the costs of departing customers are assigned to shareholders rather than other customers, then an alternative approach such as that recommended by Mr. Sterzinger should be re-evaluated.

3. Confidentiality of Data

The current practice is acceptable. That is, the utility or its customer may request that specific information in the filing be treated as confidential. However, the utility will provide requested information to regulators as quickly as possible under an order of confidentiality.

SPECIAL ECONOMIC INCENTIVE CONTRACTS CRITERIA

QUALIFYING CRITERIA

1. Customer has the ability and incentive to reduce or eliminate purchases at tariff rate, but will maintain or increase load at a special non-tariff rate, OR
2. An enterprise will not locate in Utah in the absence of special non-tariff rates, OR
3. PacifiCorp serves competitors to a customer at special non-tariff rates in Utah or elsewhere in its service territory.

DECISION CRITERIA

1. Contract prices cover all **incremental capacity and energy costs**, including incremental cost of generation, transmission and distribution as appropriate and make a contribution to fixed costs.
2. A net benefit to tariff customers results, as evaluated by the current[1] IRP and allocation methodology.
3. Similar rates will be charged to customers having similar load characteristics.
4. Customer must be of sufficient size to justify the cost of developing and administering the contract.
5. Contract must be for no more than five years, with no automatic renewals.
6. Contract must meet all applicable regulatory standards, including just, reasonable and non-discriminatory.

DEFINITIONS:

Incremental Capacity and Energy: For now, PacifiCorp will file with the contract information on two ways of calculating Incremental Costs:

Make a contribution to Fixed Costs: Cover at least 5% of fixed costs and/or make a significant contribution to the state and local economy through increased employment or tax base.

While these standards are not precise, the PSC will make a judgement on the contract meeting them, based on information from the utility and the recommendation of the DPU.

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1. "Current" in this document refers to current practice, recognizing that there may not be current PSC decisions or orders on these matters.

DEGREE OF AGREEMENT

The following page tabulates the degree of agreement of the parties with the recommendations shown above. The industrial customers were represented by a number of individuals, but their agreement or disagreement is lumped as "IC" unless there were individual differences on agreement. Once again, note that CCS objects to making recommendations or the issuance of a report and will respond separately to the PSC.

DISCUSSION

1. CRITERIA

Our discussions quickly made it clear that a distinction needs to be made in special contracts between those contracts with special load characteristics and those customers with special financial needs. Some of the Special Contracts currently referred to as Special Incentive Contracts are in fact interruptible service customers who are covering all of their fixed and variable cost of service, but have lower rates than tariff because they have lower costs. The appropriateness of these rates should be evaluated using normal cost of service criteria, and so consideration of them is not included within this Task Force.

Special Economic Incentive Contracts - Every customer would like to receive an economic incentive from the utility. Some customers, however, have options that most customers don't have. They can generate their own electricity or acquire it somewhere else, or simply go out of state or out of business. With the current method of cost allocation, all customers pay higher rates when a customer leaves or reduces load, so it is to the benefit of all customers to retain that load if possible. A Special Incentive Contract at a price that covers all incremental cost and makes a contribution to fixed cost is better for other customers than having the customer leave the system.

The two key criteria here are first, that the customer must demonstrate their ability and economic incentive to leave the system, unless they receive special prices. This is the so-called "But-For" condition. PC currently reviews each proposed Special Economic Incentive Contract [SEIC] for compliance with this condition and has turned down several customers who wanted Special Contracts but couldn't adequately demonstrate the But-For condition.

The second key criteria is that the SEIC must cover all incremental capacity and energy costs and make a contribution to fixed costs. This is necessary for other customers to be better off with the SEIC than with the customer leaving. In the rate case, the DPU recommended a specific definition of incremental costs and a definition of the contribution to

SUMMARY OF DEGREE OF AGREEMENT ON RECOMMENDATIONS

SPECIAL ECONOMIC INCENTIVE CONTRACTS RECOMMENDATION

PC AGREES

DPU AGREES

CCS AGREES

IC AGREE *

COMMENTS **

1. Customer will reduce or eliminate load at tariff

YES

YES

1

YES

2. Or, customer will not locate in Utah at tariff

YES

YES

1

YES

3. PC serves competitors at non-tariff rates

NO

YES

1

YES

4. Cover all incremental capacity and energy cost

YES

YES

1

YES

5. Make a contribution to fixed cost

YES

YES

1

YES

6. Net benefit to tariff customers results

YES

YES

1

YES

7. Similar rates for similar customers

NO

YES

1

YES

2

8. Customer of sufficient size to justify

YES

YES

1

YES

9. Contract term no more than five years

NO

YES

1

NO

3

10. Meet all applicable regulatory standards

YES

YES

1

YES

DEFINITIONS

11. Review Incremental Cost filings

YES

YES

YES

12. 5% Contribution to fixed costs, incl. other factors

???

YES

NO

4

RATEMAKING TREATMENT RECOMMENDATION

11. Use current ratemaking treatment, unless

YES

YES

1

YES

12. Costs shifted to shareholders, then reconsider

NO

YES

1

YES

5

CONFIDENTIALITY OF DATA RECOMMENDATION

13. PC or customer may request confidentiality

YES

YES

1

YES

NOTES:
1. CCS indicated that its believes the Task Force should not issue a report. In accord with that, they have chosen not to respond to our recommendations as a part of this report, but have also indicated that they will issue a separate report.
2.PC states that while this is proper for tariffs, special contracts require a But-For which PSC can address case-by-case.
3.PC states that a shorter or longer term could be justified.
4. PC prefers to rely on the discretion of the PSC for adequate contribution to fixed costs.
5. PC is opposed to this premise.
* In general, the industrial customers support the 1992 criteria without additions. Some of them introduced and support Recommendation 3 above, where a special incentive contract with a competitor in another PC state allows consideration of a special incentive contract in Utah.
** Specific comments of Task Force parties pertaining to this report are attached in Appendix C.

DISCUSSION
(CONTINUED)

fixed costs required. In the task force meetings, the DPU representatives were persuaded that leaving the terms more general has worked adequately in the past, and gives more room to the DPU and the PSC for including non-quantifiable variables in their consideration.

We have recommended here, however, that PC file two different ways of evaluating incremental cost, for the consideration of regulators:

1) PSC approved avoided cost, and 2) PC filed avoided cost. We have also recommended a 5% minimum for contribution to fixed cost, but have allowed consideration of other variable such as tax base and employment in that analysis. While these standards are not precise, the PSC can make a judgement on the contract meeting them, based on information from the utility and the recommendation of the DPU.

We have recommended contract terms no longer than five years with no automatic renewal, to give regulators the opportunity to continue to evaluate these contracts in light of changing conditions.

2. Ratemaking Treatment

The foregoing discussion assumes the current ratemaking treatment of special incentive contracts. That is, the demand and energy costs of the customer with the SEIC become system costs and are allocated among the states based on allocation factors computed from loads that do not include the special contract loads. The revenues from the SEIC are also allocated among states based on the same allocation factors, so the customers in each state are better off than they would be if the costs of a departing customer were allocated to them, but no corresponding revenues were available to offset costs [i.e., the customer leaves the system.]

This treatment, called the PITA approach, has two key assumptions: 1) that the costs of a departing or SEIC customer become system costs, and 2) that those costs are allocated between states with typical allocation factors. This has come to be called the "PITA approach."

The Consumer Committee consultant, George Sterzinger, argued in the rate case that with this treatment PC has no incentive to get the best deal possible on the SEIC. He suggested that the shareholders absorb a part of the short-fall of revenues below full embedded costs up to the return on equity portion of the revenue requirement. Since the shareholders were sharing in the lost revenues of the SEIC, they would have an incentive to negotiate the best rate possible for the SEIC.

PC representatives argued in the rate case and before the Task Force, that to the contrary, this approach would guarantee a shareholder loss on each special contract, and therefore the shareholder's representatives would not sign any SEIC, thus eliminating ratepayers' contribution-to-fixed-cost benefit from special contracts.

After extensive meetings and model exchanges, it became apparent that the CCS position required one additional implied assumption for its conclusions to be true: that the fixed cost associated with the special contract customer before it leaves the system be declared not used and useful when it does leave and therefore not flowed through in rates to remaining tariff-paying customers. In that case the shareholders would absorb all the departing customer costs. Given that assumption, the shareholders would be better off with the SEIC, even with the sharing of costs recommended by Mr. Sterzinger.

In order to complete a comprehensive review of these and other possibilities, the Task Force looked at all the assumptions typically made in handling these contracts and tested their validity. We also tested a number of options for treating those contracts, including a couple not raised in the rate case, but brought before the Task Force by Doug Kirk of the PSC staff.

ANALYSIS OF RATEMAKING TREATMENTS

Appendix B contains the detailed analysis of the ratemaking options for a customer who leaves or threatens to leave the system. The first nine pages are a description of the possible options that we considered. The next page is a model of the impact on ratepayer costs and

shareholder costs of the options, followed by its supporting documents. This model was prepared by PC at the request of the DPU, and subsequently checked by the DPU. At the bottom of page10 is a matrix summarizing the model results for various options. This model and matrix supports the conclusions drawn here and on the individual case pages.

From this matrix we can draw the following conclusions:

- If the PSC were to disallow the costs of a departing or SEIC customer from rates, then the CCS option of sharing potential unrecovered costs between shareholders and ratepayers is the most economic alternative for ratepayers. The presence of a SEIC benefits both ratepayers and shareholders under this condition, and the Company has an incentive to get the highest rate possible on the SEIC. It must be noted that this would be a drastic change from current regulatory practices. It would be vigorously opposed by PC. It is not supported at this time by the DPU.
- If the PSC were to continue to allow the costs of departing or SEIC customers in rates, the CCS option would result in increased shareholder costs with an SEIC and therefore none would be signed by PC.
- Sharing of SEIC costs and revenues between states [PITA method] may not be the lowest cost option for the loss of a customer in a non-host state, but is a rate increase mitigating option and is very likely the only realizable option that does reduce rates for all customers in all states relative to losing the special incentive contract candidate's load entirely. This approach also acts to share the risk and cost if there were multiple departures from many states. For this reason, many of the parties recommend continuing this treatment.

CONFIDENTIALITY OF DATA

In the Task Force meetings, both PC and the representatives of the industrial customers insisted that confidentiality of certain data in the filings for approval of SEICs was absolutely necessary. PC stated that if the price of a contract became known, that price would become the ceiling for the price negotiations for new SEICs. This would gradually bring all the prices down, reducing the contribution of the contracts to fixed costs.

The industrial customers stated that information on their energy use and price could give their competitors an advantage. Regulators pointed out that the data is usually available elsewhere, but the industrials insisted on locking all the barn doors they could.

At the same time, the request for confidentiality has not worked a hardship on the DPU review of the contracts except some slowing of the process. CCS, on the other hand, has had some difficulty in obtaining confidential information. It is our understanding that this problem was worked out in the course of the Task Force. To the degree it was not, it can be handled in another venue.

Since confidentiality is critical to PC and the industrial customers, and not a particular problem for regulators, we recommend that we accede to the wishes of the parties with regard to the need for confidential treatment of information that is filed for approval of SEIC's.

APPENDIX A

TASK FORCE MEMBERSHIP LIST

SPECIAL INCENTIVE CONTRACT TASK FORCE

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APPENDIX B

CASE DESCRIPTIONS AND ANALYSIS

CASE 1--BASE CASE–Customer Stays on Tariff

PREMISES:

- All costs fully rolled in.
- Production costs allocated to states in proportion to demand and energy requirements of that state.
- All tariff revenues assigned situs to state where customer is located.
- In a rate case, costs are allocated to states and classes based on demand and energy requirements of loads in the individual states.
- In the rate case, tariff revenues are assigned to the state where the tariff customer is located and to the class that is appropriate for the customer.
- No special contracts.

CONCLUSION:

1. Given that rates are appropriately set, the revenue from each class of customer in each state covers all its assigned and allocated costs. Customers of other classes in all states are neither hurt nor helped by the presence of any customers in a particular class.

DISCUSSION

1. This is the preferred status for all customers [preferred by other customers and regulators in all states]. However, some large industrial customers may have options to generate or buy electricity at rates lower than tariff rates, or have other options that create a valid But-For option. Others may not be able to make a satisfactory return at tariff capacity and energy costs and either go out of business or relocate. Still other potential customers may choose to not locate in the state at tariff rates.

CASE 2–LARGE INDUSTRIAL CUSTOMER LEAVES SYSTEM-- **DEPARTED CUSTOMER COSTS ALLOCATED TO ALL REMAINING CUSTOMERS** [Historic treatment and therefore a reasonable basis for comparing other treatments]

PREMISES:

1. A tariff large industrial customer leaves the Company's Utah system or substantially reduces load, either by self-generating, municipalization, moving elsewhere, producing its product with a less electricity intensive process, going out of business, or through some other valid But-For option.
2. The capacity and energy that was used to supply the customer is no longer needed to serve that particular customer. However, the fixed costs of that capacity and the fixed cost of that energy remain the same.

3. In the next round of rate cases, a new allocation is performed, with smaller loads for Utah and the total system reflecting the loss of the now exited customer. With smaller loads the calculated cost [$/KWh] would increase in all states for all customer classes.
4. With no revenue from the now-exited customer to cover those costs, revenue requirement for all other customers in all states would go up, on a $/KWh basis, until normal load growth absorbed the capacity and energy no longer used by the exited customer.

CONCLUSIONS:

1. In comparison to Case 1, all customers in all states are harmed by a customer leaving the system.
2. This is true regardless of which state the departed customer took service in.
3. This is true regardless of the class of service or size of the departed customer, but the impact on other customers would only be appreciable for very large customers. For other customers the impact would be to small to be perceptible and absorption by normal load growth would occur quickly.

DISCUSSION:

1. This is the likely outcome of a large customer leaving the system, absent some specific action being taken to mitigate it. The previous case and the following cases represent alternative methods of mitigating that impact.

CASE 3–CUSTOMER SIGNS SPECIAL INCENTIVE CONTRACT RATHER THAN LEAVING. HOST JURISDICTION ABSORBS REVENUE SHORTFALL– No Shareholder Absorption of Lost Equity Return for Special Contract

PREMISES:

1. A current tariff-paying large industrial customer threatens to leave the Company's Utah system, through one of the But-For options listed in Case 2.
2. PacifiCorp verifies the But-For contention of the customer and is able to negotiate a special contract at a price that covers the incremental capacity and energy costs of serving the customer and makes a contribution to fixed costs. PacifiCorp therefore signs a Special Economic Incentive contract with the customer. [Note: these two criteria -- valid But-For option and acceptable price, are the two key criteria of the 1992 guidelines and the recommendation of this report. In the remainder of the report "meets key criteria" will be used as shorthand to indicates that these two conditions are assumed to be met.
3. The SEIC load is included in the allocation factor calculation, so the costs, including the fixed costs of the SEIC customer are allocated to Utah.
4. As previously stated, the customer special contract rate includes a contribution to fixed costs.
5. The SEIC revenue is revenue credited directly to Utah.

CONCLUSIONS:

1. All customers in all other states would have no change in revenue requirement as compared to Case 1.
2. Remaining tariff-paying Utah customers would have a rate increase, since their revenue requirement would increase.
3. Shareholders would have no decrease in earnings compared to in Case 1.
4. These conclusions would apply to any state that adopted situs revenue credit treatment of a Special Incentive Contract.

DISCUSSION:

1. This is the lowest cost likely case for customers in other states.
2. However, since the host state has higher costs and rates than if the customer simply left the system, the host state's PSC would have a clear incentive to not approve the special contract and so this potential benefit would not in fact become available to other states tariff customer.
3. The benefit of the special contract to all remaining tariff-paying customers in all states, including the host state, would be foregone as a result of the host jurisdiction rejecting the contract.
4. This consequence would be the result of the host state's PSC acting rationally given a flawed allocation system that produces sub-optimal results.

CASE 4–CUSTOMER SIGNS SPECIAL INCENTIVE CONTRACT RATHER THAN LEAVING. SITUS ASSIGNMENT OF COSTS AND REVENUES. –Shareholders Absorb Equity Return For Special Contract

PREMISES:

1. The PSC has ordered that the fixed capacity and energy of any large industrial customer who leaves the system are not "used and useful" and the cost of that capacity and energy will not be included in rates charged to remaining tariff-paying customers. [This is a reversal of long-standing practice and would be strongly opposed by some parties.]
2. A current tariff-paying large industrial customer threatens to leave Utah, through one of the But-For options previously listed.
3. The key criteria are met and PacifiCorp therefore signs a special incentive contract with the customer.
4. The Company [i.e. shareholders] are required to absorb the equity return portion of costs when the customer signs a special contract. [Note: this is an application one version of the CCS proposal.]
5. The other fixed costs of the Special Incentive Contract customer are allocated among remaining Utah tariff-paying customers for rate-making purposes.
6. The customer special contract rate includes a contribution to fixed costs, of which any amount of revenue up to that needed to begin to cover equity return is credited to Utah. Additional SEIC revenue, if any, accrues to shareholder to mitigage, but not eliminate the earnings deficit resulting from the special contract.

CONCLUSIONS:

1. All customers in all other states would have no change in revenue requirement as compared to Case 1.
2. Utah customers may or may not have a rate increase depending on the customer contribution to fixed cost.
3. Shareholders would have a decrease in earnings compared to Case 1 or Case 2, but an increase in earnings compared to what they would have without the Special Contract, given the lost load cost disallowance that is a premise of this case.

DISCUSSION:

1. The first premise does not presently occur in Utah. Without that premise, the Company would have an incentive to refuse to do lower-than-tariff special contracts and incur the loss on all such contracts. Therefore any value to this proposal is not available without a corresponding PSC approval of the first premise.

2. Further discussion of this issue is presented in case 7, which differs from this case in that no special contract is possible, i.e., the case where the candidate actually leaves the system because no special contract that meets the key criteria is adequate to retain the customer.

CASE 5–CUSTOMER SIGNS SPECIAL INCENTIVE CONTRACT RATHER THAN LEAVING. SYSTEM-WIDE REVENUE CREDIT APPROACH –No Shareholder Absorption of Equity Return for Special Contract. [The current PITA approach]

PREMISES:

1. A tariff large industrial customer threatens to leave Utah through one of the But-For options previously described.
2. Key criteria are met and PacifiCorp therefore signs a special incentive contract with the customer.
3. The customer special contract rate includes a contribution to fixed costs.
4. All fixed costs are reallocated among all remaining tariff-paying customers in all states.
5. The revenues from the Special Incentive Contract are allocated to all other customers in all states.

CONCLUSIONS:

1. All customers in all states would still have an increase in revenue requirement as compared to Case 1.
2. All customers in all states would have a smaller rate increase than they would in Case 2.
3. Shareholders would not have a decrease in earnings.

DISCUSSION:

1. This is what has been happening up to now in Utah and the other states

served by PC.

2. Company is not presented with a disincentive to sign special contracts, in that shareholders are not punished for doing them.
3. Assuming guidelines similar to the 1992 proposals, remaining tariffed customers receive the contribution to fixed cost benefit available from the contract.

CASE 6–CUSTOMER SIGNS SPECIAL INCENTIVE CONTRACT RATHER THAN LEAVING. SYSTEM WIDE REVENUE CREDIT TREATMENT –Shareholders Absorb Equity Return for Special Contract

PREMISES:

1. The PSC has ordered that the fixed capacity and energy of any large industrial customer who leaves the system are not “used and useful” and the cost of that capacity and energy will not be included in rates charged to remaining tariff-paying customers. [This is a reversal of long-standing practice and will be strongly opposed by some parties.]
2. A tariff large industrial customer threatens to leave Utah through one of the But-For options previously discussed.
3. The key criteria are met and PacifiCorp therefore signs a special incentive contract with the customer.
4. The Company [i.e. shareholders] are required to absorb the equity return portion of costs when the customer signs a special contract. [Note: this is an option of the CCS proposal.]
5. The customer special contract rate includes a contribution to fixed costs.
6. All other fixed costs (i.e., those not covered by the special contract price or absorbed by shareholders) are reallocated to all other customers in all states.

CONCLUSIONS:

1. All customers in all states would still have an increase in revenue requirement as compared to Case 1.
2. All customers in all states would not have as much of a rate increase as they would in Case 2.
3. Shareholders would have a decrease in earnings compared to Case 1.

DISCUSSION:

1. The first premise does not presently occur in Utah. Without that premise, the Company would have an incentive to refuse to do lower-than-tariff special contracts and incur the loss on all such contracts. Therefore any value to this proposal is not available without a corresponding PSC approval of the first premise. Further discussion is presented in case 7.

CASE 7–LARGE CUSTOMER LEAVES THE SYSTEM--DEPARTED CUSTOMER COSTS ALLOCATED TO SHAREHOLDERS

PREMISES:

1. The capacity and energy that was used to supply the customer is no longer needed to serve that particular customer. However, the fixed costs of that capacity and the fixed cost of that energy remain the same.
2. A tariff large industrial customer leaves PacifiCorp system in Utah through one of the But-For options previously discussed.
3. Any fixed cost of the capacity and energy for the departed customer is determined by regulators to be no longer used and useful. These costs are not allowed in rates.

CONCLUSIONS:

1. The costs of all other customers in all states do not change. No change in revenue requirement occurs and thus no change in rates
2. All customers in all states are held harmless in comparison to Case 1.
3. Shareholders are harmed in comparison to Case A and all other options.

DISCUSSION:

1. Shareholders are harmed by the actions of regulators in that either earnings are decreased and/or the price of the stock will fall.
2. In consequence, the risk premium for this company could increase and a higher rate of return could be justified.
3. The higher rate of return could increase rates causing harm to customers in comparison to Case 1, contrary to Conclusion 1 above.
4. This has not been a traditional rate-making approach, either in Utah or other states. Concerns with this approach include:
    a. Use of the method could be considered discriminatory in that it is not applied to all classes or all customers.
    b. To be just and reasonable, the method could require a symmetric automatic addition to rate base when a large customer is added.
    c. Use of the method could be considered retroactive ratemaking, in that findings that resources had been prudently incurred are reversed.
    d. Even if this were appropriate, the mechanics of accomplishing it would be difficult and highly contentious.
    e. Use of the method may trigger an up and down alternation of rates that induces rate instability for customers remaining on tariff. This violates rate stability objectives.
    f. The utility is being punished for customer decisions, or economic conditions that it has no control over.
    g. This method holds the utility to an inappropriate and unrealistic “exact-match” standard between its power supply assets and its load on a customer-decision by customer-decision basis.

We believe that given these concerns, this option has a very low probability of being adopted by the Utah Public Service Commission. Regardless, this is not now the practice and would have to be proposed to the PSC, supported and ruled on by the PSC before other decisions should be based on it.

CASE 8–LARGE INDUSTRIAL CUSTOMER LEAVES SYSTEM-- DEPARTED CUSTOMER COSTS ALLOCATED TO OTHER HOST

USMag Exhibit 1.8

JURISDICTION INDUSTRIAL CUSTOMERS

PREMISES:

1. A tariff large industrial customer leaves Utah through one of the But-For options previously discussed.
2. The capacity and energy that was used to supply the customer is no longer needed to serve that particular customer. However, the fixed costs of that capacity and the fixed cost of that energy remain the same.
3. At the next rate case, the allocation of costs to classes, and among the states, is maintained as if the departed customer were still on the system. The revenue requirements of the other industrial customers would go up sharply and therefore their rates would go up.
4. With no cost allocation from the now-exited customer, the revenue requirement for all other customers in all states would stay the same as Case 1.

CONCLUSIONS:

1. The other industrial customers are harmed in comparison to all other options.
2. Justification for this course of action would be extremely difficult.
3. All other customers are held harmless in comparison to Case 1 and are better off than other Cases.
4. Shareholders are held harmless in comparison to Case 1.

DISCUSSION:

1. This option violate cost causation principles of allocation in that remaining host jurisdiction industrial customers would be required to pay disproportionately for costs their consumption does not impose on the system.
2. This option could cause large rate increases for other industrial customers. This would, in turn, cause those customers to look elsewhere for their energy. This could accelerate the departure of customers and start an upward spiral of rates and departures for industrial customers that would be counterproductive to our purposes.

CASE 9–LARGE INDUSTRIAL CUSTOMER LEAVES SYSTEM-- DEPARTED CUSTOMER COSTS ASSIGNED TO DEPARTING CUSTOMER WITH EXIT FEES

PREMISES:

1. A tariff large industrial customer leaves Utah, through one of the But-For options previously discussed.
2. The capacity and energy that was used to supply the customer is no longer needed to serve that particular customer. However, the fixed costs of that capacity and the fixed cost of that energy remain the same.
3. The departing customer is charged an exit fee that represents the present worth of fixed costs for departing load, until normal load growth absorbs the surplus capacity and energy.
4. With the exit fee revenue from the now-exited customer to cover those costs, revenue requirement for all other customers in all states would stay the same, on a $/KWh basis.

CONCLUSIONS:

1. In comparison to other cases, all customers in all states are not harmed by a customer leaving the system.
2. This is true regardless of which state the departed customer took service in.
3. This is true regardless of the class of service or size of the departed customer, but the impact on other customers would only be appreciable for very large customers. For other customers the absorption by normal load growth would occur quickly.

DISCUSSION:

1. Collection of the exit fee would be extremely difficult, especially from an out-of-business customer. Tariff terms would have to be created by the PSC to impose such fees on customers that leave the system. Collection of the fee in advance would also be difficult; further, we couldn't know which customer might be leaving. If we assigned an advance exit fee to all large industrial customers, some would be charged unfairly, since they would not leave the system. This would also raise the rates for this class of customer and hasten their departure for more economical power. Advance collection could also lead to double collection because fixed costs of service are recovered in rates.

SUPPORTING INFORMATION FOR ANALYSIS OF REVENUE CREDIT ALTERNATIVES
This is a brief write-up of the Revenue Credit Alternatives analysis. To reflect regulatory impact, for both Host and Other jurisdictions we created a highly simplified model of a hypothetical utility serving load in two jurisdictions (Host and Other). One customer in the Host area has a "But For" option and will leave the system if it is not given a lower-than-tariff special contract. The model calculates Allocation Factors, Revenue Requirements and Rates. To reflect PacifiCorp stockholder impact we also calculated fixed cost coverage and fixed cost shortfalls. To bring regulatory and company perspectives together, we developed probability of acceptance binary indicators, where "one" indicates acceptance and "zero" indicates non-acceptance. Results column shows the outcome of acceptability probability.

Input assumptions.

The top section of the worksheet shows the background conditions, consisting of the two jurisdictions, with the Host jurisdiction divided into the Special Contract load and the Host-rest of customers. Simplified fixed, variable and total revenue requirement is calculated for each customer set. Special contract price, the revenue generated and the margin for special contracts is also presented, (special contract margin being special contract revenue minus the variable cost of special contracts). This margin is the special contract's "contribution to fixed costs." Using a typical, hypothetical weighted average cost of capital of 50% debt and 50% equity and using 8% and 10% rate of return on debt and equity, respectively, gives us a return on rate base of 9%. Using a net rate base of 5,556 dollars we calculated the special contract return to debt and equity. Note these are just numerical, hypothetical values and do not reflect actual values.

Sample numeric examples and formula for Host Special Contract Candidate

Allocation factor of 10% is equal to ratio of Special Contract Customer load to system load
(10 mwh/100 mWh)=10%

Fixed cost factor is equal to the allocation factor of 10% from above and total system fixed cost of $500.

Variable cost is equal to the allocation factor of 10% from above and total system fixed cost of

$550.

Total revenue requirement is equal to sum of fixed and variable costs from above.

($50+$55=$105)

Special contract Price is an input ($8)- Users can specify alternative prices to analyze alternative scenarios.

Revenue is equal to the product of the above input price and the special contract candidate's load. 8 * $10 = $80

Margin is equal to above revenue minus variable cost allocated to special contract. $80- $55= $25

Special Contract return on debt and equity is equal to portion of the net rate base allocated to special contract multiplied by the debt proportion of weighted cost of capital, multiplied by the rate of return on debt ($5556 * 10% * 50% * 8%) = $22.2

Special Contract return on equity is equal to portion of the net rate base allocated to special contract multiplied by the equity proportion of weighted cost of capital, multiplied by the rate of return on equity ($5556 * 10% * 50% * 10%) = $27.8

Some explanatory notes: We are using two new abbreviations in this model. First abbreviation is SLER, which stands for Shareholders Lost Equity Return on Special Contract. The Second abbreviation in SLTC, which stands for Shareholders Lost Total Fixed Cost on Special Contract. These two abbreviations are used in the Cases 3-7.

Case 1: Customer Stays on Tariff.

Given the current loads, 40% of the system load is in the host area and the 60% in the Other jurisdiction. Total revenue requirement of $1050 is allocated using 40% and 60% factors. Tariff paying customers rate is 10.50 $/mWh. Fixed cost is 500 and it is fully covered there are no shortage. This is the most acceptable case for both the company and the DPU. Note that this is the ideal, though not valid option for comparison to the other cases given that customer has a valid "But For" option and has indicated that they will leave the system at tariff level of $10.50 per mWh.

Case 2: Customer Leaves the System, and ratepayers absorb the cost (Base Case)

In this case the allocation factors for the two regions change. Host regions share of system cost goes down from 40% to 33% and the revenue requirement goes down to $332 = ($1050-$55)*1/3. There is full coverage of fixed cost and there is no shortage.

Note: in cases 3-6, numerical discussion is based on $8/mWh Special Contract price. Different outcomes will result from different Special Contract price assumption.

Case 3: Special Contract, Situs method, SLER is 0% (Pre-1997 PITA method)

In this case one customer is found to have a valid but-for alternative, the costs are allocated using Situs method. Allocation factors are as they were before. The revenue from the special contract lowers revenue requirement for the Host area. Host revenue requirement is equal to (40% * $1050)- $80 =$340. The Other jurisdiction revenue requirement is (60% * $1050) = $663. Rates for the rest of customers in the Host jurisdiction and Other jurisdiction are calculated as revenue requirement divided by mWh. For Host are it is ($340/30 mWh) =11.33 $/mWh and for the Other jurisdiction it

is ($ 663 / 60 mWh)=10.50 $/mWh. Fixed cost is covered and there is no shortage.

The DPU of the Host jurisdiction would reject this because of rate for the rest of ratepayers has gone above the case 2, i.e. Host ratepayers would be better off with the special contract customer off the system.

Case 4: Special Contract, Situs method, SLER is 100% (A special case of the CCS proposal)

Case 4 is variation of case 3, except that revenue requirement for Host, rest of customers is lowered by an amount that PacifiCorp's stockholders lose. The amount lost by stockholders is equal to allowed return minus margin. Given that, for this Special Contract, allowed return is $50 and margin is $ 25 dollars, stockholders loss is $25 dollars. This amount lowers Host Jurisdiction "rest of customers" revenue requirement which was $340 dollars, under Case 3, to $315 dollars.

Case 5- Special Contract, System-wide Revenue Credit (PITA 1997), SLER 0% (DPU and PacifiCorp Proposal)

Allocation factors in this case do not include the special contract customer's load. The revenue requirement for the Host is calculated as total cost minus the revenue from the special contracts times the new allocation factor. 323= 33%*(1050-80)
Rates for the rest of customers in the host jurisdiction is calculated ($342/30 mWh)=10.78
Fixed costs are fully covered and there is no shortage.
This case is acceptable to both DPU and Company.

Case 6- Special Contract, system-wide allocation, SLER 100% (A Variation on CCS proposal)

This case is variation of case 4, where stockholders lost 100% of their return on equity for the special contract sales. However, unlike Case 4, the ratepayers in the host jurisdiction do not receive the full 100% of the credits but rather the credit is allocated to each jurisdiction using the allocation factors used to distribute the system cost. Stockholders lost $25 dollars. This amount is allocated to each jurisdiction using PITA allocation method, in our example $8.3 dollars would go to Host and $16.7 dollars would go to "Other" jurisdiction. Case 6 is not acceptable to PacifiCorp and acceptability by DPU depends on the price of special contract.

Case 7- Customer Leaves but Shareholders Pay. The SLTC 100%

In this case customer leaves the host service area and the fixed cost attributed to that customer is considered disallowed and shareholders of the company are faced with a shortage equal to the full fixed cost.
New allocation factors, revenue requirements and rates are calculated as if special contract customer did not exist. Rates to the rest of customers stay the same, because the shareholders are given the full share of disallowed cost. The shareholders will be short $50 dollars which was the fixed cost allocated to special contract customer. This case is acceptable the neither DPU nor Company, due to the large and unreasonable losses forced on stockholders.

Summary Tables

We have presented two summary tables. The first table shows calculated rates and the fixed cost coverage for each scenario. To facilitate in comparison between cases we have prepared a second table where in each cell we are comparing the

host jurisdiction's other-customers rates in the case shown in the column heading against the case shown in the row heading. For example comparing prices between case 2 against case 1 we see that prices went up to 11.06 $/mWh from 10.50 $/mWh.

APPENDIX C
COMMENTS OF TASK FORCE MEMBERS
WITH REGARD TO THE FINAL REPORT