

In the Matter of a Proceeding to Establish )  
An Allocation Methodology to Separate )  
PACIFICORP's Assets, Expenses and )  
Revenues Between Various States )

DOCKET NO. 97-035-04

REPORT AND ORDER

ISSUED: July 7, 1998

**SHORT TITLE**

**Determination of the Value of the Fairness Adjustment**

**SYNOPSIS**

The Commission herein orders a merger fairness adjustment of \$43.2 million for 1996. This amount increases jurisdictional revenue requirement as determined by the Rolled-In allocation method. It will decrease by one-fifth annually thereafter, to \$34.56 million for 1997, \$25.92 million for 1998, \$17.28 million for 1999, and \$8.64 million for 2000, reaching zero on January 1, 2001.

**TABLE OF CONTENTS**

I. PROCEDURAL HISTORY 1

II. BACKGROUND 1

III. POSITIONS OF PARTIES 2

A. PACIFICORP 2

B. THE DIVISION OF PUBLIC UTILITIES 3

C. THE COMMITTEE OF CONSUMER SERVICES 4

IV. DISCUSSION, FINDINGS AND CONCLUSIONS 5

A. REJECTION OF PARTY POSITIONS 6

1. Position of the Committee 6

2. Position of the Company and the Division 8

B. MIDPOINT OF THE LOWER AND UPPER FAIRNESS ADJUSTMENT BOUNDS

10

V. ORDER 11

## APPEARANCES

Edward A. Hunter and John M. Eriksson of Stoel Rives	For	Pacificorp
Raymond W. Gee of Kirton & McConkie	"	Utah Farm Bureau
Michael L. Ginsberg Assistant Attorney General	"	Division of Public Utilities
Kent Walgren Assistant Attorney General	"	Committee of Consumer Services
Gary A. Dodge of Kimball, Parr, Waddops, Brown & Gee Deregulation Group	"	Energy Strategies, Inc., and Utah Electric

## I. PROCEDURAL HISTORY

On March 26, 1997, the Division of Public Utilities (Division) filed a request for a formal proceeding "to establish a procedure to allocate assets, revenues and expenses between Utah and other PacifiCorp jurisdictions." The Commission established this Docket to consider the request, giving notice of Commencement of Agency Action on April 3, 1997. Hearings were held December 9 - 12, 1997, and post-hearing briefs were filed January 16, 1998. A Report and Order was issued April 16, 1998. This Order scheduled additional hearings to consider unresolved issues. At a conference held April 30, 1998, the Division, the Committee of Consumer Services (Committee), PacifiCorp (Company), and the Utah Farm Bureau Federation entered appearances. The Commission issued a Scheduling Order on May 14, 1998, setting May 19, 1998, as the hearing date. Also appearing at the hearing were Energy Strategies, Inc., and Utah Electric Deregulation Group.

## II. BACKGROUND

Our April 16, 1998 Report and Order in this Docket reaffirmed and extended the Utah regulatory treatment of merger fairness adopted in general rate case Docket No. 90-035-06. Merger fairness is a unique concept owing to the 1989 merger of Pacific Power and Light and Utah Power and Light Companies. Because the two merging companies had unlike cost structures, the merger itself might have caused immediate, unfair rate increases in some states and decreases in others. Since 1989, a multistate effort has prevented this from occurring. In Docket No. 90-035-06, the first general rate case held in Utah for the merged company, the Commission decided that the ratemaking treatment of merger fairness required approximately a \$72 million addition to Utah's allocated share of single-system, rolled-in revenue requirement. This addition is termed a "merger fairness adjustment" or a "fairness transfer."

In reaching this decision, the Commission rejected an allocation method called "Consensus" proposed by the Company and the Division, but accepted its results. Instead of the stand-alone analysis and benefit sharing that were important aspects of the Consensus method, the Commission decided that the Rolled-In method should be used. By comparing the results obtained from both the Consensus and the Rolled-In methods, the 1990 estimate of the merger fairness

adjustment was derived. This amount, \$72 million, is the maximum divergence from Rolled-In revenue requirement permitted by the Order, which also required that it be phased out over a period of years. Although no date ending the period was specified, the Commission did establish a 10-year minimum as a goal, and suggested a longer time could be employed if shown to be appropriate by subsequent analysis. The April 16, 1998 Order in the present Docket now ends the period on January 1, 2001.

On that date, the fairness adjustment ceases. Thereafter, rates will be based on single-system, fully rolled-in revenue requirement and will reflect no further concern with merger fairness. The April 16, 1998 Order did not, however, determine how the magnitude of the fairness transfer would be determined for ratemaking purposes, but set a hearing for that purpose. Based on the record developed in the hearing, we determine the magnitude of the fairness transfer to be used in pending general rate case Docket No. 97-035-01.

### **III. POSITIONS OF PARTIES**

The Company, the Division and the Committee present testimony. Their estimates for the amount of the 1996 (the year designated for this exercise) fairness adjustment range from \$28.8 million to \$55.1 million. The lower estimate is sponsored by the Committee. In the April 16, 1998 Report and Order establishing this hearing, we asked parties to evaluate a straight-line reduction over ten years of the 1990 value of the fairness adjustment as a phase-out option consistent with the December 7, 1990 Report and Order in Docket No. 90-035-06. This is the proposal of the Committee; it reflects a 10-year, straight-line reduction of 1990's \$72 million. Both the Company and the Division oppose a straight-line reduction. The Company's estimate, based on the difference in revenue requirement when determined using the fully Rolled-In and the Accord Methods, is \$55.1 million. The Division files a somewhat lower estimate, \$51.8 million, determined by the same approach the Company recommends.

#### **A. PACIFICORP**

The Company advocates use of the Accord Method<sup>(1)</sup> to calculate the fairness adjustment. Its reasons are: (1) the Accord Method has been used since 1993 for reporting purposes, analysis of returns, and revenue requirement calculations; (2) the Division and the Committee have used it to evaluate earnings; (3) it is used for rate cases and reporting in other jurisdictions; and (4) it recently has been used to analyze electric industry restructuring. Based on the difference between the Accord and Rolled-In Methods and using the Division's proposed test-year adjustments, the Company derives a 1996 fairness adjustment of \$55.1 million. For the five-year phase-out beginning with 1996, as ordered earlier in this proceeding, four-fifths of the \$55.1 million, or \$44 million, would be added to rolled-in revenue requirement in 1997; three-fifths, \$33 million, in 1998; two-fifths, \$22 million, in 1999; one-fifth, \$11 million, in 2000; no adjustment would be made after January 1, 2001.

The Company opposes a 10-year, straight-line phase-out of 1990's \$72 million because (1) just as the Consensus Method, an interstate agreement, was reasonable to derive the \$72 million in 1990, so too is the Accord Method reasonable for use today, since it is now used by the Division, the Committee, and other states; (2) the phase-out period was not resolved in Docket No. 90-035-06, so the Company has had no reason to suppose a straight-line phase-out of the \$72 million has been in effect in the intervening years; (3) to require a straight-line reduction now would deprive the Company an opportunity to recover the costs to provide service; and (4) the 1990 value of the fairness adjustment of \$72 million may not be accurate.

#### **B. THE DIVISION OF PUBLIC UTILITIES**

The Division also advocates use of the Accord Method to calculate the fairness adjustment. It cites: (1) all states, including the Division, signed the 1993 PITA agreement to use Accord; (2) the Company uses the Accord Method for its semi-annual filings in Utah; (3) the Division audit reports are based on Company filings which use the Accord Method; and (4) like the 1990 calculation of the fairness adjustment, the 1996 calculation would be based on the difference between allocation methods. Based on the difference between the Accord and Rolled-In Methods and using its proposed test year adjustments, the Division derives a 1996 fairness adjustment of \$51.8 million. The Division

recommends that the Commission accept \$51.8 million as the maximum of the fairness adjustment for 1996 or calculate the fairness adjustment for 1996 as the difference between the Accord and Rolled-In Methods, using all final Commission-approved test-year adjustments in Docket No. 97-035-01. Thereafter, as prescribed by our April 16, 1998 Order in this proceeding, the 1996 fairness adjustment would be phased-out in equal one-fifth increments by January 1, 2001.

The difference between the Division's \$51.8 million and the Company's \$55.1 million is due to a correction made by the Company to the Division's results. Since the same test-year adjustments can have differing jurisdictional impacts under different allocation methods, the Company correction identifies the interest expenses associated with the Division's proposed test-year adjustments for the purpose of calculating jurisdictional income taxes under the Rolled-In Method. The Division has not yet analyzed this and takes no position on it at this time. As an interest synchronization adjustment, it will, if necessary, be resolved in the pending rate case. Otherwise, the test-year adjustments to actual 1996 results used by the Company and the Division to calculate the fairness adjustment are the same; both employ those proposed by the Division.

The Division does not support a 10-year, straight-line reduction of the \$72 million fairness adjustment approved in Docket No. 90-035-06 principally because the Division is a signatory party to the 1993 PITA agreement to use the Accord Method and did not withdraw its support for this Method until May, 1996. The Division testifies that its recommendation is based on the history of its involvement with PITA rather than an interpretation of the Commission's 1990 rate case Order.

### **C. THE COMMITTEE OF CONSUMER SERVICES**

In the earlier phase of this proceeding addressed in the April 16, 1998 Order, the Committee recommended immediate adoption of the Rolled-In Method and termination of the fairness adjustment. Based on its reading of the Commission's April 16, 1998 Order in the present Docket and those of the 1990 rate case, the Committee now recommends a 1996 fairness adjustment of \$28.8 million, calculated from the ten-year, straight-line phase-out of the \$72 million 1990 fairness adjustment. The Committee believes its proposal is conservative because, in its opinion, the \$72 million fairness adjustment has been embedded in Utah jurisdictional rates since the Company's last general rate case, Docket No. 90-035-06. It therefore describes \$28.8 million as a large amount to remain in rates, given what it believes Utah customers have already paid in rates for merger fairness. The Committee argues its proposal adheres to the goals established in prior Commission orders.

## **IV. DISCUSSION, FINDINGS AND CONCLUSIONS**

The Commission established the fairness adjustment amount of \$72 million and the bounds for phasing it out in Docket No. 90-035-06. In the Phase I Report and Order issued December 7, 1990, the Commission set a goal to reach single-system, rolled-in revenue requirement in ten years, subject to a caveat that the merger fairness objective might require a fairness adjustment for a longer period if subsequent analysis revealed it to be necessary. As an expression of this caveat, the 1990 Report and Order mentions that meeting the fairness objective may continue to require some modification of the Rolled-In Method, perhaps as accomplished by direct assignment to divisions of pre-merger plant and contracts, for a period no longer than plant depreciation schedules and contract renewals and terminations. Evidence suggested this would be about 30 years. The phase-out period therefore could be as short as 10 and as long as 30 years. Our April 16, 1998 Report and Order in the present Docket has fixed the period at 11 years, 1990 through 2000.

Because the 10-year and the 30-year periods have a validity independent of party testimony in the present Docket, they can be used as the upper and lower bounds of the 1996 fairness adjustment. The 1996 dollar amount of the lower, 10-year bound is \$28.8 million; of the upper, 30-year bound, \$57.6 million.<sup>(2)</sup> We note that these amounts are not dependent on allocation methods. Instead, they rely on the \$72 million initial value of the fairness adjustment determined in the April 10, 1992 Report and Order in Docket No. 90-035-06, and a straight-line phase-out of the initial value over a period specified either as a goal or a caveat in the December 7, 1990 Report and Order.

Party positions are either on or within these bounds. Testimony places the Committee at the lower bound. The Company and the Division advocate an amount near the upper bound, while the Division's alternative proposal depends for actual value upon a comparison in Docket No. 97-035-01 of two fully adjusted allocation methods.

## **A. REJECTION OF PARTY POSITIONS**

In scheduling and technical conferences prior to these hearings, we asked the parties to analyze any method that might be a candidate for fixing the amount of the 1996 fairness adjustment. The April 16, 1998 Report and Order again noted our interest in an assessment of the straight-line phase out over 10 years of the \$72 million. Because the Committee recommends the 10-year phase out of \$72 million, we examine its proposal first.

### **1. Position of the Committee**

The Committee testifies that the 10-year phase out of \$72 million is a reasonable reading of the Commission's intent in Docket No. 90-035-06. Moreover, the Committee argues that \$72 million has been embedded in jurisdictional rates and has not been reduced since that rate case. Though the Committee concludes Utah ratepayers have already paid enough to meet the objective of merger fairness, it responds to the final phase-out decision of the April 16, 1998 Report and Order by recommending the lower bound amount of \$28.8 million for 1996. We note that the record is devoid of evidence from which we might draw a conclusion about the Committee's belief that the fairness objective may already have been met without any further fairness transfer payments.

We agree that the straight-line phase out of \$72 million over 10 years is a reasonable interpretation of the 1990 Report and Order. We consider the objections to it raised by the Division and the Company.

The Division chose to negotiate merger fairness considerations within PITA. It appears the Division, acting with the independent statutory authority it possesses, chose to support PITA outcomes, as long as these outcomes were within the bounds we herein have described. Such outcomes, the Division apparently believed, would comply with the 1990 Order. Moreover, the record shows that the Division dropped its support for the Accord Method in May, 1996, when it learned that projected results of this Method in years to come progressed insufficiently toward our goal of single system, fully rolled-in pricing; that is, projected results were outside the upper bound. While this is not an unreasonable approach for the Division to take, it has had the effect of eliminating from active use the straight-line, 10-year phase-out of the \$72 million fairness adjustment. This was not the Commission's intention in the 1990 Report and Order. For this reason, we give little weight to the Division's argument that it cannot support a straight-line, 10-year phase out because it was a party to the 1993 PITA agreement to use the Accord Method.

We turn to the Company's arguments why we should not employ the 10-year, straight-line phase out to determine the 1996 fairness adjustment amount. First, the Company recommends the Accord Method and Rolled-In Method comparison because this is how it was done in Docket No. 90-035-06 when the Consensus Method was used. The Company, however, fails to consider that our reason in the 1990 Docket for using that approach no longer exists. Then, recognizing the different cost structures of the pre-merger companies and in the absence of any operating history as a merged entity, a multi-jurisdictional agreement supported the Consensus Method; indeed, the very name, "Consensus," reflects this. By contrast, we now have almost 10 years of operating history and no such consensus exists. Therefore, we reject the Company's first argument.

Second, the Company argues it had no reason to suppose that a 10-year, straight-line phase out was in effect since the 1990 Order did not determine the phase-out period. The Accord Method has been used in this jurisdiction since 1993 for reporting purposes and in other jurisdictions for both reporting and rate-case purposes. This bears importantly on our decision. The Commission based all of its regulatory analysis and decision-making on information using the Accord Method. During that time period, the results appeared to be within the bounds established by the 1990 Order. Except as the basis for the lower bound value of \$28.8 million, we therefore do not accept the Committee's recommendation to use the 10-year, straight-line reduction.

We need not examine the Company's third argument, which raises a retroactive ratemaking claim should we adopt, as we do not, the 10-year, straight-line phase out of \$72 million. Its fourth argument claims that the \$72 million 1990

amount may be in error. As the Committee notes, this Docket No. 90-035-06 decision was not challenged and the time for doing so has long since passed. The Company could have sought reconsideration or clarification of the orders in that Docket but did not. Its objection now can have no significant bearing on decisions in the present Docket.

## **2. Position of the Company and the Division**

The Company - Division recommendation is to determine the amount of the 1996 fairness adjustment by comparing the results of two allocation methods, Accord and Rolled-In. In support, the Company testifies that Accord has been in use here since 1993 for operations reporting, has been used since then by the Division and the Committee to evaluate Company earnings, has been used for reporting and rate cases in other jurisdictions, and most recently has been the basis for analyses of electric industry restructuring. The Division supports the Accord approach because of the history of its involvement with PITA, where, in 1993, the Division signed an agreement to employ this Method for regulatory purposes in Utah.

In addition to these arguments, there are other influential factors on the record. First, the Accord Method may not satisfy guidelines provided by the Commission in its Phase I Report and Order issued December 7, 1990, in Docket No. 90-035-06.<sup>(3)</sup> Based on its analysis of merger benefits relative to stand-alone operations,<sup>(4)</sup> PITA decided that the movement toward Rolled-In revenue requirement was proceeding too quickly. In other words, the Consensus Method was shifting, in PITA's opinion, an unfair share of merger benefits to the jurisdictions of the former Utah Power and Light Company. It therefore adopted the Accord Method. The record shows that continued use of the Accord Method diverges further from Rolled-In results than did the Consensus Method and delays progress toward Rolled-In results. Second, and relatedly, we are troubled by the history of PITA deliberations about the effects of the Accord Method in our jurisdiction. In this proceeding, evidence was introduced that the Company employs a tool, called the "Prototype Model" to forecast the jurisdictional effects of alternative methods over time. The Model shows that Accord produces a Utah jurisdictional fairness adjustment in years subsequent to 1993 that is outside the upper bound we established in 1990 and remains relatively constant through time at about \$60 million. Neither the Company nor the Division brought PITA's adoption of Accord or its effect on movement to Rolled-In results to our attention, even though they may conflict with the rebuttable presumptions stated in the December 7, 1990 Report and Order. (See footnote 3.) The Division, however, did drop its support for the Method at a May, 1996 PITA meeting.

Third, because we have determined that the fairness adjustment is a non-cost-based transfer that must be explicit, we do not favor any method, like Accord, which treats fairness implicitly as one or more ad hoc, internal adjustments. The magnitude of the fairness adjustment using the Company - Division approach is based on the Division's adjustments to a 1996 test period rather than the 1997 test period of Docket No. 97-035-01, the pending rate case. The 1996 adjustments will not be examined in that Docket. Under the Division's alternative approach, the magnitude of the fairness adjustment cannot be known until after the two allocation methods incorporate the regulatory adjustments that are approved in the pending rate case. This process of preparing two different allocation methods, with approved adjustments, is controversial and cumbersome. Compared to an alternative approach to estimating the fairness adjustment that does not depend on the Accord Method, it ties up scarce regulatory resources to little apparent benefit. Some regulatory adjustments, the record shows, will affect the Rolled-In and Accord methods differently, so we have no reason to believe that the results of comparing them have been or will be stable, year to year.

Cost-of-service analyses involve many controversial decisions about functionalizing, classifying, and allocating the test-year amounts in the Uniform System of Accounts to jurisdictions. We try to assure that these decisions are correct. This can only occur when our investigative staff prepares the proper analysis and the whole subject is adequately examined in evidentiary hearings. The Division's involvement with PITA, until recently, had instead shifted its focus to informal, negotiated multi-state outcomes in which ad hoc adjustments, advanced as necessary to produce fair interjurisdictional outcomes, were instead debated.

We further note that PacifiCorp is in the midst of an economic change, with implications for the institution of regulation, known as electric industry restructuring. Its outcomes are at present uncertain. As well, PacifiCorp exhibits a growing and now heavy orientation toward wholesale market operations. These matters are new; they were not a consideration when the two-method approach was used in the 1990 Docket. Our concern is that they have implications, unexamined on the present record, for interjurisdictional allocation decisions and indirectly for the magnitude of the fairness adjustment. This is contrary to the Commission's 1990 rate case decisions which set a fairness transfer amount

and ordered that it be eliminated over a period of time.

The facts advanced by PacifiCorp and the Division concerning the Accord Method's use here and in other jurisdictions since 1993 do carry some weight, but we are persuaded by these other matters which argue against its further use. The fairness adjustment is a non-cost-based transfer. We have decided that it must be explicit, rather than implicit in ad hoc allocation method adjustments. We find it should be determined independently of allocation method debates. For these reasons, we conclude that the 1996 fairness adjustment should not be based on the compared results of the Accord and the Rolled-In Methods. We reject the Company - Division proposal.

## **B. MIDPOINT OF THE LOWER AND UPPER FAIRNESS ADJUSTMENT BOUNDS**

We have reviewed the arguments for and against the parties' positions and have rejected their recommendations. We have reaffirmed the phase-out bounds set in the December 7, 1990 Report and Order in Docket No. 90-035-06, and have decided to employ them here. Thus, a ten-year straight-line phase out of the \$72 million 1990 fairness adjustment yields a 1996 amount of \$28.8 million. In like manner, the 30-year phase-out path yields \$57.6 million for 1996. Because these paths have a validity independent of party recommendations in the present Docket, they can be used to determine a reasonable amount for the 1996 fairness adjustment.

Our consideration of party testimony and argument convinces us that, for this limited purpose, the two bounds are equally plausible but neither by itself is appropriate. Each is an extreme position. Therefore, we conclude it is reasonable to accept the midpoint between them. This amount, which we further conclude should be the 1996 fairness adjustment, is \$43.2 million. As we ruled in our April 16, 1998 Report and Order in the present Docket, it will be phased out by January 1, 2001 through annual one-fifth reductions. Proper ratemaking treatment of the \$43.2 million will be decided in pending general rate case Docket No. 97-035-01. The test year in that Docket is 1997; therefore, four-fifths of the 1996 amount, or \$34.56 million, will be the fairness adjustment for the test year.

## **V. ORDER**

1. For reporting and ratemaking purposes, the Company shall use the Rolled-In Method to determine jurisdictional revenue requirement and shall add to it a lump-sum transfer of \$34.56 million as the 1997 merger fairness adjustment. Thereafter, the amounts shall be \$25.92 million for 1998, \$17.28 million for 1999, and \$8.64 million for 2000. Beginning January 1, 2001, no further merger fairness adjustment shall be made to jurisdictional revenue requirement.
2. The ratemaking treatment of the test-year fairness adjustment shall be considered in both the revenue requirement and rate design phases of Docket No. 97-035-01.

DATED at Salt Lake City, Utah, this 7th day of July, 1998.

/s/ Stephen F. Mecham, Chairman

(SEAL) /s/ Constance B. White, Commissioner

/s/ Clark D. Jones, Commissioner

Attest:

/s/ Julie Orchard

1. The Accord Method has been used since 1993 for regulatory reports on the Company's operations. This Method was adopted by the multi-state task force, PacifiCorp Interjurisdictional Taskforce on Allocations (PITA), in that year. See Report and Order issued April 16, 1998, in this Docket for discussion. We have not formally approved the Accord Method.
2. The lower bound is  $F_L(t) = 72 - (72/10) * (t - 1990)$  yielding  $F(1996) = \$28.8$  million, satisfying the goal stated in the December 7, 1990 Report and Order in Docket No. 90-035-06; the upper bound is  $F_U(t) = 72 - (72/30) * (t - 1990)$  yielding  $F(1996) = \$57.6$  million, satisfying the caveat stated in the same Report and Order.
3. The Phase I Report and Order lists "rebuttable presumptions" to guide consideration of allocation methods: (a) a fully rolled-in allocation method will be the standard of comparison by which alternative allocation methods will be judged; (b) future allocation methods will not diverge further from rolled-in cost of service than does the Consensus method; (c) future allocation methods must promote progress toward the fully rolled-in standard; (d) with the caveat noted herein [the possible use of plant depreciation schedules to determine the fairness adjustment period], ten years is a reasonable goal for the achievement of interjurisdictional allocations performed on a rolled-in, single system cost-of-service basis; (e) the opportunity to lower future system cost-of-service occasioned by the APS contracts will be weighed against the endowments assigned to divisions; (f) in the absence of a complete, original and independent least-cost plan of Utah Power & Light as a stand-alone company, it is unreasonable to assume that it would have had a higher future resource cost than the Pacific Power & Light stand-alone company; (g) future allocation methods should attempt to use system rather than divisional allocation factors for all production and transmission operations and maintenance; and (h) all post-merger costs and non-retail revenues should be allocated system-wide.
4. For discussion of the concept of merger benefits and its dependence on stand-alone analysis, see the April 16, 1998 Report and Order in this Docket.