

DISCUSSION:

At the March 16, 2004, Public Meeting, I recommended the Commission direct PacifiCorp, at the May 4, 2004, Public Meeting, to notify BPA to end the deferral of Litigation risk monies and to begin collecting such monies as soon as allowed for under contract (presumably October 1, 2004). The Commission agreed to take the issue up at the May 4, 2004, Public Meeting. To provide the public additional opportunities to provide comment, the Administrative Hearings Division sent out notice inviting comments with a schedule as follows: opening comments on April 21, 2004, and reply comments on April 28, 2004.

Many public comments were filed on this matter. The comments from publicly-owned utilities, or agencies representing as such, recommended the Commission not direct PacifiCorp to seek its Reduction in Risk monies or delay the decision for at least several months.² The public agency recommendations were based on various considerations including:

1. Rate impacts to utilities other than PacifiCorp;
2. Total impact to Oregon assuming Puget ended its deferral as well;
3. Equity of reducing PacifiCorp's relatively low rate levels;
4. Legal questioning of the soundness of the PacifiCorp/BPA contracts; and,
5. Implementing contracts that face legal challenge in the 9th Circuit.

Counsel, on behalf of staff, submitted reply comments on the 28th of April, regarding the standard by which the Commission should consider the impacts on PacifiCorp consumers, consumers of other regulated utilities, and other parties in Oregon. Those comments, and this memorandum, respond to the legal and policy considerations relating to the issues noted above.

As noted in my March 16, 2004, public meeting presentation, the global settlement proposal, which was approved by this Commission on December 15, 2003, would have settled disputes regarding benefits to residential and small farm (Residential) consumers through September 30, 2011, and allowed BPA to implement a significant rate decrease.³ Despite overwhelming regional support for this Comprehensive

² Public agencies and utilities filing comments were Canby Utility Board; joint comments by Public Power Council, Oregon Municipal Electric Utilities, Oregon People's Utility District Association, and Oregon Rural Electric Cooperative Association; Emerald PUD; Public Utility District No. 1 of Snohomish County; Clatskanie PUD; Washington Public Utility Districts Association; and Oregon Department of Energy. Others to file comments are the Citizens' Utility Board, Portland General Electric, PacifiCorp and PUC staff. The Department of Energy comments asked for a delay in the schedule to better evaluate the newly proposed settlement.

³ See the public meeting memo for agenda item #8, presented at the December 4, 2003, Public Meeting.

Settlement, a handful of publicly-owned utilities failed to join the settlement. As a consequence, the Comprehensive Settlement, which the Commission supported and directed PGE and PacifiCorp to execute, is void *ab initio*.

One aspect of that settlement included both Puget and PacifiCorp waiving contractual rights to the \$200 million Reduction in Risk payments. With the settlement void *ab initio*, the issue is ripe as to whether PacifiCorp should cease the Commission-authorized deferrals of the Litigation Risk payments. In Section 2 of BPA/PacifiCorp Contract No. 02PB-11157, the PUC is authorized to object to, or disapprove of, the continuation of the deferral of the Reduction of Risk Discount. Further, the contract requires PacifiCorp to provide notice not less than 120 days prior to the beginning of the six-month period (which is either October 1 or April 1). In this regard, PacifiCorp must provide notice by June 3, 2004, for payments to begin perhaps as early as October 1, 2004.

Some weeks after the global settlement failed, BPA began discussions with Puget and PacifiCorp to see if the provisions of the failed settlement that pertained specifically to the investor-owned utilities could be preserved through a new settlement. As those discussions progressed, the other investor-owned utilities were brought in to obtain their participation as well.

The settlement proposal at hand, for purposes of PacifiCorp, differs in the following key areas from the global settlement previously supported by the Commission:

1. Lawsuits continue---The publicly-owned utilities are not part of this settlement and are not required to dismiss current lawsuits and sign covenants not to sue regarding BPA policies and decisions regarding benefits to the investor owned utilities' Residential consumers.
2. \$75 million deferrals are eliminated---PacifiCorp is not requested to defer any current benefits it is currently receiving from BPA for repayment in the 2007 to 2011 time period. PacifiCorp offered in the global settlement to defer \$19.3 million annually for three years with repayment of these monies over the five-year period beginning October 1, 2006.
3. Instead of waiving the entire Litigation Risk Premium, PacifiCorp waives one half or \$40 million of the Litigation Risk payments and the remaining \$40 million would be paid by BPA to PacifiCorp over the 60-month period beginning October 1, 2006.

4. After the settlement is executed and in force, in the event the provisions for the payment of monetary benefits to PacifiCorp provided under Section 4(c) of the Settlement Agreement were successfully challenged, and thereby found to be void, unenforceable or unlawful, the proposed settlement becomes void *ab initio*. As a result, the Deferral Agreement would be enforceable in accordance with its then unmodified terms, and PacifiCorp would be entitled to claim the full amount of deferred Reduction of Risk Discount payments, as set forth in the Deferral Agreement.

The proposed settlement offers the key benefit to PacifiCorp's Residential consumers of stability and certainty in benefits for the five-year period beginning October 1, 2006. BPA will use a new method to calculate how much money goes to the IOUs (such as PGE and Pacific) for the 2007-2011 period. BPA will:

- a. Use a new independent source for the market price forecast, rather than BPA selecting a number. This new method will apply for the time period October 1, 2006 through September 30, 2011. This approach removes BPA's ability to arbitrarily set the level of benefits for the Residential consumers of the investor-owned utilities, and provides reasonably comparable benefits to those made available to Residential consumers of the publicly-owned utilities.
- b. Establish a floor and cap on the annual level of benefits provided to the Residential consumers of the investor-owned utilities of \$100 and \$300 million, respectively. Using the 4-state PUC agreement⁴ on allocation of benefits for the 2007 – 2011 period, this translates into roughly a floor and cap of \$40 and \$125 million per year, respectively, for Oregon's Residential consumers served by PGE, PacifiCorp and Idaho Power. The current level of benefits received by those customers is roughly \$125 million per year. The current \$125 million was set during the 2001 energy crisis, which represents a time when BPA was envisioned to be well below market, i.e., the value of the federal system was very great.

An additional benefit to PacifiCorp consumers is that the level of PacifiCorp's flexibility is increased in managing the flow of benefits to its Residential consumers. This is accomplished by increasing to 36 months the amount of benefits that can be held in PacifiCorp's balancing account for distribution to consumers. This allows the Commission to manage rate changes better so that needless rate changes can be avoided and greater rate stability provided to consumers.

⁴ The September 17, 1999, 4-state agreement regarding allocation of BPA benefits was adopted by BPA in its Record of Decision.

Finally, PacifiCorp consumers will benefit by removing the uncertainty as to whether BPA will provide benefits in the form of power or cash. By establishing up front that the benefits beginning October 2006 will be provided in cash, PacifiCorp can better plan its resource requirements and decisions.

Key Issue

The key issue is whether this settlement is beneficial for PacifiCorp Residential consumers. Staff believes the answer is "yes" and can be supported by comparing the differences between the Commission-supported global settlement and the current settlement proposal. The table on the following page provides such a comparison.

In looking at the table on the following page, it appears that the current settlement provides Oregon with over \$40 million additional dollars in benefits than that available under the global settlement assuming no adverse court ruling. This must be weighed with the litigation risk remaining open in the current settlement proposal while the global settlement dismissed current lawsuits and had parties sign covenants not to sue.

A different logic could be used to consider the merits of the settlement by comparing impacts with and without settlement. Assuming no settlement, or if the Commission determines the settlement is not in the public interest, I would recommend the Commission direct PacifiCorp to promptly provide notice to BPA to cease deferrals of the Litigation Risk monies. In that event, PacifiCorp would collect, absent adverse court rulings, the full \$80 million. That is \$40 million greater than the proposed settlement. If the Litigation Risk monies were flowed through to Residential consumers, information provided previously to me by PacifiCorp indicates that the rate reduction in Oregon would be roughly 7%. (PGE estimates that its residential rates would increase by approximately 0.6% assuming PacifiCorp ended the deferrals of the Litigation Risk monies and there is no settlement.)

And assuming no settlement, the benefits to investor-owned utility Residential consumers would not be established using the independent market price forecast. With PacifiCorp receiving 586 aMW in the second five-year period, each \$/mWh reduction in market price forecast yields roughly \$5 million. BPA would need to under-forecast the true market price forecast by just \$2 per mWh in each year of the five-year period 2006 to 2011 in order for the market price forecast effect to offset the additional \$40 million in Litigation Risk payments. I think if BPA were inclined to underestimate the true market price forecast, a reduction of \$2 per mWh is certainly within the realm of possibility. Therefore, in comparing the case of settlement to no settlement, PacifiCorp residential consumers are more likely better off with the settlement than without.

Differences in the Failed Litigation Settlement and New Settlement with respect to PacifiCorp

Major Elements of Settlement	Failed Litigation Settlement	New Settlement Agreement	Difference
<p>1. PacifiCorp's \$80 million Reduction of Risk Discount Deferral. The full Reduction of Risk Discount Deferral is \$200 million -- PacifiCorp's share is \$80 million and Puget Sound Energy's share is \$120 million.</p>	<p>PacifiCorp agrees to permanently waive the right to receive \$80 million plus interest.</p>	<p>PacifiCorp agrees to waive the right to receive \$40 million plus interest unless its 2001 Subscription Settlement Agreement is found to be void pursuant to a decision by the US Court of Appeals for the Ninth Circuit or any other Federal court. The balance of \$40 million plus interest (3.09%) would be paid to PacifiCorp in 60 equal monthly payments (\$778,289) FY '07 - FY '11.</p>	<p>PacifiCorp receives \$40 million additional dollars in payments from BPA. Additional monies for Oregon are \$26.9 million / Idaho \$11.1 million / Washington \$8.6 million</p>
<p>2. Additional Deferrals of FY '04 - FY '06 Subscription Benefits</p>	<p>PacifiCorp would defer up to \$27.9 million each year for three years (\$83.8 million total) to be repaid to PacifiCorp with interest in 60 equal monthly payment during the period FY '07 - FY '11</p>	<p>No deferrals</p>	<p>Given BPA's ratemaking, PacifiCorp's Residential consumers would have paid roughly 30% of the deferral. Assuming PacifiCorp's deferral equaled \$75 million, the increase in cost to PacifiCorp equals \$25 million. Thus consumers are \$20 million better off than in the global settlement proposal. For Oregon, the figure is \$16.9 million.</p>
<p>3. Residential and small farm customer bill impacts for 2004, 2005 and 2006</p>	<p>PacifiCorp residential and small farm customer bills in Oregon, Washington and Idaho would increase by varying amounts from 5% to 21% depending on the jurisdiction and class of service. The Idaho Irrigation customer bill increase would have been 21%.</p>	<p>No Bill Impacts</p>	<p>Near term rate increases are avoided.</p>
<p>4. Current Litigation -- motions to dismiss or limit issues</p>	<p>Yes -- Litigation would be dismissed.</p>	<p>No -- Litigation will not be dismissed</p>	<p>Benefits are at risk from legal challenges.</p>
<p>5. New Litigation -- Covenant not to sue</p>	<p>Yes -- Parties would agree not to sue.</p>	<p>No -- Parties are free to sue on new issues.</p>	<p>Benefits are at risk from legal challenges.</p>

There is a countervailing point that can be made regarding the merit of the settlement. A disturbing feature is that PacifiCorp's Residential consumers must "pay" for fair performance by BPA under the terms of the existing contract. The independent price forecast could be considered the best-unbiased estimate. The reason this whole approach was developed was to nullify BPA's discretion and threats to arbitrarily reduce the market price forecast from its "true" value. It should be recognized that BPA is a political agency. It may be worthwhile to immunize the Residential benefits from near term adverse political considerations.

Other Discussion

The BPA payments to PacifiCorp do not enrich PacifiCorp shareholders

PGE, PacifiCorp and Idaho Power all pass through to customers, in full, the BPA benefits. Shareholders earn no profits on the pass through. Before the October 1, 2003 SN CRAC increase, the Oregon portion of the benefits was \$63 million for PacifiCorp-Oregon, and \$58 million for PGE.

Consequences of no settlement

If there is no settlement, for the five-year period beginning Oct. 1, 2006, BPA must provide 2,200 average megawatts in annual benefits to the IOUs as a whole. However, BPA has the option to provide the benefits in power or cash, or a mix of the two. Accordingly, utilities do not know how much power they must have available to meet loads. Also, the current contracts provide BPA considerable latitude to establish the level of benefits available to the residential and small-farm consumers of the investor-owned utilities. This is because BPA sets the market price forecast used to determine the per kWh benefit available to IOU consumers.

Rate Impacts assuming the Deferrals of the Reduction of Risk Discount Ends

As noted above, information provided previously by PGE and PacifiCorp estimate rate impacts for the Oregon Residential consumers to be as follows: roughly a 0.6% increase for PGE and roughly a 7% decrease for PacifiCorp. Comments submitted by the Public Power Council et al. provided cost estimates to Oregon in general assuming both PacifiCorp and Puget end the Reduction of Risk Discount deferrals. In the Public Power Council Errata to comments it filed on April 21st, the analysis shows a net cost to Oregon that includes financial impacts to public power agencies. I note that the Oregon Commission does not regulate Puget, ORS 757.663 does not apply to Puget, and there is no contract provision that requires Puget to end the deferrals in the event PacifiCorp takes such an action.

Additional Background

Commission authorization for this proposed contract is required pursuant to ORS 757.663, which reads as follows:

In order to preserve the benefits of federal low-cost power for residential and small-farm consumers of electric utilities, the Public Utility Commission may require an electric company to enter into contracts with the Bonneville Power Administration for the purpose of securing such benefits. The contracts shall be subject to approval by the commission....

In docket UM 926, the Commission investigated the residential and small farm consumers' access to federal system benefits and method of delivery (power or cash). As a result of the UM 926 investigation, the Commission issued Order Nos. 00-678 and 01-427, directing both PGE and PacifiCorp to enter into 10-year power purchase contracts with BPA relating to residential exchange benefits. These contracts provided PGE and PacifiCorp both cash and cost-based federal power. On October 31, 2000, PacifiCorp and PGE executed ten-year subscription settlement agreements with BPA. PacifiCorp and BPA later agreed to convert the power sale portion of the federal system benefits into cash.

PROPOSED COMMISSION MOTION:

I recommend the Commission direct PacifiCorp to exercise its right to terminate deferral of Reduction of Risk Discount payments, so as to begin receiving such payments at the earliest possible date. However, in the event that BPA offers PacifiCorp an agreement substantively equivalent to the form of the Agreement Regarding Payment of Residential Exchange Program Settlement Benefits During Fiscal Years 2007 Through 2011, between the Bonneville Power Administration ("BPA") and PacifiCorp, BPA proposed Contract No. 04PB-11467, as set forth in PacifiCorp's Application, Exhibit A (the "FY 2007-2011 Agreement"), then PacifiCorp is directed to execute such agreement and provide an alternate form of notice of termination of Reduction of Risk Discount payments; such alternate notice would be timed so as to commence the deferred payments as of October 2006.