BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE INVESTIGATION OF INTER- JURISDICTIONAL ISSUES AFFECTING PACIFICORP DBA UTAH POWER & LIGHT CO.	)))))	CASE NO. PAC-E-02-3 DIRECT TESTIMONY OF ANDREA L. KELLY

SEPTEMBER 2003

Q. Please state your name, business address and position with PacifiCorp or "the Company".

A. My name is Andrea L. Kelly. My business address is 825 NE Multnomah Street, Suite 300, Portland, Oregon 97232. I am employed by PacifiCorp as Managing Director, Strategic Projects.

Qualifications

Q. Please summarize your education and business experience.

A. I hold a Bachelor's degree in Economics from the University of Vermont and an MBA in Environmental and Natural Resource Management from the University of Washington. After graduate school, I joined the Staff of the Washington Utilities and Transportation Commission (WUTC) as a Rate Research Specialist. In 1995, I became employed by PacifiCorp as a Senior Pricing Analyst in the Regulation Department and advanced through positions of increasing responsibility. Since 2000, I have been assigned to Major Projects with a focus on resolving the Company's inter-jurisdictional allocation challenges.

Q. Have you appeared as a witness in previous regulatory proceedings?

A. Yes, I have submitted testimony on behalf of PacifiCorp in the states of Oregon and Washington. In addition, I sponsored testimony in various proceedings as a member of the Staff of the WUTC.

Purpose of Testimony

Q. Please identify Exhibit No. 3.

A. Exhibit No. 3 is the PacifiCorp Inter-jurisdictional Cost Allocation Protocol ("Protocol") that the Company is requesting that the Commission ratify in this proceeding. Appendix

A to the Protocol is a list of defined terms. For purposes of greater clarity and consistency, when I capitalize terms in my direct testimony, it is intended that those terms have the same meaning as provided for in Appendix A to the Protocol. Also attached to the Protocol are Appendix B, identifying the allocation factors applied to each component of the revenue requirement calculation, and Appendix C, the algebraic derivation of each allocation factor. Appendix B and C are also included as Exhibits to Mr. Taylor's direct testimony and he is the witness sponsoring these issues.

Q. What is the purpose of your direct testimony?

A. The purpose of my testimony is to describe in general terms the basis and content of the Company's proposed "MSP Solution" as incorporated in the Protocol. The direct testimony of Mr. Duvall and Mr. Taylor provide a detailed explanation of the various elements of the Protocol including computations of the allocation factors and projections of the expected revenue requirement impact of adopting the MSP Solution. My direct testimony does not deal with the proposed allocation of transmission costs and revenues, distribution costs and administrative and general expense because those topics are fully covered by Mr. Taylor's direct testimony.

Background of MSP Solution

Q. How does the MSP Solution correspond to the "Dynamic" and "Hybrid" Proposals that Messrs. MacRitchie and Duvall reference in their direct testimony?

A. The MSP Solution contains elements of both the Dynamic and Hybrid Proposals as well as some new concepts.

Q. How did the Company go about formulating the MSP Solution?

A. There were widely divergent views expressed during the course of the MSP. However, it appeared that all MSP participants shared the belief that the ultimate resolution of MSP issues should be based upon principles of sound public policy and should not be a result of "horse trading" aimed only at achieving an agreeable short-term economic outcome. Therefore, in formulating the MSP Solution, we sought to harmonize, as best as we were able, the principle-based positions taken by the various MSP participants.

Q. Does that mean that MSP participants were unconcerned about customer price impacts?

A. By no means. It seemed to be generally understood and agreed that the MSP should not result in a disproportionate cost shift among States.

Q. What other principles formed the basis for the MSP Solution?

A. It seemed to be generally recognized that a resolution to MSP issues should:

a) promote economic efficiency;

b) be equitable to PacifiCorp's customers and shareholders;

c) allow individual States to pursue policy initiatives without burdening customers in other States;

d) permit continued effective regulatory oversight; and

e) not impede the provision of safe, adequate and reliable service by the Company.

While these principles enjoyed broad support, there is a tension among them. In addition, MSP participants had differing views regarding the appropriate balance of policy considerations.

Q. Please provide an example of this tension.

A. An element of the principle of promoting continued effective regulatory oversight is formulating a proposal that is relatively simple and reasonably understandable to customers. However, formulating a proposal that is responsive to individual State policy preferences inevitably increases complexity. The trick is striking the appropriate balance between these two important policy objectives.

Q. Does the Company believe that the MSP Solution furthers each of the policy principles that you listed previously?

A. Yes.

Q. How does the MSP Solution promote economic efficiency?

A. Under the MSP Solution, the Company will continue to plan and operate its system on an integrated basis with the objective of minimizing total costs to our customers. While under the MSP Solution certain resources are deemed to be assigned or allocated to some States, and not others, for ratemaking purposes, this should not create inappropriate incentives for efficient system planning or operation. Indeed, under prior allocation methods, the Company has been assigning certain resources to only some States for the last 14 years without affecting system planning or operations.

Q. Is the MSP Solution equitable from both a customer and shareholder perspective?

A. Yes. From a customer perspective, we believe that the MSP Solution will cause each State to reasonably support the costs they are imposing on PacifiCorp's system. Mr. Taylor's direct testimony describes the empirical basis for the various allocation factors underlying the Protocol. We are mindful of the concerns of some States that the expected higher load growth in Utah is being subsidized by slower-growing States. However, analyses conducted during the MSP appeared to demonstrate that Load-Based Dynamic

Allocation Factors are effective in shifting costs to faster-growing States. Mr. Duvall and Mr. Taylor's direct testimony describe these analyses. Additionally, the MSP Solution contemplates that the costs of certain Seasonal Resources are allocated in a manner that better reflects that seasonal usage. This ensures that summer peaking states bear a higher proportion of the costs of summer resources and that winter peaking states bear a higher proportion of the costs of winter resources.

From a shareholder perspective, the MSP Solution is equitable because it should afford the Company a reasonable opportunity to recover 100 percent of its prudently incurred costs, without any short-fall arising from inconsistent inter-jurisdictional cost allocation methods.

Q. How does the MSP Solution allow individual States to pursue policy initiatives without burdening customers in other States?

A. The MSP Solution accommodates individual State policy initiatives in a number of respects. For example:

a) it permits a State to adopt a Direct Access Program without shifting costs to other States;

b) it permits each State to invest in the level of Demand-Side Management Programs it deems appropriate;

c) it permits each State to adopt Portfolio Standards without unreasonably shifting costs to other States;

d) it permits States to afford industrial customers discounts which support economic development without shifting costs to other States;

e) it permits States in the Pacific Northwest to invest in the Company's hydro-electric facilities so as to enhance the surrounding environment and fish habitat without shifting costs to other States; and

f) it permits Oregon to "opt-out" of supporting the costs of a future major coal-fired Resource that may give rise to policy concerns.

Mr. Duvall and Mr. Taylor provide additional detail as to how the MSP Solution deals with individual State initiatives in each of the aforementioned areas.

Q. Does the MSP Solution permit continued effective regulatory oversight?

A. Yes. The MSP Solution does not represent a substantial departure from past allocation practices in all of our jurisdictions. It incorporates elements of the "rolled-in" method that has been relied upon in Utah. A form of "Hydro Endowment" has been used by a number of our States for more than a decade. Perhaps most importantly, the MSP Solution is supported by an extraordinary level of analysis which should reduce the likelihood of unintended consequences.

Q. Will the MSP Solution enhance the Company's ability to provide safe, adequate and reliable service?

A. Absolutely. As described in Mr. MacRitchie's testimony, the Protocol will permit the Company to make needed, cost-effective investments in Resources and transmission with a reasonable degree of confidence that it will be able to recover 100 percent of its prudently incurred costs.

Term of Protocol

Q. What is the proposed term of the Protocol?

A. Section II of the Protocol provides that it will apply to all Company rate proceedings initiated subsequent to November 1, 2003. The Protocol does not provide for a termination date.

Q. During the MSP, the Company and other parties expressed a strong interest in achieving a resolution to MSP issues that was "sustainable" through time. Does the MSP Solution accomplish this goal?

A. Yes, although the Company continues to believe that the greatest level of sustainability would be obtained from a structural separation along jurisdictional lines, as proposed in our SRP filing. However, we understand that a number of parties were concerned that a structural separation, while "durable", would commit State regulators to irreparable decisions that they could come to regret.

Mr. MacRitchie acknowledges in his direct testimony that ratification of the Protocol will not bind future Commissions or bar parties from challenging inter-jurisdictional cost allocations in future rate proceedings. This is somewhat unnerving for the Company. The sustainability of the Protocol rests upon an expectation that the same spirit of cooperation and good will among the parties that led to the MSP Solution will sustain it.

Q. Were there lessons to be learned from the prior "PITA" process regarding the sustainability of inter-jurisdictional cost allocation principles?

A. Yes. While the PITA process was valuable and produced nearly a decade of consensus, it ultimately proved ineffective because its participation was limited and because parties lost sight of the importance to the Company and its customers of maintaining a consensus on inter-jurisdictional issues. The MSP has enjoyed much broader participation. The

Protocol commits the Company to continue the process through at least annual meetings to consider changed circumstances and possible Protocol amendments. There is an important distinction between an understanding that is "static" and one that is "sustainable". Continued dialog among the parties and amendments to the Protocol as required, will be critical to its long-term viability.

Allocation of Generation-Related Costs and Revenues

Q. How are generation-related costs and revenues to be allocated under the MSP Solution?

A. This is provided for in Section IV of the Protocol. All generation Resources will be assigned to one of four categories for inter-jurisdictional cost allocation purposes and reflected on a cost-of-service basis. These categories are: a) "Seasonal Resources", b) "Regional Resources", c) "State Resources" and d) "System Resources".

Seasonal Resources

Q. What are "Seasonal Resources"?

A. The Protocol defines "Seasonal Resources" as: (a) a Simple-Cycle Combustion Turbine generating plant owned or leased by the Company, (b) any Seasonal Contract or c) the combination of Cholla Unit IV and the APS Exchange. Mr. Duvall's testimony provides the details of the resources in this category and the rationale for their inclusion.

Q. What is the basis for allocating the costs of Seasonal Resources?

A. The different treatment is intended to gain a measure of precision and assure that costs are allocated equitably. We experience peak loads in Utah during summer months. We experience peak loads in Oregon during winter months. Seasonal Resources are acquired in large measure to meet these peak loads. Therefore, it appears equitable to allocate the costs of Seasonal Resources in a manner that better reflects the seasonal peaking differences of our States.

Q. How are the costs of Seasonal Resources to be allocated?

A. Generally speaking, costs of Seasonal Resources are more heavily assigned to the months in which the Resource dispatches and, by extension, to the States with the greatest proportion of load on the system during those months. Mr. Taylor's direct testimony describes the allocation process in detail.

Regional Resources

Q. What are "Regional Resources"?

A. The Protocol provides for three types of Regional Resources. These are: a) Hydro Endowment, b) Coal Endowment and c) the First Major New Coal Resource. This classification is driven by state or regional energy policy preferences and is for cost allocation purposes only. Costs of Regional Resources are also to be allocated on a dynamic basis, but with an initial assignment to two or more States based on policy preferences.

Hydro Endowment

Q. What are "Hydro-Electric Resources"?

A. These are: a) the Company's owned hydro-electric facilities, b) contracts under which the Company purchases power from the "Mid-Columbia" projects and c) contracts entered into by PacifiCorp to directly amend or replace the Mid-Columbia contracts. Mr. Duvall's testimony provides the details of the resources in this category.

Q. How are the costs of Hydro-Electric Resources to be allocated?

A. Generally speaking, they are initially assigned to the former Pacific Power & Light jurisdictions and then dynamically allocated among these States. Mr. Duvall discusses the form of the Hydro Endowment and Mr. Taylor's direct testimony provides details of the allocation process.

Q. **What is the basis for allocating the costs and benefits of Hydro-Electric Resources in this manner?**

A. The proposed difference in treatment arises from the principles of equity and facilitating individual State policy initiatives. Parties in Oregon and Washington feel very strongly that the benefits of Hydro-Electric Resources should flow to customers in the Northwest through a "Hydro Endowment" because that is where the generation is located and where hydro-electric facilities and the mitigation of their impact on fish have long been critical policy concerns. In addition, several parties feel that the former Pacific Power jurisdictions of Oregon, California, Washington and Wyoming have an entitlement to these historically low-cost resources because these Resources predated the 1989 Pacific Power/Utah Power merger.

Those same parties also acknowledge that the Pacific Northwest States should support all of the costs of these Resources (which is not the current practice). At the current time, many of the Company's Hydro-Electric Resources are in the process of FERC relicensing. As part of this relicensing, FERC is required to consider fish and wildlife, cultural, recreational, land-use and aesthetics issues equally with energy production needs. State and Federal agencies also have the authority to place mandatory conditions in new licenses and certification is required by the State Department of Ecology. Mandatory conditions from the States of Oregon, California and Washington may require investment in fish mitigation measures that exceeds the level with which our other States would be comfortable. Treating Hydro-Resources as Regional Resources permits the Pacific Northwest States to make such policy choices and bear the costs of such choices without risk to our customers in other States.

Coal Endowment

Q. Which Resource is included in the Coal Endowment?

A. The Huntington Generating Station was selected for inclusion in the Coal Endowment.

Q. How are the costs of the Huntington Generating Station to be allocated?

A. They are initially assigned to the former Utah Power & Light jurisdictions and then dynamically allocated among these states. As discussed in Mr. Taylor's direct testimony, this allocation mirrors the allocation of the Hydro-electric Resources under the Hydro Endowment.

Q. What is the basis for allocating the costs and benefits of the Huntington Generating Station in this manner?

A. The same principles that support the basis of the Hydro Endowment – equity and facilitating individual State policy initiatives. The Huntington Generating Station is a low-cost Resource in Utah that pre-dates the 1989 Pacific Power/Utah Power merger. In addition, future investments in Clean Air initiatives will be influenced by state energy policy perspectives. As discussed in Mr. Duvall's testimony, the Coal Endowment proposal is coupled with the Hydro Endowment in a manner that also balances Resource output characteristics.

First Major New Coal Resource

Q. What is "the First Major New Coal Resource"?

A. This is defined in the Protocol as "the first Resource planned to be acquired by PacifiCorp subsequent to January 1, 2004 that: a) provides for more than 300 megawatts of capacity for at least 25 years and b) whose fuel source is principally coal".

Q. Is this necessarily a Company-owned Resource?

A. No. The Company projects a substantial need for base-load capacity in the years ahead which will be met through a combination of Company-owned, rate-based Resources and contracts with third parties. The choice for any particular Resource will depend upon economic opportunities and circumstances prevailing at the time the Resource is committed to. Therefore, the "First Major New Coal Resource" may prove to be either a Company-owned plant or a third-party contract under which the bulk of the power is provided from one or more coal-fired plants.

Q. What is the basis for allocating the costs of the First Major New Coal Resource?

A. This is being proposed consistent with the principles of being responsive to individual State policy initiatives and equity. Policy makers and customer groups in Oregon have expressed concerns about our Oregon customers supporting the costs of a major new coal plant because of its perceived potential environmental consequences. Policy makers and customer representatives in other States have not expressed the same degree of concern regarding the potential environmental costs of a coal-fired plant. A major new coal Resource would represent a major financial commitment for the Company. Unless the philosophical differences are resolved among our States regarding a major new coal Resource, it would be difficult for the Company to make that commitment, with the result that costs could be increased for customers in States who have not expressed philosophical opposition to additional coal-fired generation.

Q. Is Oregon afforded an option of whether it will share in the costs and benefits of the First Major New Coal Resource?

A. Yes. Under the Protocol, Oregon is afforded a one-time irrevocable option to participate or not.

Q. Why is Oregon afforded this option?

A. This is an important decision for Oregon that should not be made on less than a full factual record or based upon the Company's inferences regarding Oregon policy preferences. However, we believe that it is also fair to customers in our other States and to the Company for Oregon to face this decision before the Resource is committed to and before its actual costs are known.

Q. What will be the forum for resolving the issue of whether Oregon will participate?

A. Pursuant to the Protocol, PacifiCorp will initiate a filing pursuant to ORS 757.212, the Oregon generation resource rate plan statute. This statute permits the Oregon Commission to make binding decisions regarding the rate method to be applied to proposed new Resources. We believe that a generation resource rate plan could be adopted pursuant to ORS 757.212 that provides that Oregon customers will support none of the costs and receive none of the benefits of the First Major New Coal Resource. Such a plan could alternately recognize that the First Major New Coal Resource should be treated as a System Resource.

Q. Will Oregon have a similar option for future coal-fired Resources that are proposed subsequent to the acquisition of the First Major New Coal Resource?

A. The Protocol does not provide for any such additional options.

State Resources

Q. What are State Resources?

A. State Resources consist of: a) Demand Side Management Programs and b) Portfolio Standards.

Q. What is the basis for assigning the costs of State Resources?

A. It is based upon the principles of being responsive to individual state policy initiatives and equity. State resources are driven by state-specific policy initiatives and should, therefore, not unfairly burden other States. The Protocol provides for direct or "situs" assignment of certain costs so as to insulate other States from actions taken by one State.

Demand-Side Management Programs

Q. How does the Company propose to allocate the costs and benefits of Demand-Side Management Programs?

A. Costs of these programs will be assigned on a situs basis to the State in which the investment is made. Benefits from these programs, in the form of reduced consumption, will be reflected through time in each state's Load-Based Dynamic Allocation Factors.

Q. Is this consistent with the Company's current practice?

A. Yes. The appropriate allocation of the costs and benefits of Demand-Side Management Programs was a topic at some of the earlier MSP meetings. Parties appeared to be satisfied that this approach permitted individual States to invest in the level of Demand-Side Management Programs that they deemed appropriate without unreasonably shifting costs or benefits to other States with different levels of Demand Side Management Program investment.

Portfolio Standards

Q. What are Portfolio Standards?

A. The Protocol defines "Portfolio Standards" as any "New State law or regulation that requires PacifiCorp to acquire: a) a particular type of Resource, b) a particular quantity of Resources c) Resources in a prescribed manner or d) Resources located in a particular geographic area".

Q. Can you point to any examples of Portfolio Standards?

A. Yes. Utah, California and Washington have considered legislation requiring utilities to purchase minimum quantities of renewable resources.

Q. Does this mean that Portfolio Standards are limited to laws and regulations related to requirements to purchase renewable resources?

A. No. It is entirely conceivable that a State could require the Company to acquire and locally site a non-renewable Resource for economic development purposes.

Q. Are all Resources acquired as result of Portfolio Standards to be deemed "State Resources", with a situs assignment of all of their costs?

A. No. Only the portion (if any) of the costs of such Resources that are disallowed in other States would be assigned on a situs basis.

Q. Why do you say "if any"?

A. There is no reason to assume that Resources acquired pursuant to Portfolio Standards will not be cost-effective and not properly subject to allocation as System Resources. Situs assignment should only occur if a State requires the Company to make an uneconomic investment. We expect this will be the exception rather than the rule.

System Resources

Q. What are "System Resources"?

A. System Resources constitute the substantial majority of PacifiCorp's Resources. The Protocol defines "System Resources" as any Resources that are not "Seasonal Resources", "Regional Resources" or "State Resources".

Q. How are costs and revenues associated with System Resources to be allocated?

A. All costs and revenues associated with System Resources will be allocated on a dynamic basis based upon each State's relative contribution to PacifiCorp's system peak and energy requirements. Mr. Taylor presents the details of this proposal.

Q. What do you mean by your reference to an allocation being done on a "dynamic basis"?

A. I am referring to the practice of basing a State's allocation of costs on its relative contribution to our capacity or energy requirements during the test period for which prices are being established. These allocations are "dynamic" because they change from year to year as the relative size and shape of loads in our various States change through time.

Allocation of Special Contracts

Q. What inter-jurisdictional cost allocation issues arise from Special Contracts?

A. Several of our large industrial customers are able to lower the cost of operating our system by curtailing their use of electricity when requested to do so by the Company. The availability of this curtailment right supports operating reserves, preserves system integrity during times of emergency and may permit us to avoid investing in new Resources that would be required if the industrial load was treated as "firm". An inter-jurisdictional cost allocation issue can arise as to whether the amount paid to the customer (either through a separate contracts or as a discount from tariff prices) represents excessive compensation for the curtailment rights that are provided.

Q. Why should other States be concerned about the Special Contract discount being excessive?

A. 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. Mr. Taylor's testimony addresses this issue in detail as well as the proposed resolution.

Allocation of the Gain or Loss from the Sale of Assets

Q. How does the MSP Solution deal with a sale of Resources and transmission assets that is unrelated to a Direct Access Program?

A. Section IX of the Protocol provides that, for inter-jurisdictional allocation purposes, the gain or loss from such a sale will be allocated among the States on the basis of the allocation factor used to allocate the fixed costs of the asset at the time of its sale.

Q. How will a State's share of the gain or loss from the sale of a Resource or transmission asset be allocated between customers and Company shareholders?

A. The Protocol provides that this will be a matter for individual States to decide in the process of approving the sale.

Industry Restructuring and Direct Access Programs

Q. Please explain some of the issues that Direct Access Programs create for a system of inter-jurisdictional cost allocations.

A. To some extent, the precise nature of the issues depends on the nature of the Industry Restructuring Program that is adopted by a State. It is still unclear what direction the implementation of SB 1149 will take in Oregon and when or if other States will pursue Direct Access Programs of their own. However, the broad issues that need to be generally dealt with among the States in the context of Direct Access are: a) resolving inter-jurisdictional entitlement to and responsibility for the benefits and costs of Resources freed up by customers electing Direct Access and b) the valuation of Freed-Up Resources for purposes of assessing "stranded costs" and "stranded benefits".

Entitlement to Freed-Up Resources

Q. How do issues arise in respect to the inter-jurisdictional entitlement to and responsibility for the benefits and costs of Freed-Up Resources?

A. A key element of the philosophy underlying Direct Access in Oregon (as reflected in the administrative rules implementing SB 1149) is that Direct Access Customers should receive the economic benefit if Freed-Up Resources prove to be less costly than prevailing market prices (a case of "stranded benefits") and that they should bear the cost if Freed-Up Resources prove to be more costly than prevailing market prices (a case of "stranded costs"). For a utility operating in a single state, this policy is fairly straightforward to implement. For a multi-state utility, this policy introduces an asymetrical risk of multiple claims to the Company's low-cost Resources. This policy can also introduce uncertainty and risks for other states. The Company's proposal protects the other states from Direct Access Programs in one state through a "wall-off".

Q. How does the MSP Solution propose to resolve this dilemma?

A. Section X.A of the Protocol provides that the load of Direct Access Customers will continue to be treated as retail load in the State conducting the Direct Access Program for purposes of calculating all Load-Based Dynamic Allocation Factors related to Resource costs.

Section X.B of the Protocol further provides that the sales of Freed-Up Resources will be separately tracked and treated as a "State Resource" assigned on a situs basis to the State conducting the Direct Access Program. Similarly Section X.C of the Protocol provides that any losses or gains on wholesale market purchases made by the Company on behalf of Direct Access Customers will be treated as a State Resource and assigned on a situs basis. Mr. Duvall's direct testimony describes this process in greater detail.

Collectively, these provisions insure that if a State adopts a Direct Access Program, other States will be neither benefited nor burdened by it. The effect of this provision is to contain all stranded costs and all stranded benefits associated with Freed-Up Resources within the State conducting the Direct Access Program. The allocation of those stranded benefits and stranded costs among customer classes then becomes a policy issue to be resolved by the State conducting the Direct Access Program.

Ongoing valuation of Freed-Up Resources

Q. Please describe the inter-jurisdictional issues arising from the valuation of Freed-Up Resources that you referenced earlier in your testimony.

A. Any Direct Access Program has to somehow deal with the calculation of stranded costs and stranded benefits prior to the allocation of those costs or benefits among customer classes. In order to calculate stranded costs and stranded benefits, one needs at least three pieces of information: a) an identification of which of the Company's Resources have been freed-up by Direct Access Customers, b) the embedded costs of the Freed-Up Resources that are identified and c) the market value of the Freed-Up Resources that are identified. For a utility like PacifiCorp serving in multiple jurisdictions, these issues cannot be resolved in a single-State vacuum without the concurrence of the other States.

Q. Why not?

A. Again, my response will reference provisions of administrative rules implementing SB 1149 in Oregon, but I believe the same issues would arise under any State's Direct Access Program.

The Oregon SB 1149 administrative rules contemplate that initially, stranded costs and stranded benefits will be measured through a process referred to as "ongoing valuation". Under this process, it is assumed that Direct Access Customers were previously served from a uniform "slice" of the system resources allocated to Oregon. Thus, the embedded cost of Freed-Up Resources is calculated (taking into account load factor differences) as a proportion of the total generation costs allocated to Oregon. Under the ongoing valuation method, power freed up from direct access is sold into short-term wholesale markets. The revenues from these sales are then compared to the calculated embedded cost of the Freed-Up Resources to determine stranded costs or stranded benefits that are either payable by Direct Access Customers or paid to Direct Access Customers.

Q. Why do other States have an interest in this ongoing valuation process?

A. A number of complex issues are presented from an inter-jurisdictional perspective. First, the ongoing valuation process assumes agreement as to what resources are being allocated to Oregon. Parties in Oregon cannot reasonably claim an entitlement to revenues from Freed-Up Resources if it is not supporting the full costs of those Resources in the first instance. If different States rely upon different inter-jurisdictional allocation methods, there is no means of achieving consensus regarding the embedded costs of Freed-Up Resources in Oregon. Second, traditionally, all States have been allocated an undifferentiated share of PacifiCorp's total revenues from short-term sales. The Oregon ongoing valuation process requires both that some of the Company's short-term sales be separately "color-coded" as being associated with the sale of power from Freed-Up Resources and it requires that revenues associated with such sales be assigned on a situs basis and not allocated to other States.

Q. How does the MSP Solution resolve issues associated with the Oregon ongoing valuation process?

A. It does the following:

a) it provides for an inter-jurisdictional cost allocation system which is accepted by all States, thereby permitting a common understanding of what embedded Resource costs are being borne by Oregon;

b) it provides for separate tracking of short-term sales made from Freed-Up Resources and provides for their situs assignment to Oregon as "State Resources";

c) by relying upon total Oregon delivered load (which includes load being served by energy service suppliers) for the purpose of calculating Load-Based Dynamic

Allocation Factors, Oregon is assured of its ability to recover the same share of revenues from short-term sales that are unrelated to Direct Access that it would receive if it did not have a Direct Access Program; and

d) by relying upon total Oregon distribution load for the purpose of calculating Load-Based Dynamic Allocation Factors, it assures other States that Oregon is supporting the same share of system Resource costs that it would in the absence of a Direct Access Program.

Again, these provisions collectively insure that other States will neither be benefited nor burdened by Oregon's ongoing valuation process.

One-time Valuation of Freed-Up Resources

Q. Earlier, you testified that the SB 1149 administrative rules contemplated that the ongoing valuation process would be used "initially". What subsequent process did the rules contemplate?

A. Many of those involved in drafting the SB 1149 administrative rules believed that the ongoing valuation method was flawed and needed to be replaced by a "one-time" valuation method as soon as practicable.

Q. How was the "one-time" valuation method expected to work?

A. A cornerstone of the one-time valuation method is PacifiCorp's preparation of a "resource plan" which would be subject to Oregon Commission approval. In the resource plan, PacifiCorp would describe all of its Oregon-allocated resources and propose:

a) which of its freed-up Oregon Resources should be dedicated to serving non-Direct Access Customers (residential and small commercial) on a cost-of-service basis; and

b) which freed-up Oregon Resources should be either sold or "administratively-valued" and deregulated.

As the name implies, it was contemplated that the process would result in a one-time, permanent determination of the stranded benefit entitlement or stranded cost obligation of Direct Access Customers.

In respect to Freed-Up Resources dedicated to serving remaining cost-of-service customers, payments of stranded benefits would be made by cost-of-service customers and payments of stranded costs would be credited to cost-of-service customers. In respect to Freed-Up Resources that were to be sold or administratively valued and deregulated, payments of stranded benefits would be effectively made by PacifiCorp shareholders and payments of stranded costs would be effectively paid to PacifiCorp shareholders.

Q. Why do other States have an interest in this one-time valuation process?

A. The issues for other states (as well as PacifiCorp's shareholders) are legion. The one-time valuation process appears to assume that there is a fixed share of Resources assigned to Oregon and that a fixed portion of that share can be deemed to be freed up and valued once and for all. In fact, under the traditional approach to inter-jurisdictional allocations, no State is afforded a fixed share of PacifiCorp's system. Instead, shares of cost responsibility and entitlement to benefits change from year to year based upon each State's relative contribution to system peak and energy requirements.

Because it appears that Oregon's loads are not expected to grow as rapidly as those in other States, Oregon's claim to a fixed share of the Company's resources would be problematic. Selling Freed-Up resources as a means of valuing them can only work if other States approve those sales. Similarly, "deregulating" Freed-Up Resources following an administrative determination of their value only works if other States recognize that the Resources have been "deregulated" and not available to serve their cost-of-service customers.

Q. Is a one-time valuation process likely to occur soon in Oregon?

A. Although a one-time valuation process is still provided for in the SB 1149 administrative rules, it is highly uncertain as to when, if ever, the Oregon Commission will require the Company to file a resource plan and begin the one-time valuation process.

Q. Why is that?

A. A one-time valuation requires that some or all PacifiCorp customers who are eligible for Direct Access irrevocably commit to never again purchase electricity from the Company based upon cost-of-service prices. Because of concerns about a lack of market liquidity and concerns regarding the availability of reasonable transmission access, we have had no customers volunteering to permanently leave the system and the Oregon Commission appears presently unlikely to conscript anyone.

Q. If the Oregon Commission undertook to implement a one-time valuation process, how would it be dealt with under the MSP Solution?

A. The MSP Solution resolves most, but not all, issues that could arise under a one-time valuation. By ratifying the Protocol, we believe that Oregon would be acknowledging that it is not entitled to a fixed share of the Company's resources, without specific concurrence of the other States. By relying upon total Oregon distribution load for the purpose of calculating Load-Based Dynamic Allocation Factors, the Protocol assures Oregon that the costs and benefits of some amount of Freed-Up Resources will be allocated to it. However, this amount will change over time based upon the loads of

Direct Access Customers relative to the loads of PacifiCorp customers in other States. It appears feasible for the Oregon Commission to administrative value a dynamic quantity of Freed-Up Resources and either dedicate those Resources to cost-of-service customers or deem them to be "deregulated". It also appears feasible for the Oregon Commission to approve the long-term fixed-price sale of a dynamic quantity of power from Freed-Up Resources if a buyer could be found for such a proposition. Most problematic is an asset sale as a means of one-time valuation that would have to be approved by the other States.

Q. What does the Protocol provide in respect to such an asset sale?

A. Section X.B of the Protocol provides that the other States would review such a sale on the basis of a "no-harm" standard.

Loss or Increase in Load

Q. Does the Protocol contains provisions related to a material gain or loss of retail load in a State?

A. Yes, this is provided for in Section XI of the Protocol. Under the MSP Solution, if a State experiences a gain or loss of load arising from condemnation or municipalization of Company service territory, sale or acquisition of new service territory (less than 5 percent of system load), realignment of service territories, changes in economic conditions or the gain or loss of large customers, the gain or loss will be reflected as changes in the Load-Based Dynamic Allocation Factors.

Q. Suppose the Company proposes to acquire or merge with another utility that greatly increases its load in a State?

A. The Protocol recognizes that such major transactions will continue to be subject to Commission review and approval pursuant to applicable State law. Allocation issues arising from such transactions will be dealt with on a case-by-case basis as part of the Commission approval process.

Sustainability of Protocol

Q. You have previously mentioned the issue of the "sustainability" of the MSP Solution. Please describe the provisions of the Protocol that are designed to make it sustainable.

A. Sustainability provisions are contained in Section XIII of the Protocol. The first topic dealt with is "issues of interpretation". Inevitably, with the passage of time, unanticipated issues will emerge and new parties will be involved in Company regulatory proceedings who did not have the benefit of participation in the MSP and these proceedings. The Protocol provides that if issues of Protocol interpretation arise, there will be an attempt to resolve them with reference to testimony offered in proceedings associated with the ratification of the Protocol and Commission ratification orders. We wish to have as full a record as possible in these proceedings explaining what is intended by the Protocol provisions. The Protocol further provides for the establishment of an MSP Standing Committee consisting of one member of each Commission. At least once each calendar year, the Company will convene a meeting of the MSP Standing Committee and interested parties for the purpose of discussing emerging inter-jurisdictional issues facing the Company and considering possible amendments to the Protocol that would be equitable to PacifiCorp customers in all States and to the Company. The MSP Standing Committee could also commission studies, appoint subcommittees or take other actions to determine how best to encourage consensus among states.

Q. What will be the process for amending the Protocol?

A. PacifiCorp will submit proposed amendments to Commissions for ratification. The Protocol will be deemed amended if all the Commissions who originally ratified the Protocol ratify the amendment. The Protocol provides that PacifiCorp will not seek Commission ratification of an amendment unless and until it has provided interested parties with at least six months advance notice of its intent to do so and endeavored to obtain consensus regarding the proposed amendment. The Protocol also provides that, prior to departing from the terms of the Protocol, and consistent with their legal obligations, Commissions will endeavor to cause their concerns to be presented at meetings of interested parties from all States in an attempt to achieve a proposed resolution of those concerns.

Conclusion

Q. Does this conclude your direct testimony?

A. Yes it does.