

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND)	
TRANSPORTATION COMMISSION,)	
)	
Complainant,)	
)	
v.)	Docket No. UE-100749
)	
PACIFICORP d/b/a PACIFIC POWER &)	
LIGHT COMPANY,)	
)	
Respondent.)	

POST-HEARING BRIEF
ON BEHALF OF
THE INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES

February 11, 2011

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I. INTRODUCTION

1 Pursuant to WAC § 480-07-390 and the Second Prehearing Conference Order, the Industrial Customers of Northwest Utilities (“ICNU”) hereby submits this post-hearing brief requesting that the Washington Utilities and Transportation Commission (“WUTC” or the “Commission”) significantly reduce PacifiCorp’s proposed rate increase as described below. PacifiCorp is proposing an almost \$48 million or about 20% rate increase for residential and industrial customers^{1/} during the worst economic recession that its service territory in Washington has experienced since the Great Depression. Instead of cutting and holding down its costs to protect its customers during these difficult economic times, PacifiCorp is continuing its relentless pursuit of larger and larger annual rate increases by proposing the largest rate increase in the history of the Company’s Washington operations.

II. BACKGROUND

2 PacifiCorp has pushed for rate increases as rapidly as possible following its acquisition by Mid-American Energy Holdings Company (“MEHC”).^{2/} On February 22, 2006, the Commission approved the sale of PacifiCorp to Mid-American Energy Holdings Company,^{3/} and the merger was finalized on March 22, 2006.^{4/} As part of the

^{1/} Reiten, Exh. No. RPR-2T at 1 (\$48.5 million increase); Exh. No. 15C (PacifiCorp Response to Bench Request No. 3) (PacifiCorp agreed to remove the Chehalis operating reserve adjustment reducing the proposed increase by \$0.712 million).

^{2/} Early, Exh. No. MBE-1T at 2-3.

^{3/} Re MEHC and PacifiCorp, Docket No. UE-051090, Order No. 7 (Feb. 22, 2006).

^{4/} Early, Exh. No. MBE-1T at 3.

merger, MEHC promised ICNU “that MEHC’s approach is to ‘get the rates correct’ and then leave them in place for a long period of time (at least five years).”^{5/} MEHC has not attempted to set rates in place for a period of time, but has instead filed near annual rate cases, which is “exactly the opposite approach” that was promised and is “quite remarkable given the current economy and the fact that MEHC has significantly reduced many of the costs at PacifiCorp.”^{6/}

3 Since the merger in 2006, PacifiCorp has filed four general rate cases, approximately one per year and progressively requesting a larger percentage increase. On October 3, 2006, PacifiCorp filed its 2007 general rate case with the Commission proposing a \$23.2 million, or 10.2% average (10.8% for industrial customers), rate increase.^{7/} After a contested proceeding, the Commission authorized PacifiCorp to increase its rates by \$14.2 million, or approximately 6.5%.^{8/}

4 PacifiCorp filed its 2008 general rate case on February 6, 2008. The Company requested approximately \$34.9 million, which would have been overall rate increase of 14.6% (and 17.3% industrial rate increase).^{9/} PacifiCorp was ultimately allowed to increase rates by about \$20.4 million or 8.5%.^{10/}

^{5/} Id. at 3:2-4.

^{6/} Id. at 3:2-5.

^{7/} WUTC v. PacifiCorp, Docket Nos. UE-061546 and UE-060817, Final Order (June 21, 2007).

^{8/} See id. at 1.

^{9/} WUTC v. PacifiCorp, Docket No. UE-080220, Order No. 5 ¶ 2 (Oct. 8, 2008). The actual proposed rate increase was higher because PacifiCorp requested recovery of the costs of its 2005 hydro deferral, which would have increased industrial customer rates about 18.7% on average.

^{10/} Id. at ¶ 1.

5 PacifiCorp filed a 2009 general rate case requesting a \$38.5 million, or
15.1% rate increase (and about a 20% industrial increase).^{11/} The Commission ultimately
authorized PacifiCorp to increase rates by \$13.5 million or 5.3% on December 16,
2009.^{12/}

6 Although Pacific Power's President is unaware of how many Washington
rate cases the Company has filed or the size of its past rate increases,^{13/} PacifiCorp's
customers are keenly aware of how much and how frequently their rates have increased.
Industrial customer rate increases have been even larger than average, and increased in
each of the last three years, including about a 6.7% increase in 2007, an 8.8% increase in
2008, and a 5.3% increase in 2009, all have greatly exceeded the annual rates of
inflation.^{14/} PacifiCorp's service territory is suffering from significant economic
hardship, and many of its customers have been forced to lower their own operating costs
to offset these rate increases.^{15/}

7 The Company's recent rate increases and the current state of the economy
should have prompted PacifiCorp to seriously evaluate its costs, eliminate certain
discretionary programs, and only request new increased rates if it was absolutely
necessary. Instead, PacifiCorp filed this 2010 general rate case on May 4, 2010, shortly
after its last rate increase. The Company did not make efforts to defer costs or

^{11/} WUTC v. PacifiCorp, Docket No. UE-090205, Order No. 9 ¶ 2 (Dec. 16, 2009). PacifiCorp also
requested to amortize is Chehalis deferral, which would have increased rates by about another 1%.

^{12/} Id. at ¶ 1.

^{13/} Reiten, TR. 212:7-21.

^{14/} Early, Exh. No. MBE-1T at 2:19-22; Nachbar, Exh. No. NLN-1T at 1:17-21.

^{15/} Nachbar, Exh. No. NLN-1T at 2:1-5.

investments into the future or otherwise reduce the size its rate increase due to the recession.^{16/}

8 The Company’s filing originally requested a \$56.7 million revenue requirement increase, which would have been about a 21% overall increase.^{17/} PacifiCorp has slightly reduced its rate increase request in rebuttal testimony to account for errors and corrections, nearly all of which were identified by ICNU’s experts, and the Company is now requesting an almost \$48 million rate increase, which is still about 20% for industrial and residential customers.^{18/} Without explanation, PacifiCorp has agreed to Staff’s rate spread proposal after originally proposing a more equitable equal percentage proposal that is supported by ICNU and Public Counsel.^{19/}

III. ARGUMENT

A. PacifiCorp’s Rate Increase Should Be Significantly Reduced

9 The Commission should not treat this rate case as a business-as-usual rate proceeding. The overall amounts requested by the Company are so large that they constitute “rate shock.”^{20/} Given the current state of the economy and the cumulative impact of near annual rate increases, many of PacifiCorp’s customers cannot afford to

^{16/} See Reiten, TR. 218:6-12, 217:4-22, 203:10-15.

^{17/} Reiten, Exh. No. RPR-1T at 2:14-16.

^{18/} Reiten, Exh. No. RPR-2T at 1; Exh. No. 15C (PacifiCorp Response to Bench Request No. 3).

^{19/} Schooley, Exh. No. TES-1T at 36-40.

^{20/} Early, Exh. No. MBE-1T at 2:8; see also Schooley, Exh. No. TES-1T at 35:19 (stating, “[a] 20 percent increase is shocking enough...”).

pay increased rates, which may result in closures, reduced operations and cost reductions that could have devastating impacts on the community.^{21/}

10 PacifiCorp characterizes this rate case as being driven by factors outside of its control, including higher power costs caused by expiring contracts, investment in the system, and “[u]nder-recovery of historical costs due to foregone base rate increases from the last rate case resulting in a revenue deficiency in the historic test period.”^{22/} This mischaracterizes the fact that the vast majority of the proposed rate increase is entirely within factors the Company controls. The single largest component of PacifiCorp’s rate case is the proposed increase in its cost of capital.^{23/} The Company controls the pace of its investments, and PacifiCorp has not attempted to defer or slow the speed of its infrastructure investments in light of the economy.^{24/} Finally, the Company’s complaint about “under-recovery” from past cases is particularly disingenuous as PacifiCorp agreed that its last rate case would provide it with “sufficient” revenues.

11 The table below is the minimum amount of revenue requirement adjustments based on the testimony of ICNU witnesses Randall Falkenberg and Michael Gorman, and ICNU and Public Counsel witness Greg Meyer. The Commission should utilize its discretion and further reduce this proposed increase.

^{21/} Id. at 2-3; Nachbar, Exh. No. NLN-1T at 1-2, 6-7.

^{22/} Reiten, Exh. No. RPR-2T at 2:19-20.

^{23/} Reiten, TR. 207:22-25, 208:1.

^{24/} Id. at 206:9-19.

ICNU Proposed Adjustments to PacifiCorp's Rate Increase on a Washington Jurisdictional Basis (millions)	
Cost of Capital	\$9.4
Renewable Energy Credits	\$10.0
Net Power Costs ^{25/}	
Short Term Firm Sales	\$0.586
SMUD	\$0.459
Non-firm Transmission	\$0.429 ^{26/}
Wind Integration	\$0.507 ^{27/}
Planned Outages	\$0.310 ^{28/}
Minimum Loadings and Deration	\$0.300
Abnormal Colstrip Forced Outage	\$0.376
Jim Bridger Derations	\$0.651
DC Intertie	\$1.057
Commitment Logic Screens—Hermiston	\$0.366 ^{29/}
West Control Area Cost Allocation	
Eastern Market Sale and Transmission Costs ^{30/}	\$0.853
Imputation of Additional Washington Benefits	\$0.770
Cash Working Capital	\$1.305 ^{31/}
Residential Revenues	\$2.239
Incentive Compensation	\$0.700
2010 & 2009 Wage Increases	\$0.502
Outside Legal Expense	\$0.049
Management Fee	\$0.136
Total ICNU Adjustments	\$30.995

- ^{25/} Certain net power cost numbers in this table are updated, because ICNU has estimated the impact of PacifiCorp agreeing in part with some ICNU proposals. In addition, the final amount will change depending on which adjustments the Commission accepts and the impact of the December 2010 update.
- ^{26/} This number is larger because the Company's rebuttal modeled non-firm transmission by increasing rather than decreasing net power costs.
- ^{27/} This includes all of Mr. Falkenberg's Adjustments 13, 14 and 15.
- ^{28/} Reduced because PacifiCorp accepted ICNU's Colstrip, but not Hermiston, planned outage adjustment.
- ^{29/} Reduced because PacifiCorp accepted most of ICNU's screens, except for Hermiston.
- ^{30/} This includes Mr. Falkenberg's Adjustments 3, 4 and 8, reduced because PacifiCorp agreed to remove certain Idaho transmission costs.
- ^{31/} A larger cash working capital adjustment may be warranted if the Commission agrees with Staff that cash working capital should be negative, instead of being reduced to zero.

B. PacifiCorp Has the Burden of Proof to Support Its Requested Rate Increase

12 PacifiCorp bears the burden of proof to demonstrate that its proposed tariffs are just and reasonable.^{32/} This burden includes “the burden of going forward with evidence and the burden of persuasion.”^{33/} The Company retains this burden throughout the proceeding and must establish that the rate change is just and reasonable.^{34/} Accordingly, PacifiCorp also retains the burden of proof to demonstrate that its proposed use of the West Control Area (“WCA”) cost allocation methodology will produce just and reasonable rates.^{35/}

13 When setting rates, a utility is allowed an opportunity to recover its operating expenses and to earn a rate of return on its property that is used to provide service.^{36/} The amount of a utility’s operating expenses included in rates is typically “based on actual operating expenses in a recent past period referred to as the ‘test period’ or ‘test year.’”^{37/} A utility “cannot include every expense it wishes” in rates because the Commission reviews the utility’s costs “to disallow those which were not prudently incurred.”^{38/} The Commission also removes from rates all property not used and useful

^{32/} RCW § 80.04.130(4); WAC § 480-07-540; WUTC v. Avista, Docket No. UE-100467 and UG-100468 Order No. 1 ¶ 12 (Apr. 5, 2010).

^{33/} WAC § 480-07-540.

^{34/} WUTC v. Pacific Power & Light Co., Cause No. U-84-65, Fourth Suppl. Order at 17 (Aug. 2, 1985).

^{35/} See WUTC v. PacifiCorp, Docket No. UE-061546, Order No. 1 ¶ 9 (Oct. 10, 2006); Re PacifiCorp, Docket Nos. UE-991832 and UE-020417, Eighth/Sixth Suppl. Order ¶ 22 (July 15, 2003).

^{36/} People’s Org. for Wash. Energy Resources v. WUTC, 104 Wn.2d 798, 808-11 (1985); WUTC v. Puget Sound Energy, Inc. (“PSE”), Docket Nos. UE-090704 and UG-090705, Order No. 11 ¶ 19 (Apr. 2, 2010).

^{37/} People’s Org. for Wash. Energy Resources, 104 Wn.2d at 810.

^{38/} Id.; see also WUTC v. PSE, Docket No. UE-031725, Order No. 14 ¶ 93 (May 13, 2004) (disallowing imprudent gas costs).

to serve Washington customers,^{39/} all non-recurring or one-time expenses, and other costs that a utility is unlikely to experience during the term of the proposed rates.^{40/} Costs which are abnormal, fluctuate, or are not accurately estimated in the test period must be normalized to achieve an expected level of costs based on typical conditions.^{41/} Finally, regardless of prudence, costs and expenses that do not benefit ratepayers or were incurred to benefit shareholders are not recoverable.^{42/}

C. Cost of Capital

14 PacifiCorp has requested a significant increase in its cost of capital, which is entirely unwarranted given the condition of the economy, and the Company's actual capital costs and needs. The Commission should recognize that capital costs have declined and that utilities are viewed as favorable investment opportunities in the current economy. PacifiCorp's customers should benefit from current conditions by a reduction in the Company's approved rate of return.

15 PacifiCorp has proposed an overall cost of capital of 8.34%, which is based on a 10.6% return on equity ("ROE") and a 52.1% equity ratio.^{43/} This is an increase from the Company's current approved cost of capital of 8.10%, including a 46% equity ratio and 10.2% ROE, which was last litigated in early 2006.^{44/} ICNU

^{39/} RCW § 80.04.250; WUTC v. PacifiCorp, Docket Nos. UE-050684 and UE-050412, Order No. 4 ¶¶ 48-70 (April 17, 2006).

^{40/} WUTC v. Avista Corp., Docket Nos. UE-991606 and UG-991607, Third Suppl. Order ¶¶ 205-07 (Sept. 29, 2000).

^{41/} Id. at ¶ 34.

^{42/} See U.S. West v. WUTC, 134 Wn.2d 74, 126-27 (1997); WUTC v. Avista Corp., Docket Nos. UE-080416 and UG-080417, Order No. 8 ¶ 29 (Dec. 29, 2008).

^{43/} Williams, Exh. No. BNW-1T at 3:1-7.

^{44/} Docket Nos. UE-050684 and UE-050412, Order No. 04 ¶ 379.

recommends that the Commission reduce PacifiCorp's rate increase request by \$9.4 million by adopting a more reasonable and entirely sufficient cost of capital of no more than 7.66%, based on a 9.5% ROE and 49.1% equity ratio.^{45/} The Commission should also consider setting a lower cost of capital, which would be appropriate because a lower equity ratio is reasonable and provides sufficient revenues.^{46/}

1. The Commission Should Significantly Reduce PacifiCorp's Proposed Return on Equity

16

The Commission establishes a return on equity to allow utilities an opportunity earn a return on the value of the property that is employed for providing service to customers commensurate with the returns in other businesses having similar risks.^{47/} The Commission reviews expert recommendations regarding ROE, but ultimately relies upon "a broader body of evidence to make [its] determinations, which are informed by, but not dictated by the experts' modeling results."^{48/} For example, the Commission often considers when setting an overall cost of capital how well the utility has been able to attract capital at its current rates, the state of capital markets and overall economy, the decisions of other utility commissions, and whether the utility's decisions are the most economical for customers.^{49/}

^{45/} Gorman, Exh. No. MPG-3 at 1 (Rate of Return); Gorman, Exh. No. MPG-22T at 1-4.

^{46/} Elgin, Exh. No. KLE-1T at 2.

^{47/} Docket Nos. UE-050684 and UE-050412, Order No. 04 ¶¶ 235, 263 (citing the seminal U.S. Supreme Court decisions of Bluefield Water Works & Improvement Co. v. Public Serv. Comm'n of W. Virginia, 262 U.S. 679 (1923), and Federal Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591 (1944)).

^{48/} PSE v. WUTC, Docket Nos. UE-060266 & UG-060267, Order No. 8 ¶ 84 (Jan. 5, 2007).

^{49/} Id. at ¶¶ 85-86; Docket Nos. UE-050684 and UE-050412, Order No. 04 ¶ 231; Docket Nos. UE-090704 and UG-090705, Order No. 11 ¶¶ 292-93.

17

The broad array of analytical and non-analytical evidence strongly supports lowering the Company's ROE. PacifiCorp has been able to attract significant amount of new equity at its current rates without harming its credit rating. The overall state of the economy in PacifiCorp's Washington service territory is in a poor condition, but electric utilities have been able to weather the current recession well.^{50/} In fact, the current economic conditions make utilities like PacifiCorp more attractive investment opportunities because they appeal to investors looking for stable investments during poor economic times.^{51/} Finally, the most recent utility decision setting PacifiCorp's cost of capital in a fully contested proceeding lowered the Company's ROE to 9.9%.^{52/}

18

The weight of the experts' analytics evidence also supports a reduction, rather than a large increase, in PacifiCorp's ROE. Mr. Gorman submitted testimony recommending an 9.5% ROE, based on the results of five financial models, including: 1) a constant growth Discounted Cash Flow ("DCF") model; 2) a sustainable growth DCF model; 3) a multi-stage growth DCF model; 4) a Risk Premium model; and 5) a Capital Asset Pricing model ("CAPM").^{53/} Similarly, correcting Dr. Hadaway's studies also supports a lower ROE. Mr. Gorman's analysis is supported by a similar 9.5% ROE recommendation from Staff witness Ken Elgin.^{54/} Messrs. Gorman and Elgin's ROE

^{50/} Gorman, Exh. No. MPG-1T at 3-8.

^{51/} Id. at 3:12-15, 8:10-30; Gorman, TR. 442:16-18, 444:3-10.

^{52/} Reiten, Exh. No. RPR-11 at 2 (Interlocutory Order in IPUC Case No. PAC-E-10-07).

^{53/} Gorman, Exh. No. MPG-1T at 16:18-25.

^{54/} Elgin, Exh. No. KLE-1T at 2, 20-49.

recommendations will fairly compensate PacifiCorp’s investment risk and preserve the Company’s financial condition.^{55/}

a. Both ICNU and PacifiCorp’s Risk Premium Model Results Support a 9.5% ROE

19 The risk premium “model is based on the principle that investors require a higher return to assume greater risk.”^{56/} Common equity securities are considered riskier than bonds because bonds have more security of payment than common equity and the coupon payments on bonds represent contractual obligations.^{57/} The model estimates this risk premium by estimating the difference between returns on common equity and bonds. The overall reasonableness of the risk premium model should be evaluated based on whether this “premium” accurately estimates the additional compensation that equity investors can expect over bond investors.^{58/} Mr. Gorman’s risk premium analysis produces a return on equity estimate of 8.98% to 9.94%, with a midpoint of 9.46%, and supports ICNU’s overall 9.5% ROE recommendation.^{59/}

20 The Commission has relied upon the risk premium model when setting past utility return on equities, and has specifically adopted Mr. Gorman’s approach while rejecting Dr. Hadaway’s manner of calculating a risk premium.^{60/} Mr. Gorman estimates the equity risk premium by: 1) calculating the difference between the required return on

^{55/} Gorman, Exh. No. MPG-1T at 38:1—41:20.
^{56/} *Id.* at 28:3-4.
^{57/} *Id.* at 28:1—29:5.
^{58/} Elgin, Exh. No. KLE-1T at 44:9—46:16.
^{59/} Gorman, Exh. No. MPG-1T at 32.
^{60/} Docket Nos. UE-050684 and UE-050412, Order No. 04 ¶ 261.

utility common equity investments and U.S. Treasury bonds; and 2) calculating the difference between regulatory commission authorized returns on equity and contemporary “A” rate bond yields.^{61/} Mr. Gorman estimates current market conditions using a relatively long period of stock prices, and gauges investor expectations using current utility bond spreads.^{62/} Mr. Gorman’s recommendations are consistent with the direction of this Commission who found “credible the arguments offered by Dr. Rothschild and Mr. Gorman that risk premium analyses that rely upon utility bond yields are better calibrated to currently-known yields rather than forecasts of future yields....”^{63/}

21

PacifiCorp, in contrast, proposes an unreasonable risk premium analysis.

First, Dr. Hadaway’s risk premium relies upon “forecasted interest rates and volatile utility spreads, which are highly uncertain and produce inaccurate results.”^{64/} This is contrary to Commission precedent^{65/} and inflates the risk premium, because forecasted interest rates have been and are expected to continue to be inaccurate.^{66/} Second, Dr. Hadaway relies upon a “simplistic inverse relationship between equity risk premiums and interest rates” that “is not supported by academic research.”^{67/} While such a relationship has existed in the past, the relationship changes over time and is not expected to exist in the current marketplace.^{68/} Correcting Dr. Hadaway’s risk premium studies results in “a

^{61/} Gorman, Exh. No. MPG-1T at 28:10—29:5.

^{62/} Id. at 29:17—31:10.

^{63/} Docket Nos. UE-050684 and UE-050412, Order No. 04 ¶ 261.

^{64/} Gorman, Exh. No. MPG-1T at 47:20-25.

^{65/} Docket Nos. UE-050684 and UE-050412, Order No. 04 ¶ 261.

^{66/} Gorman, Exh. No. MPG-1T at 47:20—49:14.

^{67/} Id. at 49:15-19.

^{68/} Id. at 49:15-50:2.

return on equity in the range of 9.06% to 10.03%, with a midpoint of 9.55%,”^{69/} almost the same as ICNU’s recommendation in this case.

b. The DCF Model Results Support ICNU’s ROE Recommendation

22 The Commission has historically relied upon DCF model results as one set of analytical data when determining an appropriate ROE, and all three cost of capital witnesses in this case utilized the DCF model. The DCF model relies upon the premise that the value of any asset is the present value of all future cash flows.^{70/} Mr. Gorman used three different DCF models, which produced an average ROE of 9.8%. Mr. Gorman included the constant growth DCF model results in his analysis even though Mr. Gorman had strong concerns about its accuracy at this time.^{71/}

23 DCF estimates rely upon a current stock price, expected dividends, and (the most controversial aspect) expected growth rates.^{72/} The Commission has recognized that assumptions regarding growth rates are a key matter of dispute in DCF estimates.^{73/} Mr. Gorman relied upon forecasted growth rates consistent with PacifiCorp’s last litigated cost of capital decision in which the Commission found “persuasive Mr. Gorman’s argument, that if growth in GDP is used for this critical input to the DCF formula, it should be a forward-looking, not an historical average.”^{74/}

^{69/} Id. at 51:1-10.

^{70/} Elgin, Exh. No. KLE-1T at 24:19-23; Gorman, Exh. No. MPG-1T at 18:1-5.

^{71/} Gorman, Exh. No. MPG-1T at 21:1—23:18, 27:16-18.

^{72/} Id. at 18:21-24, 43:1—47:3.

^{73/} Docket Nos. UE-050684 & UE-050412, Order No. 04 ¶ 261.

^{74/} Id.

24 Mr. Gorman’s highest estimated ROE is based on the market analysts’ constant growth DCF model that produced a 10.5% ROE. The constant growth DCF model produces abnormally high ROE estimates at this time because it is based on a growth rate that is in excess of the long-term sustainable growth rate.^{75/} Research has demonstrated that over the long-term a utility’s earnings cannot grow at rate that exceeds the U.S. GDP growth rate.^{76/}

25 Mr. Gorman also included in his analysis the multi-stage DCF model, which estimated PacifiCorp’s ROE at 9.9%. The Commission has previously criticized use of this model because it is “more complex and assumption-intensive;”^{77/} however, its results are useful in this proceeding because it reviews more realistic growth expectations than the analysts’ constant growth DCF method.^{78/} The multi-stage DCF model not only looks at short term growth expectations, but also considers expectations during short, medium and long periods, using consensus economists’ expectations.^{79/}

26 Finally, Mr. Gorman utilized the sustainable constant growth DCF model, which estimates a 9.19% ROE for PacifiCorp using a growth rate “based on the percentage of the utility’s earnings that are retained and reinvested in utility plant and equipment.”^{80/} These results produce accurate estimates of the utility’s cost of capital

^{75/} Gorman, Exh. No. MPG-1T at 19:20—23:18.

^{76/} Id. at 22:3—23:18.

^{77/} Docket Nos. UE-050684 & UE-050412, Order No. 04 ¶ 261.

^{78/} Gorman, Exh. No. MPG-1T at 23:19-24, 24:21—25:2.

^{79/} Id. at 25:15—26:16.

^{80/} Id. at 23:23-24.

because they rely upon more sustainable growth estimates. Mr. Gorman averaged all three DCF results to achieve an ROE estimate of 9.8%.

c. The Results of the CAPM Support Lowering PacifiCorp's ROE

27

Consistent with Commission precedent, Mr. Gorman performed a CAPM estimate of PacifiCorp's cost of equity. The CAPM method is based on "the theory that the market required rate of return for a security is equal to the risk free rate, plus a risk premium associated with the specific security."^{81/} The CAPM relies upon an estimate of the market risk-free rate, the company's beta, and the market risk premium.^{82/} Mr. Gorman utilized the long-term Treasury bond yields as an estimate of the risk free rate, obtained PacifiCorp's proxy group average beta from Value Line, and he derived two market risk premium estimates using forward looking data and long-term historical average information.^{83/} Although Mr. Gorman believes market analysts reports often overestimate and inflate the market risk premium, Mr. Gorman relied upon market analysts' data in order to show the overall reasonableness of his analysis.^{84/}

28

Mr. Gorman's CAPM analysis supports an ROE in the range of 8.28% to 9.31%, with a midpoint of 8.80%.^{85/} Mr. Gorman, however, did not use the midpoint 8.80% for his CAPM results when averaging all of five model results, but instead inflated

^{81/} Id. at 32:8-10.

^{82/} Id. at 33:8-10.

^{83/} Id. at 33:11—34:14.

^{84/} Id. at 35:10—36:3.

^{85/} Id. at 37:1-5.

his low end CAPM estimate to 9.10%, which produced an ROE range of 9.10% to 9.90%, with a midpoint of 9.50%.^{86/}

29

Dr. Hadaway, in contrast, did not perform the CAPM analysis in this proceeding because it did not pass his “smell test” for the sole reason that it produced results lower than he believed were reasonable.^{87/} This arbitrary approach is inconsistent with the Commission’s explanation in its most recent litigated case resolving cost of capital issues that it relies upon the CAPM as one of a variety of models to set a solid foundation to construct a reasonable range for ROE.^{88/} Dr. Hadaway has not provided an explanation as to why the Commission should depart from this recent precedent.^{89/} Dr. Hadaway’s approach should also be contrasted with Mr. Gorman’s approach of including those DCF model results which he believed were overly high in his range of reasonable common equity recommendations.^{90/}

2. The Commission Should Set a Reasonable Equity Ratio that will Maintain Financial Integrity but at Lower Cost to Customers

30

The Commission has been provided with three divergent proposals regarding the appropriate common equity ratio for PacifiCorp. PacifiCorp has proposed increasing its common equity ratio from 46% to 52.1% based on the argument that the Company’s actual equity ratio should be used absent a clear and compelling justification

^{86/} Id. at 37:12-14.

^{87/} Hadaway, TR. 251:13-16.

^{88/} Docket Nos. UE-090704 and UG-090705, Order No. 11 ¶¶ 292-300.

^{89/} Hadaway, TR. 247:7-25, 248:1-25, 249:1-7.

^{90/} Gorman, Exh. No. MPG-1T at 21:1—23:18, 27:16-18.

for using a different ratio.^{91/} Mr. Gorman proposed a 49.1% common equity ratio based on PacifiCorp's actual common equity that is used to support regulated operations in Washington.^{92/} Mr. Gorman's approach "is more reasonable for setting rates because it reflects the actual common equity capital PacifiCorp relied on to invest in utility plant."^{93/} It will support PacifiCorp's credit rating and financial integrity, and cost much less than PacifiCorp's proposal to inflate its common equity ratio up to 52%. PacifiCorp provided no evidence that its proposal to increase its equity ratio up to 52% is in anyway cost justified or reasonably necessary to maintain Washington utility operations. Indeed, both Staff and ICNU witnesses found that PacifiCorp has an incentive to increase its common equity ratio because doing so increases its profit and benefits its parent company. PacifiCorp's proposed equity ratio should be rejected because it is unnecessarily expensive and beyond what is necessary to reliably support PacifiCorp's regulated Washington operations at competitive rates.^{94/}

31 Staff witness Elgin proposed a hypothetical equity ratio of 46.5% based on the average capital structure of the companies in his proxy group.^{95/} Mr. Elgin's analysis is also consistent with the capital structures used by the Commission in recent proceedings in which PSE was authorized a 46% equity ratio and Avista 46.50%.^{96/} Mr. Elgin's overall approach is reasonable because PacifiCorp's parent company MEHC

^{91/} Williams, Exh. No. BNW-7T at 1:9-16.

^{92/} Gorman, Exh. No. MPG-1T at 12:1—15:4.

^{93/} Id. at 13:22-23.

^{94/} Gorman, Exh. No. MPG-1T at 4:1-2; Gorman. TR. 453:3-18, 456:8-16.

^{95/} Elgin, Exh. No. KLE-1T at 14:3-16:9.

^{96/} Id. at 16:13-17; Docket Nos. UE-090704 and UG-090705, Order No. 11 ¶ 283; WUTC v. Avista, Docket Nos. UE-100467 and UG-10468, Order No. 7 ¶ 8 (Nov. 19, 2010).

controls the actual capital structure, which has the financial incentive to capitalize PacifiCorp with more expensive equity.^{97/} Although Mr. Gorman and Mr. Elgin take different approaches, they establish that PacifiCorp is not minimizing its cost of capital to maintain its financial integrity at the lowest cost to customers, but has instead proposed an excessive capital structure that unnecessarily inflates the common equity ratio to increase PacifiCorp's profitability and cash flows.^{98/}

32 Mr. Gorman calculated PacifiCorp's actual equity that is used for regulated operations by using PacifiCorp's most recent five quarters of information to develop an average equity ratio of 52.2% for year ending June 30, 2010.^{99/} Mr. Gorman removed from the common equity those assets that have not been used to support investments in utility plants, including: 1) the acquisition adjustment; 2) special deposits; 3) short-term investments; and 4) the difference between notes receivable from affiliate companies and notes payable to affiliate companies.^{100/} Mr. Gorman correctly concluded that ratepayers should not pay for equity that is not supporting utility investments.^{101/}

3. ICNU's Recommendations Will Maintain PacifiCorp's Financial Integrity

33 Mr. Gorman's recommended 9.5% ROE and 49.1% equity ratio will support an investment grade bond rating for PacifiCorp and should not result in any credit

^{97/} Elgin, Exh. No. KLE-1T at 13:14-21; Gorman, MPG-22T at 1:13—4:18.

^{98/} Gorman, Exh. No. MPG-22T at 1:13—4:18.

^{99/} Gorman, Exh. No. MPG-1T at 13:12-15; Gorman, TR. 476:3—478:8.

^{100/} Gorman, Exh. No. MPG-1T at 13:16—14:6.

^{101/} Gorman, TR. 476:3—478:8.

ratings down grade for PacifiCorp.^{102/} Mr. Gorman compared the key credit rating financial ratio for PacifiCorp based on his proposed capital structure, which support continuation of PacifiCorp’s current credit rating.^{103/} Mr. Gorman utilized S&P’s own credit rating metrics to determine that “an authorized return on equity of 9.50% will support internal cash flows that will be adequate to maintain PacifiCorp’s current investment grade bond rating.”^{104/}

D. The Commission Should Impute \$10 Million in REC Revenues to Washington in this Proceeding

34 PacifiCorp has a demonstrated history of understating its Renewable Energy Credit (“REC”) revenue data in its general rate case filings, unfairly taking advantage of regulatory lag and abusing the confidential status of its REC data to conceal the true amount of REC revenues it receives. PacifiCorp’s customers, not its shareholders, should receive the benefit of its REC revenues, and PacifiCorp has even acknowledged this stating: “customers are generally entitled to a revenue credit for REC sales. The Company does not contest this premise.”^{105/} PacifiCorp is understating its expected REC revenue, and the Commission should make an adjustment of \$10 million to account for REC revenues.^{106/}

^{102/} Gorman, Exh. No. MPG-1T at 37:1—41:20; Gorman, TR. 479:9-13.

^{103/} Gorman, Exh. No. MPG-1T at 37:1—40:20.

^{104/} *Id.* at 40:18-20.

^{105/} Duvall, Exh. No. GND-5T at 8:3-6; Amended Petition of Puget Sound Energy, Inc. For an Order Authorizing the Use of the Proceeds from the Sale of Renewable Energy Credits and Carbon Financial Instruments, Docket. No. UE-070725, Final Order ¶¶ 41-47 (May 20, 2010) (recognizing that, absent unusual or extraordinary circumstances, REC revenues should be credited to ratepayers).

^{106/} Falkenberg, Exh. No. RJF-8CT at 6:1-4.

35

In the 2009 General Rate Case, PacifiCorp represented that it expected to receive \$657,755 in REC revenue based on a pro forma adjustment which purported to reflect expected REC sales and REC prices in the 2010 rate effective period.^{107/} The REC reports PacifiCorp has provided pursuant to the Stipulation in the 2009 General Rate Case show that Washington-allocated REC revenue is estimated to be \$4,955,609 for only the first six months of 2010.^{108/} Thus, the estimate of \$657,755 in REC sales provided in the pro forma adjustment was off by at least 750%, and this is only for the first half of 2010. If the Washington-allocated revenue estimate provided in the REC report is annualized, the figure is closer to \$10 million.^{109/}

36

Consistent with its practice of understating REC revenue, PacifiCorp did not include any REC revenues when it filed this case. PacifiCorp claims that it failed to include REC revenue in the 2010 general rate case filing because it did not expect to sell any Washington-allocated RECs in anticipation of a legislative amendment to the Washington Renewable Portfolio Standard (“RPS”) which would have permitted utilities to bank RECs for longer periods of time for future RPS compliance.^{110/} This excuse for not including REC revenue is disingenuous since the legislative session had ended on

^{107/} Reiten, TR. 296:17-25, 297:1-3; Reiten, Exh No. RPR-10 at 8 (Settlement Stipulation in Docket UE-090205).

^{108/} Reiten, Exh. No. RPR-7C (Excerpt from PacifiCorp’s Response to ICNU Data Request (“DR”)); Reiten, Exh. No. RPR-9C (Excerpt from PacifiCorp’s Response to ICNU DR No. 24.2). PacifiCorp claimed at hearing that this amount was for the six month period of December 2009 to June 2010. Duvall, TR. 302:7-25, 303:1-13. The total amount for a six month period remains the same.

^{109/} Falkenberg, Exh. No. RJF-8CT at 6:1-4. This amount is similar to the approximately \$98 million in REC revenues PacifiCorp earned on a total Company basis for the 12 months ending June 30, 2010.

^{110/} Id.

April 12, 2010, without the passage of any RPS amendments, fully three weeks before PacifiCorp made its initial filing on May 4, 2010.^{111/}

37

PacifiCorp will have a significant amount of RECs in 2010 that cannot be banked for future compliance and will receive substantial REC revenues for the rate effective period that were not included in its initial filing. Staff and ICNU originally proposed adjustments of \$4.2 and \$4.9 million.^{112/} PacifiCorp concedes that its rates should be adjusted by \$5 million to account for REC revenue not included in its initial 2010 general rate case filing.^{113/} PacifiCorp's proposed \$5 million adjustment does not go far enough, given updated evidence finally produced. The Commission should make a \$10 million adjustment based on the amount of REC revenues that PacifiCorp is expected to actually earn in 2010, which is similar to the amounts the Company actually earned for the twelve month period ended June 2010.

E. The Commission Should Adopt Reasonable Revisions to the WCA Methodology

38

The Commission adopted the WCA as part of PacifiCorp's 2007 general rate case over the objections of ICNU and Public Counsel.^{114/} The way in which the WCA has been implemented has been more costly to Washington ratepayers than PacifiCorp's Revised Protocol because it fails to pass to Washington customers many of the benefits of its system operation.^{115/} Although the Commission could reject

^{111/} *Id.*; Duvall, TR. 298:4-14.

^{112/} Falkenberg, Exh. No. RJF-8CT at 5:6-10.

^{113/} Duvall, Exh. No. GND-5T at 5:4-6; Dalley, Exh. No. RBD-4T at 10:1-8.

^{114/} Docket Nos. UE-061546 and UE-060817, Final Order ¶¶ 56-58.

^{115/} Falkenberg, Exh. No. RJF-1CT at 21-22; Early, Exh. No. MBE-1T at 4-5.

PacifiCorp's entire filing based on the flaws in the WCA, ICNU is aware that the Commission adopted a five-year trial period for the WCA. Instead of discarding the WCA in favor of a more accurate and equitable methodology, ICNU has sponsored changes that work within the framework of the WCA.^{116/}

39 The inequity of the current WCA methodology is demonstrated by the fact that the merger of Utah Power & Light Co. and Pacific Power & Light Co. has benefited Utah by shifting costs to states like Washington, and allowed other states to capture the benefits of system integration.^{117/} Evidence of this cost shift is that "the average industrial rate in Washington at the time of the merger was 3.77 cents/kWh while in Utah it was 4.27 cents/kWh."^{118/} Even though Washington rates are based on low cost hydro, and the lack of local growth reduces the need for capital projects, Washington industrial rates currently exceed Utah industrial rates.^{119/} The inequity between Washington industrial customers and Utah industrial customers will be even greater if PacifiCorp is granted this rate increase.^{120/}

40 PacifiCorp's primary argument against ICNU's cost allocation adjustments is that no adjustments should be made "without a thorough evaluation of the WCA methodology."^{121/} PacifiCorp's argument ignores that this is the first fully litigated

^{116/} Falkenberg, Exh. No. RJF-1CT at 21-22.

^{117/} Id.; Falkenberg, Exh. No. RJF-4 (Comparison of West Control Area to Revised Protocol).

^{118/} Early, Exh. No. MBE-1T at 4:20-22; Falkenberg, Exh. No. RJF-5 at 9 (PacifiCorp Data Responses).

^{119/} Exh. No. WRG-18 at 10 (Edison Electric Institute Ranking of Rates); Exh. No. WRG-19 at 2, 5 (PacifiCorp's Response to UM 1050 ICNU DR No. 13.2).

^{120/} Early, Exh. No. MBE-1T at 5:2-5.

^{121/} Duvall, Exh. No. GND-5T at 34:9-10.

proceeding in which the Company's actual implementation of the WCA is being reviewed.^{122/} ICNU's adjustments are minor modifications consistent with the intent of the Commission's order adopting the WCA.^{123/}

1. The Commission Should Correct PacifiCorp's Modeling of Eastern Market Sales

41 The Commission adopted the WCA methodology because it could allow for the allocation of indirect benefits and costs that could be quantified and demonstrated.^{124/} This includes the inclusion of indirect "benefits and costs if purchases or sales between the control areas are economic."^{125/} PacifiCorp's modeling of the eastern market sales in the WCA contains significant errors and omissions that result in the WCA not accurately capturing the value of purchases and sales between the eastern and western control areas. Specifically, PacifiCorp only captures a portion of Washington's share of the "benefits that result from transacting energy between the western and eastern markets."^{126/}

42 Mr. Falkenberg's testimony in this proceeding demonstrates that the Company's modeling fails to reflect quantifiable indirect benefits of system integration.^{127/} First, PacifiCorp "models only sales from the west to the east control area," but does not provide Washington any portion of the benefits associated with

^{122/} Falkenberg, TR. 655:19-23.
^{123/} Falkenberg, Exh. No. RJF-1CT at 16-20, 30-33.
^{124/} Docket Nos. UE-061546 and UE-060817, Final Order ¶ 56.
^{125/} *Id.* at ¶¶ 47, 56.
^{126/} Falkenberg, Exh. No. RJF-1CT at 15:16-17.
^{127/} *Id.* at 2 (Mr. Falkenberg's Adjustments 3 and 4).

purchases.^{128/} Next, PacifiCorp’s approach penalizes Washington when the western system provides reliability benefits to the eastern system.^{129/} Finally, the Company’s complex modeling only captures “a portion of the economic sales, and introduces many uneconomic sales into the WCA model simulation.”^{130/}

43

The WCA model is based on the assumption that it would model the indirect costs and benefits of both sales and purchases between the control areas.^{131/} There are times when it is economic for the western system to make purchases from the eastern system because during some limited time periods prices in the west are higher than those in the east.^{132/} PacifiCorp does not account for these purchases, and Washington should not be deprived these system integration benefits.

44

There are many transfers from the western to the eastern system that are made because of reliability rather than economic reasons.^{133/} PacifiCorp’s power cost model places a high value on these reliability transfers because they avoid costly imbalances.^{134/} While these are valuable and beneficial transactions, the way that PacifiCorp includes these reliability transfers in the WCA model actually penalizes the western system for providing “capacity for reliability purposes to the east.”^{135/} Mr. Falkenberg proposes to make a minor modification which values these reliability benefits

^{128/} Id. at 16:19-21.

^{129/} Id. at 19:21—21:7.

^{130/} Id. at 19:3-5.

^{131/} Docket Nos. UE-061546 and UE-060817, Final Order ¶¶ 47, 56.

^{132/} Falkenberg, Exh. No. RJF-1CT at 20:14-21.

^{133/} Id. at 19:2—20:13.

^{134/} Id. at 19:24—20:2.

^{135/} Id. at 20:2-5.

in the same manner as the Company's power cost model, and then equally splits the benefits of these reliability benefits between the western and eastern system.^{136/}

45 PacifiCorp criticizes ICNU's method for calculating the reliability benefits because it is "arbitrary," but fails to present its own resolution of this problem of its own creation.^{137/} ICNU's proposed revision is not arbitrary, but uses the same method in the Company's own power cost model to calculate these actual reliability benefits.^{138/} PacifiCorp does not present any testimony disputing that there are reliability benefits, nor does the Company challenge the fact that the WCA penalizes the western system (instead of compensating it) for providing power for reliability purposes to the east.

46 PacifiCorp's modeling of economic value of transfers between the eastern and western systems is also flawed because the Company uses a monthly average sale for only the Heavy Load Hours ("HLH").^{139/} The model ignores potential sales during Light Load Hours ("LLH") and introduces other modeling problems, including the exclusion of many profitable sales and the inclusion of many unrealistic sales at a loss.^{140/} This problem can be easily remedied by using an hourly analysis to more accurately value the eastern market sale in GRID.^{141/} Mr. Falkenberg's adjustment is based on PacifiCorp's same data, logic, methodology and assumptions, except that he included off-peak hours and hourly data rather than monthly average data.^{142/}

^{136/} Id. at 21:1-7.

^{137/} Duvall, Exh. No. GND-5T at 35:8-18.

^{138/} Falkenberg, Exh. No. RJF-1CT at 21:1-7.

^{139/} Id. at 18:14-22.

^{140/} Id. at 18:14-22, 19:8-20.

^{141/} Id. at 20:6-13.

^{142/} Id.

2. The Commission Should Remove All Eastern Transmission Costs from PacifiCorp’s Modeling of the WCA

47 PacifiCorp’s proposed modeling of the WCA should be revised to exclude certain eastern system transmission costs, more accurately allocate the costs of Colstrip transmission, and remove all costs associated with the western system providing dynamic reserves to the eastern system.^{143/} PacifiCorp admits that it erroneously included some costs related to isolated Idaho loads that should be removed from the WCA, but ignores most of ICNU’s proposals and instead incorrectly argues that they are inconsistent with the WCA methodology.^{144/}

48 PacifiCorp attempts to charge Washington customers too large a portion of the transmission costs associated with Colstrip. The Company proposes to include half the Colstrip transmission costs because half of the plant is authorized to be included in Washington rates.^{145/} PacifiCorp’s approach ignores that its transmission topology maps “show that more than half of the costs related to Colstrip wheeling are attributable to providing service to” the eastern system.^{146/} ICNU’s approach is reasonable because it allocates these costs based on the system’s actual capacity.

49 The Commission should also remove the costs associated with PacifiCorp’s western resources providing dynamic reserves to the eastern system by removing a portion of the costs associated with the Idaho Point to Point contract (“Idaho

^{143/} Id. at 4:2-6, 31-32.

^{144/} Duvall, Exh. No. GND-5T at 6:7-15 (PacifiCorp agrees Mr. Falkenberg’s Adjustment 7, which removes Idaho transmission costs that should have not been included in its original filing).

^{145/} Falkenberg, Exh. No. RJF-1CT at 31:7-14 (citing WUTC v. PacifiCorp, WUTC Docket No. UE-090205, Direct Testimony of Hui Shu, Exhibit No. HS-1T at 12 (Feb. 9, 2009)).

^{146/} Id. at 31:17-19.

PTP”).^{147/} The Commission’s order adopting the WCA rejected a proposal by ICNU to include the benefits from the reserve transfers between the western and eastern system.^{148/} Since the dynamic reserve benefits have been excluded from the WCA their associated costs should also be removed.^{149/} ICNU’s and Staff’s adjustments do not remove all the costs associated with dynamic reserves because many of PacifiCorp’s resources provide reserve benefits to both the eastern and western system.^{150/} Instead, the proposal is that these costs be split, even though a higher cost allocation to the east could be justified.^{151/}

50

PacifiCorp argues against ICNU and Staff’s proposal to split costs between the eastern and western systems because “it is a proposal to split costs that have already been split once before.”^{152/} PacifiCorp, however, does not explain to the Commission that the Idaho PTP has western and eastern components. The eastern aspect of the contract only provides service to the east, while the western part provides service to both east and west.^{153/} The “split” the Company is obliquely referring to is that the Company assigns all the costs of the eastern part to the east and assigns all the costs of the western part to the west. A further “split” is warranted because the western part of the Idaho PTP contract serves both the east and west.

^{147/} Id. at 32:1-17; Buckley, Exh. No. APB-1CT at 20:1—21:5.

^{148/} Docket Nos. UE-061546 and UE-060817, Final Order ¶¶ 53-54, 57.

^{149/} Falkenberg, Exh. No. RJF-1CT at 32:9-15.

^{150/} Id. at 32:13-17; Falkenberg, Exh. No. RJF-8CT at 3:9-14; Buckley, Exh. No. APB-1CT at 20:1-23.

^{151/} Falkenberg, Exh. No. RJF-1CT at 32:13-17; Buckley, Exh. No. APB-1CT at 20:1-23.

^{152/} Duvall, Exh. No. GND-5T at 26:12-13.

^{153/} Falkenberg TR. 654:19—655:18; see also Exh. No. GND-42C (PacifiCorp Response to ICNU DR 26.44 at 3 (description of how the Idaho PTP is assigned to PACE and PACW)).

3. The Commission Should Impute Additional Benefits to Washington

51 The manner in which PacifiCorp has implemented the WCA does not pass on to Washington customers the full benefits of system operations. The specific adjustments discussed above correct some of the more obvious errors and total about \$900,000. These adjustments only capture a portion of the system benefits that Washington is not being provided, as the Company's own analysis demonstrates that the WCA assigned to Washington revenue requirements about \$1.7 million higher than under the Revised Protocol method.^{154/} The Commission should further modify the WCA by assigning a different split between margins and volumes in the eastern market sale, which would reduce PacifiCorp's rate increase by an additional \$770,000.^{155/}

52 The eastern market sale component of the Company's calculation of the WCA assumed that the western system will obtain only 40% of the margins and only 60% of the volumes of these transactions.^{156/} These numbers "are essentially arbitrary."^{157/} For example, the significant reduction in the benefits to transactions volumes was based on a theory that there would be competition for sales to the east, but the volumes have been developed from system wide power cost run which renders such an assumption "baseless."^{158/} Except for complaining that it is inconsistent with the WCA, PacifiCorp did not provide any evidence in response to ICNU in rebuttal

^{154/} Falkenberg, Exh. No. RJF-4 at 2 (Comparison of West Control Area to Revised Protocol).

^{155/} Falkenberg, Exh. No. RJF-1CT at 22:1—23:12.

^{156/} Id. at 18:1-13.

^{157/} Id. at 18:8.

^{158/} Id. at 18:10-13.

testimony to justify these arbitrary reductions.^{159/} Therefore, the Commission should adopt Mr. Falkenberg’s recommendation that “100% of volumes be included in the calculation of the Eastern Market sale.”^{160/}

F. PacifiCorp Has Significantly Overstated Its Net Power Costs

53

Power costs are major component of PacifiCorp’s overall proposed rate increase. The Company originally requested that it be authorized to recover \$569.9 million in west control area allocated power costs,^{161/} which was reduced to \$557.6 million in rebuttal testimony^{162/} and to \$554.3 million after agreeing to remove Chehalis.^{163/} PacifiCorp’s rebuttal testimony corrected certain obvious errors identified in ICNU’s and Staff’s rebuttal testimony, but also proposed alternative and new ways to “correct” identified errors in a effort to maintain a large overall power cost increase. The Commission should allow the Company to recover no more than \$532.5 million in overall west control area power costs, which would reduce PacifiCorp’s proposed rate increase by a little more than \$5 million.^{164/}

^{159/} Duvall, Exh. No. GND-5T at 26:8-15.

^{160/} Falkenberg, Exh. No. RJF-1CT at 23:1-2.

^{161/} Duvall, Exh. No. GND-1T at 2:6-8.

^{162/} Duvall, Exh. No. GND-5T at 14:2-8.

^{163/} Exh. No. 15C (PacifiCorp Response to Bench Request No. 3).

^{164/} This amount is an estimate, as the final revenue requirement impact will differ when run through the GRID model depending on which adjustments the Commission ultimately adopts. This estimated revenue requirement impact does not include ICNU’s WCA adjustments that total about \$1.67 million on a Washington basis that are addressed in the previous section of this Brief. The final power cost model result for net power costs should incorporate the Commission-adopted WCA adjustments.

1. PacifiCorp’s Test Year Fails to Include Margins that the Company Is Certain to Obtain

54 PacifiCorp’s decision to use a far forward test period for net power costs results in the Company failing to include numerous margins that the Company will earn on arbitrage sales in the western system. The Commission should correct this problem by imputing additional revenues from margins as did the Oregon Public Utility Commission (“Oregon Commission”).^{165/} This would reduce PacifiCorp’s rate increase by about \$586,000.^{166/}

55 PacifiCorp has proposed a future test period for net power costs which ends on March 31, 2012.^{167/} The use of a test period that is that is so far in the future causes problems because the Company only includes those wholesale transactions that it is aware of.^{168/} In a full historic test period, PacifiCorp could include all its short-term firm (“STF”) sales, but in a future test period many of these STF sales have not been completed.^{169/} PacifiCorp’s filing includes “very few STF transactions” and the Company has not included many of these routine profits that the Company will make during the test period.^{170/} PacifiCorp should not be permitted to game the arbitrary use of a 2012 test year in this manner.

^{165/} Re PacifiCorp’s 2008 Transition Adjustment Mechanism, Oregon Commission Docket No. UE 191, Order 07-446 at 7, 9 (Oct. 17, 2007).

^{166/} Falkenberg, Exh. No. RJF-1CT at 2 (Mr. Falkenberg’s Adjustment 1). The Washington revenue requirement impact of many of ICNU’s power cost adjustments is included in the Brief for illustrative purposes, as the final numbers may differ for those adjustments that are run through the final GRID model update, which will include the December 2010 forward price curve update. The adjustments may also change based on which adjustments the Commission ultimately adopts.

^{167/} Duvall, Exh. No. GND-1T at 1:20-21.

^{168/} Falkenberg, Exh. No. RFJ-1CT at 6:6-21.

^{169/} Id.

^{170/} Id. at 6:16-21; Buckley, Exh. No. APB-1CT at 6:12—8:4.

56 There are three types of STF sales that the Company enters into balancing, trading, and arbitrage.^{171/} Balancing sales match supply and demand to minimize costs, and ICNU does not propose an adjustment to this component.^{172/} Trading is an inherently risky activity that occurs when the Company takes a long or short position at one price and closes later at a different price.^{173/} Arbitrage is when the Company takes advantage of price differences between counterparties.^{174/} The goal of arbitrage is to generate profits and is typically less risky than trading.^{175/}

57 PacifiCorp “has not included any arbitrage and trading profits in the STF transactions it modeled in GRID.”^{176/} ICNU is not opposed to PacifiCorp’s proposal to exclude trading profits because they are risky transactions that the Company can be held responsible for.^{177/} The Company, however, should include all arbitrage STF transactions because the amounts can be quantified and they are known to occur.

58 PacifiCorp argues that arbitrage revenues are included in GRID as system balancing sales and purchases.^{178/} PacifiCorp’s arguments in this case are wrong and inconsistent with its assertions in Oregon that arbitrage is a fundamentally different type of transaction from balancing sales, balancing purchases and trading.^{179/} PacifiCorp also stated that each type of transaction has a different purpose, with system balancing being

^{171/} Falkenberg, Exh. No. RFJ-1CT at 6:19-21, 8:1—9:6.
^{172/} Id. at 8:1-12 (previous PacifiCorp power cost studies have included problems with balancing sales).
^{173/} Id. at 8:16-23.
^{174/} Id. at 8:13-15.
^{175/} Id.
^{176/} Id. at 9:9-10.
^{177/} Id. at 8:22—9:6; Buckley, Exh. No. APB-1CT at 8:17—9:2.
^{178/} Duvall, Exh. No. GND-5T at 31:16—32:3.
^{179/} Oregon Commission Docket No. UE 191, Order 07-446 at 7, 9.

designed to rebalance its loads and resources, and arbitrage and trading STF sales can produce profits.^{180/}

59 PacifiCorp argued at the hearing in this proceeding that the Commission has already rejected ICNU's proposal in the Company's 2006 general rate case.^{181/} ICNU previously argued that short-term firm sales should be removed from the Company's power cost model, which was opposed by PacifiCorp and Staff, and the Commission ultimately concluded that short term firm sales should be included in rates.^{182/} Both ICNU and Staff are following the Commission's precedent in recommending that the Commission include an accurate, normalized level of short term firm sales.

60 Staff has proposed a similar short term sales adjustment, but differs from ICNU's as it would allow the Company to retain 10% of the arbitrage "profits in order to maintain incentives for the Company to continue to maximize the use of its transmission system."^{183/} The principles of regulatory lag (which allows the Company to retain actual arbitrage profits) and normalization (which only allows customers an average rather than actual profits) should provide PacifiCorp with sufficient incentive to maximize arbitrage profits. PacifiCorp has also done nothing extraordinary that would warrant a 10% reward or to treat these sales profits differently from ordinary sales.

61 The Oregon Commission ultimately adopted a margin adjustment similar to ICNU's recommendation in this proceeding. The Oregon Commission recognized that

^{180/} Id. at 8-9.

^{181/} Falkenberg, TR. 646:3-16.

^{182/} Docket Nos. UE-061546 and UE-06817, Final Order ¶ 118.

^{183/} Buckley, Exh. No. APB-1CT at 8:6-15.

it “[i]s undisputed that GRID underestimates the volume of short-term wholesale transactions” and adopted an adjustment which reduced power costs to reflect the benefits associated with the Company’s arbitrage and trading activities because “[t]here is no evidence that those results are included in the GRID model results.”^{184/} The Oregon Commission concluded that these “revenues are properly considered in the calculation of [net power costs] and the model results should be adjusted as necessary to incorporate those revenues.”^{185/} Notably, the Oregon Commission did not believe it is necessary to provide PacifiCorp with 10% of any profits. The WUTC should make a similar adjustment, which is even more appropriate in this case because of PacifiCorp’s far forward test period.

2. The Sacramento Municipal Utility District Contract Should Be Modeled Based on Realistic Assumptions

62

PacifiCorp models the Sacramento Municipal Utility District (“SMUD”) sales contracts in a “most cost” manner by incorrectly assuming that SMUD will only take the power during the highest cost periods despite the fact that historic delivery patterns demonstrate that SMUD takes power under the contract in a lower cost delivery pattern. The Utah Public Service Commission (“Utah Commission”) has remedied this modeling error and twice adopted Mr. Falkenberg’s recommendations on this issue and

^{184/} Oregon Commission Docket No. UE 191, Order 07-446 at 11.
^{185/} Id.

rejected PacifiCorp's efforts to artificially inflate the costs of the SMUD contract.^{186/}

Correctly modeling the SMUD contract should reduce the rate increase by about \$459,000.^{187/}

63 The SMUD contract is a call option contract in which allows SMUD to pre-schedule energy deliveries based on its requirements and expected market prices.^{188/} PacifiCorp models the SMUD contract in GRID based on the assumption that SMUD will use the contract in the way that is most expensive for PacifiCorp.^{189/} As explained by the Utah Commission, PacifiCorp's approach is very unrealistic and results in modeling "such that it is more expensive to serve the obligation than has been the actual experience."^{190/}

64 PacifiCorp argues that the SMUD contract should not be based on historic delivery patterns because it assumes that SMUD will "act irrationally."^{191/} SMUD does not use its call options in the most costly manner to PacifiCorp because SMUD is not using the same forward price curves as PacifiCorp, and there are differences in delivery locations, transmission constraints, and SMUD's own generation.^{192/} In the end, SMUD

^{186/} Re Rocky Mountain Power 2007 General Rate Case, Utah Commission Docket No. 07-035-93, Report and Order on Revenue Requirements at 23 (Aug. 11, 2008); Re Rocky Mountain Power 2009 General Rate Case, Utah Commission Docket No. 09-035-23, Report and Order on Revenue Requirements, Cost of Service and Spread of Rates at 36 (Feb. 18, 2010).

^{187/} Falkenberg, Exh. No. RFJ-1CT at 2 (Mr. Falkenberg's Adjustment 6).

^{188/} Falkenberg, Exh. No. RFJ-1CT at 25:2-5.

^{189/} Id. at 25:7-17.

^{190/} Utah Commission Docket No. 07-035-93, Report and Order on Revenue Requirements at 23; Falkenberg, Exh. No. RFJ-1CT at 25:18—26:11, 28:10-22.

^{191/} Duvall, Exh. No. GND-5T at 36:8—37:12.

^{192/} Falkenberg, Exh. No. RFJ-1CT at 26:3-11; Buckley, Exh. No. APB-1CT at 12:11-16.

is attempting to serve its own customers in the least cost manner to SMUD, and is not attempting to maximize the cost to PacifiCorp.^{193/}

65 The best manner to normalize the contract for ratemaking purposes is the use of SMUD’s historic delivery patterns.^{194/} PacifiCorp argues that actual delivery patterns can be misleading.^{195/} ICNU agrees that it is often better to model contracts, but modeling the SMUD contract in the manner proposed by PacifiCorp is essentially “flying blind” because PacifiCorp does not know SMUD’s requirements for taking power under the call option contract.^{196/} Since this information is unknown and history demonstrates that SMUD does not use the contract in the “most cost” manner, the most reasonable approach is to rely upon how SMUD has used the energy in the past.

66 Finally, PacifiCorp argues in rebuttal testimony that if the SMUD contract is based on actual historic deliveries, then the Commission should recognize energy under the provisional clause of the contract.^{197/} This approach is flawed because PacifiCorp has never sought recovery of this contract option in prior proceedings, has not demonstrated its prudence, and did not propose to seek recovery of these costs in its direct case in this proceeding.^{198/} PacifiCorp has never sought recovery of the very unfavorable provisional aspects of the contract in any state and has consistently excluded this part of the contract from its power cost model presumably because of prudence

^{193/} Falkenberg, Exh. No. RFJ-1CT at 26:3-11.

^{194/} Utah Commission Docket No. 07-035-93, Report and Order on Revenue Requirements at 23; Buckley, Exh. No. APB-1CT at 12:18-14:2.

^{195/} Duvall, Exh. No. GND-5T at 38:9-19.

^{196/} Falkenberg, Exh. No. RFJ-1CT at 28:10-22.

^{197/} Duvall, Exh. No. GND-5T at 39:5-40:3; Falkenberg, Exh. No. RFJ-1CT at 29:1—30:17.

^{198/} Falkenberg, Exh. No. RFJ-1CT at 29:1-6.

concerns.^{199/} PacifiCorp has not submitted any information demonstrating its prudence in this proceeding.^{200/} When presented with similar arguments regarding the provisional clause of the contract, the Utah Commission rejected PacifiCorp's arguments and continued to base the SMUD contract on the prior four-year average of actual sales.^{201/}

3. PacifiCorp Should Accurately Model Non-Firm Transmission

67 PacifiCorp should correctly model the costs and benefits associated with non-firm transmission in GRID. PacifiCorp already models non-firm purchases and sales in GRID, and non-firm transmission is a resource that is available to the Company that is used on a daily basis that should also be included in GRID.^{202/} There is no compelling reason not to model both transmission as well as purchases and sales, which would reduce PacifiCorp's proposed rate increase by about \$429,000.^{203/}

68 PacifiCorp made a revision in rebuttal testimony to model non-firm transmission, but has done so in a counter-intuitive fashion than increases rather than decreases net power costs.^{204/} The Commission should adopt ICNU's non-firm transmission adjustment, which is consistent with how PacifiCorp models this resource in

^{199/} Id. at 29:7—30:5.

^{200/} See id. at 30:6-17.

^{201/} Utah Commission Docket No. 09-035-23, Report and Order on Revenue Requirements, Cost of Service and Spread of Rates at 36.

^{202/} Falkenberg, Exh. No. RFJ-1CT at 34:16-22.

^{203/} This estimated amount is larger than the amount included in Mr. Falkenberg's Adjustment 10 because PacifiCorp's rebuttal testimony modeled non-firm transmission in a manner that increased, rather than decreased, net power costs.

^{204/} Duvall, Exh. No. GND-5T at 27:19-22.

both Oregon and Utah.^{205/} PacifiCorp's approach should also be rejected because the Company initially proposed this new methodology in its rebuttal testimony. The Company has been modeling non-firm transmission in the same manner as proposed by Mr. Falkenberg for the last two general rate proceedings in Utah,^{206/} and the Company could have proposed a new method with its direct case, which would have provided the parties an opportunity to formally respond.

69

PacifiCorp's approach is also arbitrary and inaccurate. PacifiCorp proposes to include 100% of the historical costs associated with non-firm transmission for the most recent year, but uses a four year average to compute the non-firm transmission capacity. This mismatch inflates average costs. By modeling non-firm transmission as a fixed cost, rather than a volumetric cost as it does in Utah and Oregon, PacifiCorp creates a huge mismatch that inaccurately shows non-firm transmission as increasing rather than decreasing net power costs. Including non-firm transmission should not increase costs because PacifiCorp enters into these discretionary transactions if they are economic.^{207/}

^{205/} Falkenberg, Exh. No. RFJ-1CT at 34:8-15; see Re Rocky Mountain Power 2007 General Rate Case, Utah Commission Docket No. 07-035-93, Report and Order on Revenue Requirements, 2008 Utah PUC Lexis 158 at 160 (Aug. 11, 2008); Re PacifiCorp's 2011 Transition Adjustment Mechanism, Oregon Commission Docket No. UE 216, Stipulation at 4 (July 6, 2010).

^{206/} Falkenberg, Exh. No. RFJ-1CT at 34:8-15.

^{207/} Exh. No. GND-44 (PacifiCorp Response to ICNU DR 26.54).

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4. Washington Customers Should Not Be Charged Wind Integration Costs that Should Be Assigned to Wholesale Transmission Customers

70

PacifiCorp is seeking to charge Washington customers for the costs associated with providing wind integration services to wind projects which are not owned by the Company.^{208/} PacifiCorp has proposed that Washington customers pay all the wind integration costs associated with wind facilities that are not owned by PacifiCorp, but take wholesale transmission service from the Company. These non-Company owned wind facilities do not provide power to Washington ratepayers, who should not be charged their associated integration costs.^{209/} PacifiCorp should charge its wholesale customers for these services, and the Commission should not allow the Company to force its retail Washington customers to subsidize the Company's wholesale transmission customers. Removing these costs should reduce PacifiCorp's Washington rate increase request by \$506,607.^{210/}

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PacifiCorp plans to file a new wind integration charge as part of its Open Access Transmission Tariff ("OATT") with the Federal Energy Regulatory Commission ("FERC") next year, implicitly admitting that these costs should be charged to its

^{208/} PacifiCorp agreed to two ICNU wind integration adjustments, the inter-hour wind integration costs for non-owned resources (Mr. Falkenberg's Adjustment 12) and modeling of wind integration costs in GRID (Mr. Falkenberg's Adjustment 11). Duvall, Exh. No. GND-5T at 22:17-22 and 28:15-23. PacifiCorp also agrees that the parties do not have sufficient time to evaluate the Company's new wind integration study, and the Company has withdrawn its request to review the study in this case. Id. at 28:15-18.

^{209/} Buckley, Exh. No. APB-1CT at 24:11—25:6.

^{210/} This includes all of Mr. Falkenberg's Adjustments 13, 14 and 15 (Non-SCL, Oregon Wind Farm and Campbell Wind Intrahour Wind Integration) totaling approximately \$507,000. ICNU and Staff propose the same underlying wind integration adjustments, but the value of ICNU's adjustment is lower because Mr. Falkenberg already removed certain costs in a separate adjustment. Falkenberg, Exh. No. RJF-8CT at 3:15-23.

wholesale rather than retail customers.^{211/} PacifiCorp, however, wants retail customers to pay for these costs because the Company has elected not to seek a FERC-approved wind integration charge, even though the Company has been aware since at least 2004 that it would incur substantial wind integration costs.^{212/}

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PacifiCorp's only excuse is that FERC has provided "little regulatory guidance" regarding what would "an adequate proposal for a wind integration charge."^{213/} PacifiCorp admits that some utilities charge their transmission customers for wind integration services, but points to other utilities who have had their wind integration charges rejected by FERC.^{214/} PacifiCorp fails to recognize that in those cases in which FERC rejected a wind integration charge, FERC disputed the method the utility used to calculate the charge but did not challenge the principle that the utilities should recover these costs from their wholesale customers.^{215/} PacifiCorp has had six years to seek guidance from FERC regarding how to design an acceptable wind integration charge, and wholesale wind integration costs should not be recoverable from its retail customers because of the Company's failure to take action.

^{211/} Duvall, Exh. No. GND-5T at 46:1-11.

^{212/} Falkenberg, Exh. No. RJF-1CT at 45:3-9; Re PacifiCorp Large QF Avoided Cost Case, Utah Commission Docket No. 03-035-14, Report and Order at 23 (Oct. 31, 2005).

^{213/} Duvall, Exh. No. GND-5T at 45:12-15.

^{214/} Id. at 45:14-17 and 47:11-16 (Westar and BPA).

^{215/} Order Rejecting Proposed Tariff Revisions, FERC Docket No. ER09-1314-0000, Order No. 20091110-3051 ¶ 27 (Nov. 10, 2009).

5. The Commission Should Set Rates Based on More Realistic Planned Outage Schedules

73 PacifiCorp's proposed planned outage period for Hermiston plant should more accurately reflect the plant's operations and be scheduled during a least costly period. PacifiCorp's planned outage maintenance schedules used for ratemaking purposes have been extremely controversial,^{216/} and the Company has admitted that its proposed planned outage schedule for Colstrip 4 should be moved to a lower cost period.^{217/} The WUTC should also reject the proposed Hermiston outage schedules in favor of the more realistic schedule proposed by Mr. Falkenberg, and reduce the proposed rate increase by about \$310,000.^{218/}

74 For rate making purposes, PacifiCorp estimates the duration of planned outage events based actual outages during a historic four-year period, but uses a subjective and mechanical modeling process to determine the actual timing of the outages.^{219/} This has resulted in PacifiCorp's planned outage schedules proposed for ratemaking purposes being subject to repeated litigation and has resulted in significant disallowances in previous proceedings.^{220/}

75 Hermiston will likely undergo a significant change in planned outage strategy because of the termination of a low cost gas contract.^{221/} Historically,

^{216/} Falkenberg, Exh. No. RJF-1CT at 47:14-20.

^{217/} Duvall, Exh. No. GND-5T at 29:16-23; Falkenberg, Exh. No. RJF-1CT at 48:4-17.

^{218/} Reduced from the amount included in Mr. Falkenberg's Adjustment 16 because PacifiCorp accepted ICNU's Colstrip, but not Hermiston, planned outage adjustment.

^{219/} Falkenberg, Exh. No. RJF-1CT at 47:10-14.

^{220/} Utah Commission Docket No. 09-035-23, Report and Order on Revenue Requirements, Cost of Service and Spread of Rates at 36; Utah Commission Docket No. 07-035-93, Report and Order on Revenue Requirements at 23.

^{221/} Falkenberg, Exh. No. RJF-1CT at 48:18-22.

Hermiston operated as a baseload resource that operated nearly all the time, but once the contract expires, Hermiston will change and operate more like a peaking resource.^{222/}

The Commission should reflect these changed circumstances and assume that PacifiCorp will schedule the planned outage during a period of time “when the economics of running the plant are least attractive.”^{223/}

76

PacifiCorp makes a number of erroneous arguments against Mr.

Falkenberg’s proposed Hermiston adjustment. First, the Company argues that is unreasonable to assume that Hermiston will not have a planned outage in 2011.^{224/} This misinterprets ICNU’s proposal, as ICNU is not proposing that there not be an outage in 2011. The 2011 outage could occur before the start of the test period on March 31, 2011.^{225/} The Company also argues that it is incorrect to move the planned Hermiston outage from the spring (April and May) to the winter (February and March) when the Company may need the plant for winter peaking needs.^{226/} PacifiCorp’s argument is undermined by the fact that its actual, most current schedule for Hermiston supports Mr. Falkenberg’s recommendation.^{227/} In fact, a careful review of the actual planned outages shows that they are more closely aligned with Mr. Falkenberg’s proposed planned outage schedule than PacifiCorp’s.^{228/} The Commission should assume and require that

^{222/} Id.; Exh. No. GND-36 (PacifiCorp Response to ICNU DR 26.16).

^{223/} Falkenberg, Exh. No. RJF-1CT at 48:23—49:2; Exh. No. GND-35 (PacifiCorp Response to ICNU DR 26.13).

^{224/} Duvall, Exh. No. GND-5T at 30:8-11.

^{225/} See Exh. No. GND-52C (PacifiCorp Response to ICNU DR 27.2).

^{226/} Duvall, Exh. No. GND-5T at 30:8-11.

^{227/} Exh. No. GND-33C at 3-6 (PacifiCorp’s Response to ICNU DR No. 1.17); Exh. No. GND-52C (PacifiCorp Response to ICNU DR 27.2).

^{228/} Exh. No. GND-33C at 3-6 (PacifiCorp’s Response to ICNU DR No. 1.17).

PacifiCorp protect ratepayers by scheduling the planned outages for the Hermiston facility during a more reasonable time period.

6. GRID Fails to Properly Model Thermal Units' Minimum Capacities and Heat Rates

77 PacifiCorp's GRID model fails to properly account for the impact of forced outage rates on thermal units' minimum capacities and heat rates and unrealistically inflates net power costs. PacifiCorp's approach is also inconsistent with standard industry practice, and has been rejected by the Oregon Commission.^{229/} This would reduce PacifiCorp's proposed rate increase by about \$300,000.^{230/}

a. The Minimum Capacity of Thermal Generation Units Should Be Derated

78 Power cost models, including GRID, often model outages by "derating" the outages.^{231/} The purpose is to replace the actual capacity of a unit with the expected capacity that would occur under normal conditions. GRID models outages by "derating" the maximum capacity of a unit in every hour of the year based on historic forced outage rates.^{232/} For example, if a 100 MW unit has a 5% forced outage rate, then the unit is modeled as having a maximum capacity of 95 MW 100% of the time.^{233/}

^{229/} Falkenberg, Exh. No. RJF-1CT at 55:2-16. After a nearly three year proceeding, the Oregon Commission adopted ICNU's forced outage recommendations regarding modeling GRID's minimum capacities and heat rates. Re Commission Investigation into Forecasting Forced Outage Rates for Electric Generating Units, Oregon Docket No. UM 1355, Order No. 10-414 at 7-8 (Oct. 22, 2010).

^{230/} Falkenberg, Exh. No. RJF-1CT at 2 (Mr. Falkenberg's Adjustment 19).

^{231/} Oregon Docket No. UM 1355, Order No. 10-414 at 7.

^{232/} Duvall, Exh. No. GND-5T at 53:7-10.

^{233/} See Falkenberg, Exh. No. RJF-1CT at 55:16-19.

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PacifiCorp, however, does not apply the “deration factors” to the minimum capacity or the heat rate, contrary to standard industry practices.^{234/} The GRID model assumes that when a plant is experiencing outages, it cannot run at its maximum capacity, but it can run at its minimum capacity. In contrast, other standard industry models assume that when a generator is experiencing an outage, it does not run at either the maximum or minimum capacity.^{235/}

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PacifiCorp argues that the minimum capacity should not be adjusted because it is not “realistic to derate the minimum generation level” and that the reduction to the maximum capacity adequately reflects “the amount of generation no longer available due to outages.”^{236/} PacifiCorp ignores that the entire “deration” approach of modeling outages is “unrealistic” because it models each thermal unit as never being able to run at its maximum capacity. PacifiCorp also ignores that outages can occur when the unit is expected to operate at either minimum or maximum capacity.

81

PacifiCorp’s approach artificially inflates the “useful capacity” of a generation unit, which is the difference between the maximum and minimum capacity.^{237/} The goal of derating a unit’s minimum and maximum capacity is to estimate its expected operation levels. If a generator’s minimum capacity is not derated, then GRID simply assumes that the unit will never experience an outage when operating at its minimum

^{234/} Id. at 55:2-16.

^{235/} Id. at 55:5—56:9.

^{236/} Duvall, Exh. No. GND-5T at 54:19—55:6.

^{237/} Falkenberg, Exh. No. RJF-1CT at 56:1-9.

capacity. This fails to accurately model expected operations, overstates the expected value of the unit's capacity, and unnecessarily inflates net power costs.

b. Generator Heat Rates Should Realistically Model Generator Operations

82 A unit's heat rate must also be adjusted to correctly use a deration methodology when modeling forced outages. A heat rate is the amount of heat a generating unit consumes based on the capacity level the unit operates at. Thermal generators typically need less energy per unit of output when output rises. In other words, thermal units become more efficient as output increases.

83 PacifiCorp's deration approach lowers the capacity of generating units and simultaneously lowers their heat rates.^{238/} When derating the maximum capacity of a generation unit, GRID shows the unit as appearing to be less efficient than it actually is.^{239/} In order to avoid an overstatement in the amount of heat consumed, the heat rate curve should be adjusted so that the heat rate curve produces the same heat consumption at the derated maximum and minimum capacities as the unit would actually experience during normal operations. The heat rate consumption at the derated maximum capacity should equal the unit's actual maximum capacity, and the heat rate at the derated minimum capacity should equal the unit's actual heat rate at minimum capacity.

84 PacifiCorp agrees that ICNU's concerns are applicable when a unit is dispatched at its maximum capacity, but argues that ICNU's approach inflates the heat

^{238/} Id. at 56:10—59:13.

^{239/} Id. at 58:5—59:13.

rate during other time periods.^{240/} ICNU disagrees that its approach inflates heat rates, but it is important to note that the potential problems alleged by PacifiCorp can occur only during the time when units operate between the minimum and maximum derated capacities, which is a small minority of the time and a small portion of the ICNU’s heat rate adjustment.^{241/} The Oregon Commission rejected PacifiCorp’s arguments and explained that, since PacifiCorp has elected to use a deration approach to modeling forced outages that produces problems with the heat rate the majority of the time, “a corresponding adjustment to the unit’s modeled heat rate curve is necessary.”^{242/}

85 The overall reasonableness of ICNU’s minimum capacity and heat rate adjustments is also demonstrated by the fact that PacifiCorp applies both techniques to “fractionally owned units, such as Bridger and Colstrip.”^{243/} From a modeling perspective, fractional ownership is essentially the same as capacity deration, and there is no justification for applying the techniques for fractionally owned units, while ignoring them for units that are modeled as a fraction of their total capacity.

7. Abnormal Outages Should Be Removed From Normalized Ratemaking

86 PacifiCorp has proposed an unrealistic forced outage rate which assumes that extremely rare outages will occur during the test period. The Commission should make a standard normalizing adjustment and cap all extreme outages to more accurately

^{240/} Duvall, Exh. No. GND-5T at 53:17—55:19.

^{241/} See Falkenberg, Exh. No. RJF-1CT at 57:4—58:4.

^{242/} Oregon Docket No. UM 1355, Order No. 10-414 at 8.

^{243/} Falkenberg, Exh. No. RJF-1CT at 55:13-15.

predict the forced outages that are likely to occur when rates are in effect. Specifically, the Commission should adjust PacifiCorp's unplanned outage rate by capping the 2009 Colstrip 4 outage at 28 days, reducing the rate increase by about \$376,000.^{244/}

87 PacifiCorp's power cost model estimates the amount of unplanned outages during the test period by using a historic four-year period to estimate the outage rate for each thermal facility.^{245/} The forecasted planned outage rate reduces each unit's capacity, which reduces the amount of generation assumed to be available and increases net power costs.^{246/} PacifiCorp proposes to include the Colstrip 4 outage in the 2006-2009 four-year average, which was a very long and rare unplanned outage that results in an excessive Colstrip outage rate in for 2009 and inflates the outage rate for the test period.^{247/}

88 ICNU proposes that the Commission normalize the four-year outage rate by capping all outages at 28 days.^{248/} Normalization is a standard Commission accepted process for removing extreme events from historic data to more accurately set rates.^{249/} PacifiCorp's power costs should not be inflated to include costs associated with rare outages that are not expected to occur during the test period.^{250/} ICNU's proposal is also

^{244/} Falkenberg, Exh. No. RJF-1CT at 2 (Mr. Falkenberg's Adjustment 17).

^{245/} Id. at 49:1—50:2.

^{246/} Id. at 49:4-11.

^{247/} Id. at 49:17-50:8; Buckley, Exh. No. APB-1CT at 15:1-2.

^{248/} Falkenberg, Exh. No. RJF-1CT at 50:9-13. Staff similarly opposes the inclusion of the entire Colstrip outage in estimating PacifiCorp's outage rate that is expected to occur during the test period. Buckley, Exh. No. APB-1CT at 15:6-13. Mr. Buckley recommends that an 8% outage rate be imputed, which is still well above the historic outage rate for Colstrip. Buckley, Exh. No. APB-1CT at 17:8-12. Either Mr. Buckley's or Mr. Falkenberg's approach is reasonable.

^{249/} Docket No. UE-991606 and UG-991607, Third Suppl. Order ¶¶ 205-07.

^{250/} Buckley, Exh. No. APB-1CT at 15:6-13.

consistent with Oregon Commission precedent which states that an outage of longer than 28 days of duration, “no matter what the cause, is anomalous, and raises issues regarding its inclusion in normalized rates.”^{251/}

89 PacifiCorp argues that the Colstrip outage was prudent, and that ICNU’s proposal would result “in an abnormally low outage rate in the test year.”^{252/} PacifiCorp misconstrues ICNU’s normalization argument as a prudence challenge and does not address why a four-year outage rate should include extremely rare events. PacifiCorp did not rebut evidence that the use of a 28-day cap significantly improves the accuracy of outage rate forecasts, or dispute that the vast majority of all outages (99.8%) during the July 2004 to June 2008 period were less than 28 days in duration.^{253/} There is simply no reason to assume that an extreme outage is likely to occur during the test period, and PacifiCorp, who has the burden of proof, has presented no evidence that its abnormally high outage rate is more accurately predictive of future outage rates than ICNU’s proposal.

8. The Commission Should Remove the Costs Associated with Low Quality Bridger Fuel Supply

90 PacifiCorp’s Jim Bridger coal plant has experienced high cost and low quality fuel which has resulted in extremely high levels of lost production. The Commission should reduce rates by about \$651,000 and disallow the additional costs

^{251/} Re PacifiCorp, Docket No. UE 191, Order No. 07-446 at 20 (Oct. 17, 2007); Oregon Docket No. UM 1355, Order No. 10-414 at 5; Oregon Docket No. UM 1355, Notice at 3 (Oct. 7, 2009).

^{252/} Duvall, Exh. No. GND-5T at 49:9-21.

^{253/} Falkenberg, Exh. No. RJF-1CT at 51:1-9, 53:5-13.

caused by the poor Bridger fuel and remove all management bonuses, meals, gifts and donations associated with the Bridger plant because of this poor performance.^{254/}

91 Bridger has suffered abnormally high derations that have been caused by poor fuel quality.^{255/} Bridger’s fuel quality losses significantly exceed industry averages and have caused 78% of the lost energy at the facility.^{256/} These problems are excessive, especially in light of the fact that the coal produced at Bridger is from a captive mine under the Company’s direct control.^{257/} Despite these problems, PacifiCorp proposes to include almost \$1.8 million in management bonuses, meals and gifts associated with Bridger.^{258/}

92 PacifiCorp does not dispute that Bridger has poor fuel quality, but argues that overall plant costs are low and that the Commission should not focus on one poorly performing aspect of the Bridger plant.^{259/} The Company tacitly admits, however, that it is experiencing problems at the Bridger plant, and explains the variety of options it is exploring to resolve its fuel quality problems.^{260/} The Company even believes that it “anticipates that the consistency of the heat value and ash coal quality will improve”^{261/} and that it may not experience as many high outages in the future. The Commission should not set rates based on the assumption that PacifiCorp will fail to make these

^{254/} Id. at 2, 54:11-24 (Mr. Falkenberg’s Adjustment 18).

^{255/} Id. at 54:4-10.

^{256/} Id.

^{257/} Id. at 54:11-16.

^{258/} Id. at 54:17-24.

^{259/} Duvall, Exh. No. GND-5T at 51:8—53:5; Wilson, Exh. No. EDW-3T at 16:8—17:4.

^{260/} Duvall, Exh. No. GND-5T at 52:7-11; Exh. No. GND-57 at 14 (PacifiCorp Response to ICNU DR 28.10 (Rebuttal Testimony of Cindy Crane)).

^{261/} Exh. No. GND-50 (PacifiCorp Response to ICNU DR 26.96).

necessary improvements at Bridger, and should withhold any Bridger management related bonuses until the Company has demonstrated that it has fixed the fuel quality problems.

9. The Costs of the DC Intertie Should Be Removed from Rates

93 ICNU's and Staff's witnesses both recommend that all costs associated with the DC Intertie should be excluded from normalized rates. PacifiCorp has proposed to include significant annual costs associated with the DC Intertie and associated BPA contract that provides wheeling from the Nevada-Oregon Border ("NOB").^{262/} The Company admits that the contract is unlikely to be used and no purchases are modeled during the test period.^{263/} Removing the DC Intertie is estimated to reduce PacifiCorp's rate increase by about \$1.057 million.^{264/}

94 PacifiCorp does not dispute the basic facts associated with the DC Intertie contract, but instead argues that the Company prudently entered into the contract 16 years ago and that a disallowance should not occur unless ICNU shows "substantial evidence that the utility acted imprudently at the time they entered into the contract."^{265/} PacifiCorp's position ignores the principles of normalized ratemaking, which only charges customers those costs that the Company expects to incur on a normalized basis. PacifiCorp also did not provide any evidence demonstrating that the contract itself is

^{262/} Buckley, Exh. No. APB-1CT at 18:15-23; Falkenberg, Exh. No. RJF-1CT at 33:1—34:6.
^{263/} Buckley, Exh. No. APB-1CT at 19:2-13.
^{264/} Falkenberg, Exh. No. RJF-1CT at 2 (Mr. Falkenberg's Adjustment 9).
^{265/} Duvall, Exh. No. GND-5T at 42:16—43:22.

actually prudent.^{266/} The Company did not provide any information that it sought to modify the contract to benefit ratepayers.^{267/} Finally, “the Commission should remove the annual amount related to this contract from the determination of net power costs” because the Company has not identified, quantified and included the corresponding benefits for ratepayers.^{268/}

10. Start Up O&M Costs Should Be Accounted for When Adjusting the Company’s Start Up Commitment Logic

95 PacifiCorp’s GRID model contains a significant logic error that results in incorrect start up and shut down times for the Company’s gas fired units.^{269/} PacifiCorp agrees to make ICNU’s adjustment to correct the logic error to correct the “screens” which result in erroneous start up and shut down times.^{270/} A “screen” is a correction to the GRID logic that forces a specific daily schedule for gas plants to conform the decision to start to more realistic assumptions.^{271/} The Company, however, disagrees with making an Operations and Maintenance (“O&M”) change to the Company’s screens that lowers its power costs.^{272/}

^{266/} Duvall, TR. 304:14-17, 307:2-7.

^{267/} Exh. No. GND-47 (PacifiCorp Response to ICNU DR 26.85); Exh. No. GND-48 (PacifiCorp Response to ICNU DR 26.86); Falkenberg, TR. 659:6—660:13.

^{268/} Buckley, Exh. No. APB-1CT at 19:9-13; Falkenberg, TR. 658:17-22.

^{269/} The exact net power cost impact of this adjustment will depend on being run through the GRID model. Increased O&M costs should be removed from Mr. Falkenberg’s original calculation, but ICNU recommends that additional O&M costs should not be considered when determining the appropriate screen. Falkenberg, TR. 673:10-14, 669:2-17.

^{270/} Duvall, Exh. No. GND-5T at 22:4-11.

^{271/} Falkenberg, Exh. No. RJF-1CT at 11:10—12:2.

^{272/} Duvall, Exh. No. GND-5T at 55:20—56:11.

PacifiCorp claims that ICNU provided no explanation or support for its O&M screen adjustment.^{273/} PacifiCorp clarified in discovery that ICNU supported its adjustment with detailed workpapers and other information, but that the Company simply disagrees with ICNU’s recommendation.^{274/} ICNU agrees that PacifiCorp did not include increased O&M costs in its modeling of start up costs, but the Company includes O&M costs when determining the appropriate “screen” to modify GRID’s flawed start up logic.^{275/} Essentially, PacifiCorp is including in the screen calculation start up O&M costs which do not actually exist when determining whether a unit should start up or shut down.^{276/} Nonexistent start up O&M costs should not be considered in the screens because they produce fewer economic starts and unnecessarily increase net power costs.

11. Power Cost Updates

ICNU strongly disagrees with the manner in which PacifiCorp updated its power costs in its rebuttal testimony; however, while ICNU has concerns with PacifiCorp’s forward price curve updates, ICNU does not oppose the use of the December 2010 forward price curve update in its compliance filing in this proceeding. PacifiCorp’s power cost updates in other proceedings have been fraught with controversy and mistakes.

^{273/}

Id.

^{274/}

Exh. No. GND-53 (PacifiCorp’s Response to ICNU DR No. 27.17); Exh. No. GND-54 (PacifiCorp’s Response to ICNU DR No. 27.18); Exh. No. GND-55 (PacifiCorp’s Response to ICNU DR No. 27.21).

^{275/}

Falkenberg, TR. 673:10-14, 669:2-17 (PacifiCorp did not include start up O&M costs directly).

^{276/}

Id. at 669:9-13.

For the purposes of this proceeding only, ICNU does not oppose updating the Company's final power costs with the December 2010 forward price curve update that was included in the Company's response to the Commission Bench Request ("BR")

3. ICNU notes, however, that it has concerns with using the Company's forward price curves in updates because they are not based on published and verifiable data, but upon an opaque and assumption driven methodology developed by the Company. ICNU has also had difficulty conducting discovery regarding the Company's forward price curve in other proceedings, as the Company has objected to reasonable discovery requests and argued that ICNU must review certain information at the Company's or its attorneys' offices. Therefore, ICNU's acquiescence to the use of the December 2010 update in this proceeding is to reduce controversy and because of the limited apparent impact of the update in this case.

G. The Commission Should Adopt an Equal Percentage Rate Spread

If PacifiCorp is allowed to increase its rates in this case, then the Commission should spread any rate increase in this proceeding among all customer classes on an equal percentage basis. The Commission should follow its past precedent in ordering an equal percentage increase when all major customer classes are close to parity and rejecting a mechanical application of deriving cost-based increases on a single cost of service study.

The Commission has long recognized that spreading rate increases among customer classes is not an exact science and should often not be based strictly on only one cost of service study. For example, in PacifiCorp's 1985 general rate case, the Commission reaffirmed its standard and stated that "[w]e shall avoid the mechanical application of results of a given study and instead, as required by law, exercise our own considered judgment based upon the evidence in each proceeding to establish just and reasonable rates."^{277/} It is inappropriate to mechanically apply cost of service studies because there are numerous judgments inherent in such studies that prevent any single study from perfectly reflecting actual costs of providing service.^{278/} The Commission often considers other important factors, including the general economic conditions in the service territory, overall fairness, equity, gradualism and rate stability.^{279/}

The Commission's recent proceedings regarding rate spread have been consistent with this standard, and have adopted equal percentage increases for all classes that are within a range of reasonableness. When most customer classes are relatively close to parity, the Commission often adopts an equal percentage rate increase for all customer classes, except those which are significantly over or under recovering their costs.^{280/} This is consistent with PacifiCorp's last general rate case in which the

^{277/} WUTC v. Pacific Power & Light Co., Cause No. U-84-65, Fourth Suppl. Order at 41-42 (Aug. 2, 1985).

^{278/} WUTC v. Washington Natural Gas Co., Docket Nos. UG-940034 and UG-940814, Fifth Suppl. Order at 17 (Apr. 11, 1995); Schoenbeck, Exh. No. 3T at 3:1-10.

^{279/} Docket Nos. UE-090704 and UG-090705, Order No. 11 ¶ 307.

^{280/} Schoenbeck, Exh. No. DWS-3T at 3:7-18; e.g. Docket Nos. UE-090704 and UG-090705, Order No. 11 ¶ 307.

Commission approved equal percentage increases for all customers classes, with the exception of street lighting.^{281/}

102 The results of PacifiCorp’s current cost of service study support an equal percentage increase for all major customer classes. PacifiCorp’s initial filing proposed an equal percentage increase for all customer classes except a smaller increase for street lighting.^{282/} PacifiCorp’s cost of service study showed that all major classes were within 97% to 107% of parity.^{283/} The Commission should adopt an equal percentage increase for all customers with similar parity ratios because all the major classes are within a range of reasonableness, and cost of service results can vary significantly based on the underlying assumptions.^{284/}

103 Staff proposed that the rate spread in this proceeding be primarily based on an application of the results of PacifiCorp’s cost of service study, which would result in industrial and residential customers receiving a rate increase of 114% of the average using Staff’s recommended overall rate increase.^{285/} With scant analysis or explanation, PacifiCorp agreed to adopt Staff’s rate spread proposal in rebuttal testimony.^{286/}

^{281/} Docket No. UE-090205, Order No. 9 ¶¶ 19-22. While the approved rate spread was based on a settlement, Staff specifically supported the equal percentage approach as being reasonable, even though the industrial and commercial classes were much further from “parity” than in this case. Id. at ¶ 21; Schooley, Exh. No. TES-4T at 11:10-11.

^{282/} Griffith, Exh. No. WRG-1T at 2:22—3:5.

^{283/} Schoenbeck, Exh. No. DWS-1T at 5:12-13. A parity ratio is commonly used by the Commission to determine whether rate spread proposals are equitable among customer classes, and a parity ratio of less than 100% indicates that the class may not be paying its full share of costs while a parity ratio of more than 100% indicates that the class may be paying more than its full share of costs. Id. at 4:16—5:13.

^{284/} Id. at 5:12-13; Schoenbeck, Exh. No. DWS-3T at 2:1—4:8.

^{285/} Schooley, Exh. No. TES-1T at 34:13-23.

^{286/} Griffith, Exh. No. WRG-7T at 2:8—3:5.

Staff’s primary argument is that a range of reasonableness of “ten percent above or below” parity allows certain customer classes to “persistently benefit or suffer without meaningful movement towards a fair sharing of the system costs.”^{287/} First, in this proceeding ICNU has proposed that the Commission adopt an equal percentage increase to all customers within the reasonable range of 96% to 107% of parity, not the 90% to 110% of parity criticized by Staff. Next, Staff’s mechanical approach would disregard the principles of gradualism and rate stability, and could result in wild swings in the rate spread among classes from case to case. Staff’s recommendation is also inconsistent with the parity ratios from prior five years of PacifiCorp proceedings. Some customer classes, like residential customers, have seen their parity ratios sometimes slightly exceed, and other times be slightly under, 100% parity.^{288/} Other customers like industrial and general service customers have gradually moved toward closer to 100% parity.^{289/} Small changes in the assumptions in the Company’s cost of service study, or even unrelated or temporary economic or weather changes can have dramatic impacts upon the overall results of these parity ratios, which support not moving completely to the results of any single cost of service study, and adopting an equal percentage increase for all customers within a reasonable range.

Finally, the Commission should postpone consideration of Staff’s proposal if the Commission is inclined to move away from an equal percentage approach and

^{287/} Schooley, Exh. No. TES-4T at 12:1-8.

^{288/} Id. at 11:10-11 (the results are based on PacifiCorp’s filed cost of service results, which ICNU does not support).

^{289/} Id.

adopt a rate spread based more strictly upon a thoroughly vetted cost of service study. The Commission should provide all parties with advance notice prior to changing its historic approach to rate spread to rely upon a mechanical application of the results of a single cost of service study. ICNU's witness Don Schoenbeck would have conducted a more thorough review of PacifiCorp's cost of service study and proposed additional adjustments if he "had known of such a revised policy."^{290/} ICNU relied upon PacifiCorp's direct testimony that proposed an equal basis increase. As it has in the past, the Commission should adopt an equal percentage increase when classes are close to parity and provide the parties with notice and opportunity to more fully review PacifiCorp's cost of service study in the next proceeding.^{291/}

H. The Commission Should Make Significant Revenue Requirement Reductions Related to Administrative and General Costs

106 ICNU jointly sponsored the testimony of Greg Meyer with Public Counsel regarding a number of Administrative and General ("A&G") costs. ICNU joins the brief filed by Public Counsel regarding the technical aspects of these issues, but the Commission should note that Mr. Meyer's adjustments were very conservative, and he did not propose as aggressive of revenue requirement reductions that could be warranted in light of the current economic conditions. The Commission should consider making further and more significant revenue requirement reductions in light of the Company's overall failure to reduce its costs.

^{290/} Schoenbeck, Exh. No. DWS-3T at 3:18-21.

^{291/} WUTC v. Avista, Docket Nos. UE-090134, UG-090135 and UG-060518, Order No. 10 at ¶ 31 (Dec. 22, 2009).

1. Cash Working Capital

107

Mr. Meyer proposed a conservative cash working capital adjustment which recommends a zero allowance.^{292/} Staff has proposed a different approach to calculating cash working capital that results in a zero allowance and removes additional costs from rate base, which has a larger revenue requirement impact.^{293/} Both ICNU's and Staff's approaches are reasonable, especially in light of the controversy surrounding past PacifiCorp cash working capital issues^{294/} and the fact that the Company has not performed a proper lead lag study showing what working capital, if any, it actually has for Washington. Any future lead lag study should be calculated to determine the working capital necessary for service in the western control area.^{295/}

2. Compensation

108

The Commission should at a minimum adopt Mr. Meyer's wages, salaries and bonuses adjustment and should consider completely disallowing all non-union wages and salaries in light of the current economy. PacifiCorp is clearly operating on a business-as-usual basis in terms of controlling its internal costs and has cherry-picked comparison companies to construct the relevant market for ascertaining the amount of its proposed salary increases by selectively ignoring those companies (including some electric utilities) which have not increased their employee salaries.^{296/}

^{292/} Meyer, Exh. No. GRM-1CT at 2:1-2, 3:20—9:8.

^{293/} Schooley, Exh. No. TES-1T at 6:3-7.

^{294/} Docket Nos. UE-061546 and UE-060817, Final Order ¶¶ 158-164.

^{295/} Id. at ¶162.

^{296/} Meyer, GRM-1CT at 2:1-2, 3:20—9:8.

3. Other A&G Issues

109 ICNU supports the brief of Public Counsel recommending revenue requirement reductions associated with residential revenues, outside legal expense, pro forma adjustments, and the MEHC management fee.

IV. CONCLUSION

110 Given the size of this proposed rate increase on the heels of a 5.3% general rate increase, the Commission should carefully review all proposed increases in this case. The level of proposed increase is rate shock. The record demonstrates that the Commission should at a minimum reduce PacifiCorp's rate filings by approximately \$31 million. The Commission should also exercise its discretion to further reduce PacifiCorp's rate increase because of PacifiCorp's failure to adopt significant cost reductions in light of current poor economic conditions, and PacifiCorp's previous misleading and inaccurate information regarding its costs and revenues, including revenues from REC sales. Finally, the Commission should adopt an equal percentage rate increase consistent with historical practice and the Company's initial filing.

Dated this 11th day of February, 2011.

Respectfully submitted,

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