ORDER NO. 96-175

ENTERED JUL 10 1996

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BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UE 94

In the Matter of the Revised Tariff Schedules in Oregon filed by PACIFICORP, dba Pacific Power and Light Company.	)))	ORDER

DISPOSITION: STIPULATION ADOPTED; RATES APPROVED

SUMMARY

In this order, we approve new rate schedules for PacifiCorp, dba Pacific Power and Light Company (Pacific). Under the new schedules, Pacific's base electricity revenues will increase by $26,800,000, or approximately 4.0 percent. The rate spread adopted for the new schedules will result in increases ranging from 1.8 percent for large industrial customers to 6 percent for residential customers. The rate increase is the first overall revenue requirement based increase approved by the Commission for Pacific since 1988.

INTRODUCTION

Procedural Background

On September 1, 1995, Pacific filed Advice No. 95-139, a general tariff revision designed to increase rates to its Oregon retail electric customers, effective October 15, 1995.
It also requested the approval of an alternative form of regulation (AFOR) plan, as authorized under ORS 757.210(2). Pacific stated that the AFOR was designed to place more emphasis on performance than traditional regulation and to act as a transitional step to a more competitive electric power industry. The company proposed that the AFOR become effective with its new tariff schedules and continue for a term of five years.

In its tariff schedules, Pacific stated that the company could justify a $117.6 million, or approximately 17 percent, increase in revenues based on its results of operations testimony. [1] However,

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[1] Pacific's filing included two test periods. The first test period covers the 12-month period ending June 30, 1997, and the second test period covers the 12-month period ending June 30, 1998.

to facilitate the implementation of it AFOR plan, Pacific proposed to limit the overall increase in revenues to $26.8 million, or 4.0 percent.

In Order No. 95-969, we found good and sufficient cause to investigate the reasonableness of the rates and ordered the suspension of Advice No. 95-139 for a six-month period. *See* ORS 757.215. In Order No. 96-096, we subsequently ordered further suspension of the Advice until no later than July 15, 1996.

Prehearing Conference

On October 9, 1995, Michael Grant, an Administrative Law Judge (ALJ) for the Commission, held a Prehearing Conference in this matter to identify parties and interested persons, and to adopt a procedural schedule. A list of the parties to this proceeding is set forth in Appendix A.

Public Comment Hearings

In December 1995, we held public comment hearings in Bend and Medford to allow Pacific ratepayers to comment on the proposed rate increase. We had also scheduled a public comment hearing in Portland in January 1996; however, that hearing was canceled due to inclement weather.

Bifurcation

On March 20, 1996, Pacific, the Commission Staff (Staff), the Citizens' Utility Board (CUB), the Oregon Department of Energy (ODOE), and the Natural Resources Defense Council (NRDC), filed a joint motion to bifurcate the hearing in this matter. The moving parties requested the Commission to defer examination of issues related to Pacific's request for an AFOR plan and decoupling. They requested the bifurcation to allow additional time to review and discuss the various AFOR proposals submitted by the parties. On March 28, 1996, the ALJ granted the motion and bifurcated this proceeding into Phase I, Traditional Cost-of-Service Regulation, and Phase II, AFOR and related issues. Specifically, Phase I addresses revenue requirements under traditional regulation, including rate spread and rate design, and the presentation of testimony on any decoupling proposal applicable to traditional regulation.
Phase II addresses AFOR issues, decoupling, service quality standards, system benefits charges and renewable resource incentives.

PHASE I

Issues

In its settlement document dated December 28, 1995, Staff identified 45 potential issues in what has been designated as Phase I of this proceeding. We will use Staff's numbering system in our discussion of those issues.

Applicable Law

As the petitioner in this rate case, Pacific bears the burden of proof on all issues. ORS 757.210 provides that, in a rate case, "the utility shall bear the burden of showing that the rate or schedule of rates proposed to be established or increased or changed is just and reasonable."

Stipulation

On March 11, 1996, Staff and Pacific submitted a stipulation intended to resolve a majority of the identified issues in the Phase I portion of the proceeding, subject to our approval. The stipulation is attached as Appendix B and incorporated by reference. The stipulation was supported by joint testimony of Ed Busch of Staff and Bruce Hellebuyck and Carole Rockney of Pacific. (Staff-Pacific Ex. 1.) The ALJ admitted the stipulation and supporting testimony into the record as evidence pursuant to OAR 860-14-085(1).

Evidentiary Hearing

On April 9, 1996, ALJ Grant held a Phase I evidentiary hearing in Salem, Oregon. James Fell and Katherine McDowell, attorneys, appeared on behalf of Pacific. Paul Graham, Assistant Attorney General, appeared on behalf of Staff. Grant Tanner, attorney, appeared on behalf of the Oregon Committee of Fair Utility Rates (OCFUR). Jason Eisdorfer, attorney, appeared on behalf of CUB. J. Tim Watson appeared on behalf of himself. Gary Grange, authorized representative, appeared on behalf of the Bonneville Power Administration (BPA).

Based on the record in these proceedings, we make the following:

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Stipulated Issues

The stipulation covers all Phase I issues identified by Staff, except for certain capital structure and cost of capital issues identified in S-0 and S-42. In addition, Staff has withdrawn several proposed adjustments for issues previously identified in S-9, S-20, S-24 and S-25. OCFUR and CUB are not parties to the stipulation, however, and object to portions of the proposed resolution of Issue S-43: Rate Spread. Accordingly, we will treat Issue S-43 as a contested issue and will address it with other issues not covered in the proposed stipulation.

In the stipulation, Staff and Pacific agree that the company should be authorized to implement its $26.8 million rate increase over the first test period revenues, notwithstanding the unstipulated cost of capital and capital structure issues. The parties considered agreement on those issues to be unnecessary, as the stipulated revenue increase would produce acceptable results under either the Staff's or Pacific's proposed cost of common equity and capital structure. The stipulated revenue requirement and Staff's proposed capital structure produces an 8.46 percent overall rate of return. Staff considers that figure to be within the range of reasonable overall rates of return. Pacific is

willing to accept the overall revenue requirement developed through the stipulation, because it supports the company's requested 4 percent increase.

Staff and Pacific recommend that we not make any findings in Phase I of the case regarding cost of common equity or capital structure. Both parties state that these issues will be addressed further in Phase II in connection with the authorized benchmark rate of return and earnings band under an AFOR. The parties also agree that, in future jurisdictional earnings reports, Pacific will incorporate adjustments based on those detailed in the stipulation and calculate earnings using a capital structure consistent with the principles underlying Staff's proposal. Pacific also agrees to use an 8.46 percent overall rate of return for purposes of affiliated interest reports and calculating interest on deferred accounts.

In the stipulation, Staff and the company also agree to the removal of all costs, both fixed and variable, related to the Columbia Hills and Foote Creek wind resource projects from the calculation of Pacific's revenue requirement. The parties further agreed that Pacific may file to incorporate these costs into rates at the time the wind projects are placed into service.

We have reviewed the stipulation with regard to the non-contested issues (Issues S-1 to S-41). For the reasons set forth in the joint supporting testimony, we find the stipulation on those issues reasonable and adopt it. Furthermore, as contemplated by the terms of the stipulation, we will not make any findings in this phase regarding cost of common equity or capital structure. Those issues will be addressed further in Phase II in connection with the authorized benchmark rate of return and earnings band under an AFOR.

Contested Issues

As noted above, we address Issue S-43, Rate Spread, as a contested issue. Furthermore, Watson and the Public Interest parties raised issues not identified by Staff. We will address these contested issues separately.

S-43 Rate Spread

As part of its filing, Pacific submitted a marginal cost study. The study is designed to demonstrate the marginal costs or savings from providing one unit more or less of electric service. The study is similar to those used by the Commission to determine cost causation and to help allocate those costs to customer classes.

The cost study demonstrates that commercial and industrial customers pay a higher rate relative to the cost of providing service than residential customers. For example, the study shows that current residential rates collect only 91.6 percent of average recovery of marginal cost, while large commercial and industrial rates collect over 110 percent of this average. To move customer classes closer to recovering an equal percentage of marginal costs, Staff and Pacific stipulated to a rate spread that assigns a higher percentage rate increase to residential customers than to large industrial and commercial customers. Specifically, the parties propose allocating the overall 4.0 percent base revenue

increase by applying a 6.0 percent (1.5 times) increase to the residential customers, the overall increase of 4.0 percent (1 times) to small general service customers (0-100 kW) and agricultural customers, a 2.0 percent (0.5 times) increase to large general service customers under 1000 kW served under proposed optional Schedule 26/27, and 1.8 percent (0.45 times) to large general service customers over 1000 kW.

CUB and OCFUR are not parties to the stipulation and challenge different aspects of the stipulated rate spread proposal. CUB disputes the methodology used to determine distribution costs in the marginal cost study. OCFUR contends that the proposal should be modified to more quickly eliminate inter-class subsidies. We address each argument separately.

CUB argues that Pacific's use of a "minimum system" approach to allocate the distribution costs in the marginal cost study assigns too many of those costs to residential customers.[2] CUB contends that this approach tends to classify a large share of the cost of the distribution system as customer-related, instead of allocating those costs by the demand consumers place on the system. CUB recommends that a study of various methodologies for estimating joint and customer costs should be conducted and the Commission should consider which one is best to accurately reflect those costs in rate spread decisions.

We have reviewed Pacific's marginal cost study and find that its minimum system approach is acceptable for allocating distribution costs in this proceeding. Pacific and other electric utilities in this state have used that method in the development of marginal costs for many years. Moreover, as we recognized in Portland General Electric's last general rate case, Docket UE 88, Order No. 95-322, a recent study by the National Economic Research Associates found that the minimum system approach was the most frequently used method in the treatment of distribution costs.

OCFUR agrees with Staff and Pacific that interclass subsidies, where they exist, must be reduced. It does not agree, however, with the parties' proposed methodology or time frame for accomplishing that goal. OCFUR recommends that the Commission immediately begin a process to move all customers to cost-based rates. It proposes that large commercial and industrial customers that are paying rates above their cost of service have their rates reduced in five equal annual steps. During this period, OCFUR explains, those customer classes currently being subsidized would have their rates adjusted to absorb the reductions so that the revenue impact on Pacific would be neutral. In the alternative, OCFUR contends that the stipulation should be modified to allocate a greater share of the rate increase to residential customers to quicken the movement to cost-of-service rates.

This Commission has long recognized the need for cost-based ratemaking and has taken steps to reduce differences in class recovery of marginal cost. We have also recognized, however, the importance of protecting residential customers from rate shock as we move to a more

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[2]The minimum system approach divides distribution costs between customer-related and demand-related by determining the cost of building a theoretical distribution system to serve customers at minimum demand levels. The poles, underground conduits, conductors, transformers, service drops and meters of the minimum system are defined as customer-related. Additional costs associated with expanding the minimum-sized system to meet a customer's demand are defined as demand-related.

balanced distribution of the costs of service. To minimize such price impacts and to respond to customers' perceptions of fairness, this Commission has adopted a policy that precludes any customer class from receiving a rate reduction in the face of an overall increase in revenue requirement. We are not convinced that that policy should be abandoned at this time. Indeed, small customers' perceptions of fairness are critical to our ability to move the electric industry toward a more competitive marketplace.

After review, we find the rate spread proposal set forth in the stipulation to be reasonable and, accordingly, adopt it. While it will not eliminate the current rate disparity, it will continue to help achieve a more balanced distribution of the costs of service without subjecting residential customers to rate shock.

Street Lighting

Watson objects to Pacific's proposed $68,000, or 1.9 percent, price increase for public street lighting service. He contends that Pacific has failed to meet its burden of proof to support the rate increase, because: (1) the rates are not supported by a cost of service analysis; (2) the average public street lighting period of dusk-to-dawn occurs during off-peak hours; and (3) on a time-of-use basis, street lighting rates are above marginal costs. For these reasons, Watson argues that we should not authorize any increase of rates for this class of service.

The stipulation between Staff and Pacific adopts the company's proposed price increase for public street lighting, which represents less that 1 percent of Pacific's Oregon revenues and kilowatt-hour usage. Although Pacific did not provide a cost of service study for street lighting customers, the parties believe that the proposed rate increase is independently supported by several factors. First, they contend a comparison to residential and commercial rates demonstrates that street lighting prices are just and reasonable. Energy prices for public street lighting customers are from 6 to 17 percent less than the present tail-block energy price for residential service, and from 9 to 28 percent less than the energy charge for small general service. Because the monthly usage of public street lighting customers is similar to that of residential and small commercial customers, Staff and Pacific contend that these price comparisons suggest that street lighting prices are consistent with prices for comparable service for which full cost of service studies have been performed.

Second, Staff and Pacific contend that street lighting customers find their rates to be reasonable. In Schedules 51 and 52, Pacific offers high pressure sodium street lighting service from a company-owned system where customers pay fixed charges for installation, maintenance, lamp and glassware renewal. In Schedule 53, Pacific offers high pressure sodium street lighting service to customers who choose to own and maintain their own systems. Because more than 75 percent of all high pressure sodium street lighting customers have selected Schedules 51 and 52 and agreed to pay fixed charges for a company-owned system, Staff and Pacific contend that the customers find the charges reasonable in comparison with the option of owning and maintaining their own system.

Finally, Staff and Pacific contend the price increase for public street lighting is reasonable when compared to other price increases proposed in the stipulation. They note that the proposed rate

increase is 1.9 percent, compared to an overall average percentage increase of 4.0 percent. The parties contend that the price change is consistent with the equitable principle of allocating some rate increase to all customer classes in a general rate increase filing. Furthermore, even with the price increase, they add that public street lighting prices on average will be only 5 percent higher that they were in 1987, while inflation has increased over 37 percent since that time.

We agree with Staff and Pacific and conclude that the proposed rate increase for public street lighting, as set forth in the stipulation, should be adopted. While Watson is correct that marginal cost of service studies are generally used to support the assignment of price increases, they are not a prerequisite to a finding of reasonableness. As Pacific notes, the Commission "is not obligated to employ any single formula or combination of formulas to determine what are in each case 'just and reasonable' rates." *Pacific N.W. Bell v. Sabin*, 21 Or App 200, 224 (1975). Rather, it is "the end result of an order of a regulatory authority which determines the question of its validity and not the process by which the authority reached the result." *Valley & Siletz R.R. v. Flagg*, 195 Or 683, 699 (1952). For the reasons cited above, we are convinced that the record, as a whole, supports a finding that the proposed price increase to public street lighting customers is just and reasonable.

UKRB/USBR Allocation

In prefiled testimony, Watson challenged the jurisdictional allocation of contract rates being paid by certain irrigation customers in the Klamath Falls area. These customers, referred to as Upper Klamath River Basin (UKRB) and United States Bureau of Reclamation (USBR) customers, receive discount rates in exchange for water rights for hydroelectric projects on the Klamath River. Watson expressed concern that the entire discount associated with these contracts is being allocated to the Oregon jurisdiction, while only some 55 percent of the direct costs and benefits of the generating projects are allocated to this state.

Pacific responded that all costs, including the Klamath River generating resources, are allocated in accordance with the PacifiCorp Interjurisdictional Task-Force on Allocations (PITA) Accord Method. Because the PITA Accord Method was developed jointly by PacifiCorp's seven state commissions and represents a balancing of the interests of all jurisdictions, Pacific contended that it would be inappropriate to unilaterally change one item in isolation from all others.

At hearing, Watson, Pacific, and Staff agreed to further address the allocation issues related to the UKRB/USBR contract rates in Phase II portion of this proceeding, relative to the AFOR workshops. Accordingly, we will not further consider this issue at this time and, pursuant to the parties' agreement, defer resolution of the matter until Phase II.

Decoupling and System Benefits Charge

The CUB, NRDC, NCAC and ODOE (Public Interest Parties) request that we adopt a decoupling mechanism and establish a system benefits charge in this Phase I order. They contend that an immediate decision on these issues is necessary to help assure a successful transition from traditional cost-of-service regulation. They recommend that we make a statement that business as usual is not an

option and that decoupling will be incorporated in any cost-of-service structure that is not supplanted by an AFOR.

Staff and Pacific disagree with the Public Interest Parties' recommendation and, instead, request that we defer making any decision on decoupling and a system benefits charge until Phase II. They contend that these issues should be considered in conjunction with other issues related to alternative regulatory schemes, as contemplated by the joint motion to bifurcate this proceeding into two phases. They note that CUB, NRDC, and ODOE joined in that motion, which stated, in part:

> A separate schedule would be established for AFOR issues. Among other things, [Phase II] would include consideration of proposals regarding *decoupling, system benefits charges*, renewable resource incentives and service quality standards. (Emphasis added.)

After review, we agree with Staff and Pacific and will not consider proposals regarding decoupling and system benefits charges at this time. With regard to decoupling, we conclude that it would be confusing and unnecessary to adopt a cost-of-service decoupling mechanism for the implementation of Phase I tariffs. As Staff and Pacific note, if an AFOR is subsequently adopted in Phase II, a decoupling mechanism proposed under an alternative regulatory scheme may be different than that proposed for traditional ratemaking. Such differences could lead to customer confusion and problems in moving from one mechanism to another. Similar problems might arise if we adopt a system benefits charge at this time.

Furthermore, both issues are closely tied to AFOR proposals submitted by the parties. For example, the Public Interest Parties propose an alternative "functional decoupling" mechanism that would separate revenues into generation, transmission, and distribution components. We do not believe that proposals for a decoupling mechanism and a system benefits charge should be addressed in isolation from other issues associated with alternative regulatory mechanisms.

Finally, we note that there is no prejudice caused by the deferring of such discussions until Phase II. Pacific has agreed that, if we do not approve or the company does not accept an AFOR, any final order on decoupling under traditional regulation will be applicable as of the effective date of Pacific's Phase I tariff schedules. Moreover, until Phase II is concluded, Pacific's demand-side management (DSM) cost recovery mechanism will function as a limited system benefits charge for specific DSM costs and incentives.

Functionalized Billing

The Public Interest Parties further request that we adopt a functionalized billing requirement for Pacific in this Phase I order. The Public Interest Parties contend that customers are entitled to full disclosure in their electric bills and recommend that Pacific specify major cost elements of electric service, including what percentages of rates are dedicated to sustainable sources of generation. Pacific opposes this request and recommends that we defer making any decision on this issue until Phase II.

After review, we conclude that the functionalized billing proposal should be addressed in Phase II. As Pacific notes, the Public Interest Parties' billing recommendation is but one part of their system benefits charge proposal. We have already decided to defer resolution of that issue until Phase II. We find no compelling reason to address the billing component of that proposal separately from the other recommendations.

Service Quality Standards

In Order No. 96-074, we approved a stipulation between Staff and Pacific resolving safety compliance issues that had arisen in the company's Corvallis service area. Among other things, the stipulation imposed additional safety standards to ensure future compliance with National Electric Safety Code standards. In that stipulation, the parties agreed that the additional safety standards would remain in effect until this Commission issues a final order in this rate proceeding.

Staff and Pacific have proposed more permanent safety standards as part of their respective AFOR proposals. Each party has, in addition, proposed the adoption of certain service quality and reliability standards if an AFOR is implemented. Both parties request, however, that we defer making any decision on these issues until Phase II. As part of that request, Pacific has agreed to extend the effective date of the Corvallis stipulation on major safety violations through the Phase II proceedings, but not later than December 31, 1996.

After review, we agree to defer consideration of service quality standards until the order in Phase II of this proceeding.

CONCLUSIONS

1. PacifiCorp, dba Pacific Power and Light Company, is a public utility subject to the Commission's jurisdiction.

2. The Commission should adopt the stipulation attached as Appendix B.

3. Based on the record in this case, Pacific's rates that result from the stipulation and the Commission's conclusions in the body of the Order are just and reasonable.

ORDER

IT IS ORDERED that:

1. The tariffs filed on September 1, 1995, under Advice 95-139 are permanently suspended.

2. The stipulation attached as Appendix B is adopted in its entirety.

3. PacifiCorp, dba Pacific Power and Light Company, may file revised tariffs consistent with the stipulation and the findings of facts and conclusions in this Order to be effective July 15, 1996.

Made, entered, and effective ________________________.

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Roger Hamilton
Chairman

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Ron Eachus
Commissioner

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Joan H. Smith
Commissioner

A party may request rehearing or reconsideration of this order pursuant to ORS 756.561. A request for rehearing or reconsideration must be filed with the Commission within 60 days of the date of service of this order. The request must comply with the requirements of OAR 860-014-0095. A copy of any such request must also be served on each party to the proceeding as provided by OAR 860-013-0070. A party may appeal this order to a court pursuant to ORS 756.580.