

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

**WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,**

Complainant,

v.

**PACIFICORP D/B/A PACIFIC POWER
& LIGHT COMPANY,**

Respondent.

DOCKET UE-100749

INITIAL BRIEF ON BEHALF OF COMMISSION STAFF

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February 11, 2011

CONFIDENTIAL PER PROTECTIVE ORDER

Redacted Version

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I. INTRODUCTION

1 This case marks the fifth rate case PacifiCorp has filed in the last six years. This case is the Company's largest rate increase request in that time span, despite adding no major facilities.¹ Although this rate increase occurs in times of economic distress, PacifiCorp's wants to increase its revenues by nearly 18 percent.

2 A rational person would think a utility company would not ask for higher profits when interest rates are at all time lows, but they would be wrong: PacifiCorp is seeking approximately \$12 million more in profits than Staff recommends to the Commission.² PacifiCorp pumps up its profits with an equity ratio that has ballooned to over 52 percent,³ plus a return on equity (ROE) of 10.6 percent.⁴ This return on equity is not only much higher than previously authorized, but it is also well above the low end, and even above the midpoint, of the ROE range of the Company's own witness.⁵ In short, there is no way this case legitimately can be called a "make whole" case, as PacifiCorp unfathomably contends.⁶

3 Perhaps the Commission cannot tell the Company that its rate request is unrealistic. However, the Legislature places the burden of proof squarely on PacifiCorp.⁷ The Commission can and should closely scrutinize the Company's filing to assure the public that rates will be set at the lowest reasonable cost. Staff's recommendations are based on sound regulatory methodologies that produce a fair and reasonable result. For the reasons stated in this brief, the Commission should allow PacifiCorp a rate increase of no more than 9.5 percent.⁸

¹ Reiten, Exhibit No. RPR-1T at 4:7-8.

² Foisy, Exhibit No. MDF-2 at 6:1, column G. This figure is based on the per books net operating income and rate base and the differing rates of return (ROR) for Staff and Company. The profit difference between PacifiCorp's and ICNU's rate of return recommendations is approximately \$9.8 million.

³ Williams, Exhibit No. BNW-1T at 3:1-7.

⁴ Williams, Exhibit No. BNW-1T at 3:1-7.

⁵ Hadaway, Exhibit No. SCH-8T at 30:9-10 (range of 10.3 percent to 10.8 percent; the midpoint is 10.55 percent).

⁶ Reiten, Exhibit No. RPR-1T at 6:2-3.

⁷ RCW 80.04.130(4): "At any hearing involving any changes in any schedule ... the effect of which is to increase any rate ... theretofore charged, the burden of proof to show that such increase is just and reasonable shall be upon the public service company."

⁸ This figure is calculated in Appendix 1, Staff Revenue Requirements Summary. Appendix 2 is Revenue Requirement Impact of Staff Adjustments, and Appendix 3 contains a list of Staff's net power cost adjustments.

II. REVENUES

A. Normalizing Temperature Sensitive Loads

4 Many PacifiCorp customers use electricity for space heating. Changes in temperature greatly affect their usage, which in turn greatly affects the Company's revenues. In a rate case, test period revenues are normalized to reflect "normal" temperatures.⁹

5 There are two issues. The first issue relates to Adjustments 3.1 and 3.7, the "standard" temperature normalization adjustment which is based on Commission-approved procedures. The Staff/Company difference here is due to the marginal statistical support PacifiCorp provides to adjust the Commercial schedules to normal temperatures.

6 The second issue relates to an adjustment offered by ICNU/Public Counsel, based on a snapshot of evidence that suggests increasing Residential customer usage. However, that snapshot is out of focus and provides an unreliable basis for measuring Residential customer usage.

1. **The Commission Should Accept the Company's Temperature Normalization Procedures, But Reject the Adjustment for Commercial Schedules Because it is Insufficiently Supported**

7 Pursuant to the Stipulation in Docket UE-050684, the Company filed its temperature normalization adjustment in this case using the Commission-approved temperature normalization methodology.¹⁰ Staff confirmed that the methodology the Company used is consistent with that Stipulation.¹¹

8 However, as applied to the Company's Commercial schedules, PacifiCorp's application of that methodology failed to produce reliable results. Staff reviewed the statistical results, and found that while the Company was able to support the sensitivity coefficients for the Residential schedule (i.e., a model which produces an R-squared of 0.976),¹² the Company was unable to

⁹ Novak, Exhibit No. VN-1CT at 4:1-9.

¹⁰ Novak, Exhibit No. VN-1CT at 2:14 to 3:20.

¹¹ Novak, Exhibit No. VN-1CT at 2:14-15.

¹² Novak, Exhibit No. VN-1CT at 8:20.

support the sensitivity coefficients for the Commercial schedules (i.e., a model which produces an R-squared of only 0.644).¹³

9 In other words, using the Company's equations, the statistical model failed to explain 35.6 percent of the variation in Commercial loads. Consequently, Staff rejected that part of the Company's temperature normalization adjustment, which reduces the overall adjustment by \$965,317 at the revenue requirement level.¹⁴

10 PacifiCorp does not contest the calculation, but opposes the adjustment. Mr. Duvall says it is not appropriate to use R squared as a single measure of the model, because it will increase when variables are added, and those variables may not add explanation.¹⁵ Nonetheless, the R squared is a standard measure of the quality of fit to the data. If the R squared is too low, this suggests the fit function (or model) is not adequate.

11 The Company speculates the problem is due to allegedly heterogeneous customer characteristics;¹⁶ perhaps so, but that does not improve the result. Staff promotes a more detailed analysis of the data to derive a more statistically valid result for the Commercial class. In the meantime, the Commission should not accept the Company's poorly constructed adjustment.

12 Mr. Duvall goes on to argue that removing the Company's Commercial class adjustment reduces the accuracy of the load forecast.¹⁷ That is an unhelpful, circular argument because it presupposes the accuracy of the Company's temperature normalization adjustment. Staff can agree that if the Company improves the accuracy of its study, the load forecast will improve, also.

13 Citing a statistics book, PacifiCorp goes on to argue the Commission should accept the Company's adjustment unless it produces "erroneous results or was calculated in a manner inconsistent with Commission practice."¹⁸ However, the Company conceded that book had

¹³ Novak, Exhibit No. VN-1CT at 8:5-8.

¹⁴ Novak, Exhibit No. VN-1CT at 11:1-14.

¹⁵ Duvall, Exhibit No. GND-5T at 9:11-19,

¹⁶ Duvall, Exhibit No. GND-5T at 10:15-17.

¹⁷ Duvall, Exhibit No. GND-5T at 10:18-23.

¹⁸ Duvall, Exhibit No. GND-5T at 4-11.

nothing to do with burden of proof in a rate case.¹⁹ The Company's proposed standard improperly allocates the burden of proof to Staff and other non-Company parties.

14 But, even under the Company's proposed standard, the Commission should accept Staff's adjustment, because the R-squared for PacifiCorp's Commercial schedules (0.644) is inconsistent with the R-squared developed by Avista for its Commercial schedules (over 0.8²⁰).

15 Staff constructively suggests PacifiCorp should use other methods for evaluating the data, including evaluating subgroups within the class.²¹ The Company is amenable to working on the issue.²² In the meantime, the Commission should reject the Company's temperature adjustment to the extent it applies to the Commercial class.

2. The Commission Should Reject ICNU/Public Counsel's Residential Revenues Adjustment Because it is Based on Unadjusted Data. Properly Adjusted, the Data Provide No Basis for Adding More Revenue to the Test Year

16 Apart from cost of capital, the largest ICNU adjustment (also sponsored by Public Counsel) purports to "normalize" PacifiCorp's residential revenues based on the suggestion that PacifiCorp's residential customers' actual consumption is significantly higher than their temperature normalized consumption.²³

17 This unwarranted collateral attack on the temperature normalization analysis is based on a snapshot of actual Residential usage over the last five years.²⁴ The numbers show higher actual usage each year from 2005 to 2007, a decrease in 2008, followed by an increase in 2009. Remarkably, Mr. Meyer testified this information "just raised a concern"²⁵ for him, yet he converted this concern into an adjustment that imputes an additional \$2,238,744 of revenues into the test year.²⁶ Perhaps even more remarkable is the fact that Mr. Meyer told the Commission

¹⁹ Duvall, TR. 324:13-19.

²⁰ Novak, Exhibit No. VN-1CT at 9:1-5.

²¹ Novak, Exhibit No. VN-1CT at 11:16-23.

²² Duvall, Exhibit No. GND-5T at 11:1-5.

²³ Meyer, Exhibit No. GRM-1T at 16:18:13.

²⁴ Meyer, Exhibit No. GRM-1T at 17, Table 3.

²⁵ Meyer, TR. 512:11.

²⁶ Meyer, Exhibit No. GRM-1T at 18:12-13.

“you have to look at the reasons why the usage is where it is in comparison to the weather”,²⁷ yet he failed to do that analysis.

18 Staff did that analysis. Mr. Schooley compared the 12-month period ending December 31, 2009, which is the period with the largest actual consumption on Mr. Meyer’s chart, with the 12-month period ending June 2008. Like ICNU/Public Counsel, Staff also found a sizeable (two percent) increase in actual residential customer usage between these periods. However, on a temperature normalized basis, there was “virtually no change in usage,” and when the increase in customers between the periods is taken into account, “usage actually declined slightly.”²⁸

19 As Mr. Schooley concisely summarized: “In other words, all of the increase in actual usage over these two recent periods can be explained by temperature differences alone. Public Counsel and ICNU ignore this fact.”²⁹

20 It is also noteworthy that ICNU/Public Counsel failed to directly challenge any of the equations, models or other features of the Company’s temperature normalization adjustment for the Residential class.³⁰ By contrast, Staff carefully reviewed all Company equations, models and other features, and found them to be appropriate for purposes of Residential class temperature normalization.³¹ In particular, the Company’s statistical analysis supporting the Residential class temperature normalization adjustment produced an R-squared value of .976. This proves PacifiCorp has demonstrated an excellent correlation between temperature fluctuations and Residential electrical consumption.³²

21 Notably, ICNU/Public Counsel’s witness elected to not respond to Staff’s detailed review of the temperature normalization analysis, and failed to directly address any of these material facts.

²⁷ Meyer, TR. 512:6-8.

²⁸ Schooley, Exhibit No. TES-4T at 5:1-13.

²⁹ Schooley, Exhibit No. TES-4T at 5:14-16.

³⁰ Meyer, TR. 489:13-18 & TR; 490:15-22.

³¹ Novak, Exhibit No. VN-1CT at 4:11 to 6:18.

³² Novak, Exhibit No. VN-1CT at 8:18-22.

22 The choice is clear: The Commission should reject ICNU/Public Counsel's adjustment because it is founded on speculation, not explanation.³³ The Commission should accept Staff's well-founded analysis of Residential consumption that uses unchallenged facts to rationally explain the recent variations in actual usage.

B. The Commission Should Return Revenues From Renewable Energy Credits³⁴ (RECs) to the Ratepayers, and Require PacifiCorp to Create a Regulatory Liability Account to Capture REC Revenues From January 1, 2010, Forward

23 In its recent order in Docket UE-070725,³⁵ the Commission held that "PSE's retail customers should share the proceeds from the sales of the RECs ... on the same basis as the Commission allocates the costs of these resources in the ratemaking process."³⁶ Consistent with this policy determination, Staff Adjustment 3.5 returns \$4,211,639 in revenues PacifiCorp generated from the sale of RECs.³⁷

24 PacifiCorp concurs,³⁸ but supports a revised figure of \$4.8 million in test year revenues.³⁹ The Company's \$4.8 million figure is the accurate level of REC revenues for the test year ending December 31, 2009. Consequently, Staff agrees the Commission should use that figure for the test year level of RECs.

25 The dispute centers around Staff's recommendation that the Commission order PacifiCorp to establish a regulatory liability account, and book to that account all REC revenues the Company accrues from January 1, 2010 forward, for later disposition by the Commission. This will insure REC revenues are returned to the ratepayers, dollar for dollar, consistent with the Commission's order in Docket UE-070725.⁴⁰

³³ Even if this ICNU/Public Counsel adjustment had conceptual merit, the adjustment is incomplete, because it fails to account for the impact on inter-jurisdictional allocation factors and the production factor. Schooley, Exhibit No. TES-4T at 6:6-8 and Exhibit No. TES-6T at 2:11-14.

³⁴ These credits are also referred to as "Green Tags" or "Green Tag Revenues" in this case.

³⁵ *Utilities and Transportation Commission v. Puget Sound Energy Co.*, Docket UE-070725, Order 03 (May 20, 2010) at 17-19, ¶¶ 41-47.

³⁶ *Id.* at 30, Conclusion of Law 84.

³⁷ Foisy, Exhibit No. MDF-1CT at 9:20.

³⁸ Duvall, Exhibit No. GND-5T at 3:18.

³⁹ Dalley, Exhibit No. RBD-4T at 10:3.

⁴⁰ Foisy, Exhibit No. MDF-1CT at 10:21.

26 The Company objects to Staff's recommendation on three grounds, none of which hold water. First, the Company claims that using both a test year REC amount and an amount in a regulatory liability account is a "double-count" of REC revenues.⁴¹ However, this claim is premature. If a double counting issue is actually presented when and if the Commission actually disposes of funds from the regulatory liability account, PacifiCorp can raise the "double-counting" issue at that time.⁴²

27 Next, the Company complains it cannot track RECs and associated costs unless the Commission amends its view on the "pseudo-actual" issue that was raised in regard to PacifiCorp's proposed PCAM a few years' back.⁴³ The Company offers Exhibit No. GND-6C in an effort to demonstrate that because it is regulated under two inter-jurisdictional allocation methods (West Control Area in Washington and Revised Protocol in the remainder of the states), it is possible for the Company to allocate to ratepayers more RECs than it has.⁴⁴

28 The Company is not being evenhanded in its use of this argument, because it raised no such objection when it deferred (and now is collecting from ratepayers) the costs of the Chehalis Plant, which is also allocated differently to Washington than the other states.⁴⁵ More generally, PacifiCorp is identifying a problem inherent in the fact that the states in which it operates do not use the same allocation method. If the Commission accepts PacifiCorp's argument, that would negate each state's right (if not its duty), to regulate its fair share of PacifiCorp's utility operations.

29 PacifiCorp's failure to have a uniform allocation methodology in all of its states is not the fault of the Commission or the ratepayers. If the result in Exhibit No. GND-6C is a consequence of PacifiCorp's failed attempt at achieving a uniform allocation methodology in each jurisdiction it serves, so be it. There is no legal or policy reason for the Commission to resolve PacifiCorp's

⁴¹ Duvall, Exhibit No. GND-5T at 6:4-9.

⁴² If the Commission believes the Company's "double-count" claim is ripe and has merit, the Commission should simply adopt Staff's alternative, surcredit recommendation. See Foisy, Exhibit No. MDF-1CT at 11:3-8.

⁴³ Duvall, Exhibit No. GND-5T at 6:17 to 7:6.

⁴⁴ Duvall, Exhibit No. GND-5T at 7:2-6.

⁴⁵ Duvall, TR. 320:8 to 323-10.

jurisdictional allocation problems by depriving Washington ratepayers their fair share of RECs. Staff's recommendation allocates REC revenues consistent with the resources that generate the RECs.

30 Finally, PacifiCorp suggests Staff's regulatory liability account proposal is retroactive ratemaking.⁴⁶ The Company apparently believes that because no party has sought an accounting order for RECs, "it is retroactive ratemaking to defer amounts prior to the filing of a petition for a regulatory accounting order."⁴⁷

31 PacifiCorp ignores the fact that the Commission has before it a rate case, where the Company has put into issue its revenues, expenses and rate base amounts. No party is required to file an accounting petition outside a rate case when the issue is presented in the rate case itself. In other words, a rate case is a proper forum to resolve issues involving appropriate rate making treatment of issues such as REC revenues.

32 In this particular rate case, the Commission has before it a test year ended December 31, 2009, with a 2011-2012 rate year. Events and costs that materialized in 2010 are also before the Commission, and Staff's proposing nothing more than to require PacifiCorp to defer revenues associated with the period January 1, 2010, forward. This is not a case where a party seeks regulatory treatment of costs incurred prior to a test period.

33 It is common and appropriate to establish regulatory treatment of items that occur during a test year and up to and including the rate year. The Commission restates, normalizes, pro forms or eliminates expenses in the rate setting process. The Commission also permits amortization of certain costs as well.

34 For example, no party to this case is required to file an accounting petition if it finds an extraordinary item on PacifiCorp's books, and asks the Commission to require the Company to defer and amortize that cost over five years. In fact, in this case, the parties agree to shorten the amortization period for SO₂ allowances,⁴⁸ without the necessity of filing an accounting petition

⁴⁶ Duvall, Exhibit No. GND-5T at 7:7-17.

⁴⁷ Duvall, Exhibit No. GND-5T at 9-17.

⁴⁸ Dalley, Exhibit No. RBT-4T at 4:19.

or even petitioning to reopen the docket⁴⁹ in which the Commission first approved that amortization.

35 Another example is the 1999 Avista rate case, which was based on a 1998 test year.⁵⁰ An issue in that case was an adjustment called the “PGE Contract Buy Down”, in which Avista decided to assign to a subsidiary a contract obligation Avista had to PGE, in return for \$143.4 million. While Avista received the \$143.4 million (system), it amortized that amount on its books, such that during the test year, Avista was receiving annual revenues of \$1.8 million.⁵¹

36 To address the transaction, the Commission determined that Avista’s power supply costs should be increased by \$18 million per year,⁵² but ordered Avista to reflect the time value of Washington’s share of the \$143.4 million lump sum payment Avista received in 1998 “in the balance of funds available on October 1, 2000”, i.e., the 21 month period after the end of the test period.⁵³ In other words, the Commission did what PacifiCorp is saying the Commission cannot do; go outside the test year and address items related to that later period.

37 It is also instructive that in PacifiCorp Docket UE-020714, the Commission recognized that the retroactive ratemaking concept is “not so rigid as sometimes viewed.” The Commission went on to explain:

There are equally well-established exceptions [to the retroactive ratemaking concept]. The use of deferred accounting to track costs incurred by a regulated utility during one period, with the possibility for inclusion in rates in a future period, while not ratemaking per se, sets up the possibility of such an exception. When the regulatory authority allows some, or all of the prior deferred expenses in rates, this is not considered a violation of the prohibition against retroactive ratemaking, but instead is recognized as a shift in the timing of the collection of the expense. As Goodman elaborates, “the agency may lawfully allow the utility to make-up for prior deferred costs as an exception to the ‘matching principle,’ that is, the matching of ratepayer costs and benefits.”⁵⁴

⁴⁹ *Utilities and Transportation Commission vs. PacifiCorp*, Docket UE-940947, Commission Decision and Order Granting Authorization (September 14, 1994) at 3.

⁵⁰ *Utilities and Transportation Commission v. Avista Corp.*, Dockets UE-991606 and UG-991607, Third Supplemental Order (September 29, 2000) at 10, ¶ 22.

⁵¹ *Id.* at 27, ¶ 71.

⁵² *Id.* at 28, ¶ 74. The \$18 million figure was \$16.2 million plus the booked amount of \$1.8 million.

⁵³ *Utilities and Transportation Commission v. Avista Corp.*, Dockets UE-991606 and UG-991607, Fourth Supplemental Order on Reconsideration (November 9, 2000) at 3-4, ¶ 12.

⁵⁴ *Petition of PacifiCorp*, Docket UE-020714, Third Supplemental Order (September 27, 2002) at 7, ¶ 24, citing and quoting Leonard Saul Goodman, *The Process of Ratemaking* (1998), at 322.

38 Staff understands the courts have analyzed retroactive ratemaking in a wide variety of ways, some of which even might find a PCAM of questionable legal validity.⁵⁵ However, there is no judicial precedent on the issue in this state, and Staff believes the Staff's recommendation in this case is appropriate and reasonable.

39 In sum, we see no impediment to Staff's recommended deferral of REC revenues to properly apply the Commission's policy that such revenues belong to ratepayers. The Commission should adopt Staff's recommendation and order the Company to defer REC revenues from January 1, 2010, forward, for future Commission consideration, and include \$4.8 million of REC revenues in base rates.

III. EXPENSES

A. Wage and Salary Adjustments

40 There are three contested wage and salary adjustments. Adjustment 4.2, General Wage Increase Annualization, is a restating adjustment, and Adjustment 4.3, General Wage Increase Pro Forma, as the name implies, is a pro forma adjustment. Also at issue is ICNU/Public Counsel's proposal to eliminate one-half of the payments under the Company's Annual Incentive Program (AIP).

41 As we explain below, Staff evaluated each of these adjustments, and found no basis for contesting the Company's restating and pro forma adjustments. However, Staff found ICNU/Public Counsel's adjustment to be inconsistent with past Commission rulings on these types of adjustments.

42 Staff is not thrilled to support the Company's wage and salary adjustments in the tough economic climate facing the ratepayers in Washington. However, Staff could not find a defensible basis for rejecting PacifiCorp's adjustments, or accepting the adjustment of ICNU/Public Counsel.

⁵⁵ See, e.g., Stefan H. Krieger, *The Ghost of Regulation Past: Current Applications of the Rule Against Retroactive Ratemaking in Public Utility Proceedings*, 1991 Univ. Ill. L. Rev. 983.

1. The Commission Should Accept the Company's General Wage Increase Annualization Adjustment Because it Properly Restates Test Year Wages. ICNU/Public Counsel's Objections Are Ill-Supported

43 PacifiCorp included a restating adjustment to restate labor expenses to reflect the salary increases for all employees that occurred during the test year.⁵⁶ The adjustment increases revenue requirements by \$30,329. Staff reviewed the adjustment and does not contest it.

44 ICNU/Public Counsel oppose the adjustment, and want the Commission to eliminate the adjustment and reduce test year wages by another \$128,366, by reducing the salary increases for the Officer/Exempt Labor Group to 2.07 per cent.⁵⁷ In effect, Mr. Meyer gives the executives the same wage increase as the average increase paid to all other employee groups.⁵⁸

45 ICNU/Public Counsel argue the Company has not adequately supported the increases, and they cite PSE, which had lower executive wage increases (less than one percent) and another utility which elected not to seek recovery of \$2.9 million in certain management salary increases in its last rate case.⁵⁹

46 Obviously, evidence of a utility voluntarily removing a cost is not helpful to the Commission in a case like this one, where the utility has not done so. The PSE example is also unhelpful because it addresses different types of employees. As PacifiCorp noted, the majority of the employees at issue in ICNU/Public Counsel's adjustment are professional, technical, support and middle management employees, not executives.⁶⁰

47 Finally, even if ICNU/Public Counsel's adjustment was based on defensible comparisons of the various employees of the various companies, their calculation of the adjustment assumes the comparability of the wage and benefits of the various employee classifications. As PacifiCorp showed, there is no comparability.⁶¹ In other words, ICNU/Public Counsel is mixing "apples and oranges" because the compensation packages of its Officer/Exempt employees and union employees are not consistent with each other.

⁵⁶ Dalley, Exhibit No. RBD-1T at 10:15-18.

⁵⁷ Meyer, Exhibit No. GRM-1CT at 29:9.

⁵⁸ Meyer, Exhibit No. GRM-1CT at 30:1-5.

⁵⁹ Meyer, Exhibit No. GRM-1CT at 31-32.

⁶⁰ Wilson, Exhibit No. EDW-3T at 13:9-17.

⁶¹ Meyer, Exhibit No. EDW-3T at 12:14 to 13:4.

2. The Company Correctly Calculated its Pro forma General Wage Increase Adjustment; ICNU/Public Counsel’s “Matching” Argument Falls Short

48 PacifiCorp proposes a \$392,082 adjustment that gives pro forma treatment to known and
measureable union contract-based wage increases effective as of December 2010.⁶² There is no
dispute that these wage increases are known and measureable; they are real, contractual, and
have taken effect.⁶³ Staff does not contest the Company adjustment.

49 ICNU/Public Counsel wants the Commission to disallow this adjustment. Relying on a
Commission order in Dockets UE-090704 and UG-090705,⁶⁴ discussing the “matching
principle”, they claim that the Commission should offset these wage increases with additional
SO₂ revenues or the benefits of certain expiring amortizations of regulatory assets.⁶⁵

50 Staff believes that ICNU/Public Counsel have over-read the language in that prior order, ,
where the Commission noted two categories of offsetting factors: First, whether the expense
increase “directly produces any offsetting benefits”, and second, whether “contemporaneous
changes in revenues or expenses that are not directly related to the proposed pro forma
adjustment, but which offset its financial impacts.”⁶⁶

51 The first category describes traditional analysis used by the Commission to evaluate
adjustments. For the second category, however, fairness would require a party to net all changes
in revenues and expenses utility-wide to determine whether a particular adjustment is offset.

52 For example, as we noted above, ICNU/Public Counsel want the Commission to offset
the pro forma wage increase by recognizing that an amortization of a regulatory asset may be
soon expiring. However, assuming such an offset may exist, there may also be many cost
increases that “offset the offset”. In other words, while this second category of offsetting factors
has support in theory, it is very complex to apply in practice. Suffice it to say, ICNU/Public
Counsel fail to address that complexity in this case. Alternatively, if ICNU/Public Counsel

⁶² Dalley, Exhibit No. RBD-1T at 10:18-20.

⁶³ Dalley, Exhibit No. RBD-1T, Tab 4, O&M Adjustments at page 4.3.3; Wilson, Exhibit No. EDW-3T at 15:12.

⁶⁴ *Utilities and Transportation Commission v. Puget Sound Energy*, Dockets UE-090704 and UG-090705, Order 11 (April 2, 2010).

⁶⁵ Meyer, Exhibit No. GRM-1CT at 24:7.

⁶⁶ *Utilities and Transportation Commission v. Puget Sound Energy*, Dockets UE-090704 and UG-090705, Order 11 (April 2, 2010) at 12, ¶¶ 27-28, quoted by Mr. Meyer on page 23 of Exhibit No. GRM-1T.

believes the Commission should make an additional adjustment for SO₂ revenues or should adjust an amortization of a specific regulatory asset, they should have proposed those adjustments and supported them.

53 ICNU/Public Counsel goes on to allege that the Company's adjustment is inaccurate because it does not reflect work force reductions.⁶⁷ However, the reductions appear to be due to a hiring lag, not a permanent work force reduction.⁶⁸ Consequently, because these positions are available and expected to be filled, there is no reason to adjust for a workforce reduction.

54 In sum, the Commission should reject ICNU/Public Counsel's adjustments to pro forma wages.

3. ICNU/Public Counsel's Adjustments to Annual Incentive Plan (AIP) Expenses are Micro-Managing Corporate Wage Policies

55 PacifiCorp pays its employees at what the Company asserts is a market average rate.⁶⁹ However, many employees do not receive a portion of their full salary unless they meet or exceed several express goals or standards. The Company calls this portion "at risk" pay.⁷⁰ The Company awards the "at risk" amount pursuant to the "Annual Incentive Plan", or AIP.

56 ICNU's consultant Mr. Meyer hopes the Commission will deny \$700,000 of the \$1.4 million in AIP test year expenses,⁷¹ because some of the Company's performance goals which form the basis for AIP payments are subjective or otherwise not quantifiable. In his view, because PacifiCorp does not require each employee to meet only measurable and quantifiable levels of performance to qualify for AIP payments, those payments should be cut in half for ratemaking purposes.⁷²

57 Mr. Meyer is correct that certain AIP performance goals are not quantifiable. It is also true that only rarely does PacifiCorp fail to pay an employee some or all of the "at risk" amount.

⁶⁷ Meyer, Exhibit No. GRM-1T at 24:19 to 25:5.

⁶⁸ Wilson, TR. 423:12 to 424:10.

⁶⁹ Wilson, Exhibit No. EDW-1T at 3:1-14.

⁷⁰ Wilson, Exhibit No. EDW-1T at 3:7-14.

⁷¹ Meyer, Exhibit No. GRM-1CT, at 9:18.

⁷² Meyer, Exhibit No. GRM-1T at 9:18 to 10:2. As part of his recommendation, Mr. Meyer reasoned that because the Company's individual goals are weighted at 70% of wages and group goals are weighted at 30%, a 50% reduction is appropriate. This number appears arbitrary.

However, as the Commission has ruled, the ultimate issue is whether the total compensation is reasonable, not the piece parts: “The ultimate issue is whether total compensation is reasonable and provides benefits to ratepayers ...”⁷³

58 In this instance, so long as the employee’s overall pay does not exceed market, it is not particularly relevant whether a piece-part of that pay raises questions. This point was illustrated by the example Chairman Goltz offered of two accountants, working at different companies, each with the same pay level, but one having part of her pay “at risk”.⁷⁴ For ratemaking purposes, if the overall pay level is reasonable; the “at risk” part should not be a reason to reduce an otherwise reasonable pay level. Because there has been no concrete, defensible challenge to the overall pay levels, the Commission should reject this ICNU/Public Counsel adjustment.

B. The Commission Should Accept the Company’s Affiliate Management Fee Adjustment Because it Fairly Implements the Stipulation in the MEHC Acquisition Docket

59 Under Commitment WA 4(b) of the Commission-approved Stipulation in the MEHC acquisition docket, PacifiCorp agreed that the “Corporate allocations from MEHC to PacifiCorp included in PacifiCorp’s rates [will be] less than \$7.3 million.”⁷⁵ This \$7.3 million “cap” expires December 31, 2010.⁷⁶

60 The dispute in implementing this language centers primarily on whether the \$7.3 million cap is the starting point for making adjustments to remove certain items (the ICNU method), or whether the actual amount of the fee should be adjusted first, and then determine whether the cap is exceeded or not (the Company’s method).

61 The Commission should use the Company’s method. The purpose of the Commitment is to assure that MEHC will not extract excessive fees from PacifiCorp, and up until the end of 2010, the parties effectively agreed that any amount over \$7.3 million would be considered

⁷³ *Utilities and Transportation Commission v. PacifiCorp*, Docket UE-050684, Order 03 (June 9, 2005) at 48, ¶ 128.

⁷⁴ Colloquy, TR. 512:18 to 513:5.

⁷⁵ *Joint Application of MidAmerican Energy Holdings Company and PacifiCorp*, Docket UE-051090, Order 07 (February 23, 2006), Stipulation Appendix at 14, ¶ WA 4(b).

⁷⁶ *Id.* at ¶ 4(a).

excessive. Consequently, it is fair for PacifiCorp to start at the actual amount paid and adjust from there, to see if the cap is exceeded, or not.

62 In fact, the adjustments accepted by PacifiCorp take the fee level below the cap, to \$7.1 million,⁷⁷ which is the figure the Commission should accept. By contrast, the ICNU/Public Counsel method is not fair because starting at the \$7.3 million cap and adjusting from there has the effect of automatically excluding portions of the payment that may be reasonable.

63 In sum, PacifiCorp's \$7.1 million level of affiliate management fee is a reasonable outcome, it is consistent with the Stipulation, and the Commission should accept it.

C. Net Power Supply Costs⁷⁸

64 This case presents several Net Power Cost adjustments that closely examine the relationship between the transmission and generation costs allocated to Washington under the West Control Area (WCA) allocation model and the benefits corresponding to those costs. This is an appropriate application of the matching principle that underlies much of ratemaking.

65 Therefore, Staff sponsors certain power supply adjustments that add benefits to match the costs ratepayers are expected to pay. Examples include adjustments for Arbitrage Sales Margin, the DC Intertie and the Idaho Point to Point Contract. Similarly, Staff objects to certain

⁷⁷ Dalley, Exhibit No. RBD-4T at 7:11 to 9:6.

⁷⁸ Staff provides in Appendix 3 a table summarizing the remaining contested Staff adjustments to Net Power Costs. Many Net Power Supply adjustments are uncontested as between Staff, Company and ICNU. First, the Company has accepted certain adjustments proposed by Staff and/or ICNU, and included those adjustments in the Company's calculation of Net Power Costs in its rebuttal case. These adjustments are: updating Screens; limiting SMUD contract energy; removing inter-hour wind integration costs for non-owned wind projects, removal of certain wheeling expenses serving PACE loads; adjusting certain intra-hour wind integration costs; and shifting the timing of Colstrip planned outages. Duvall, Exhibit No. GND-5T at 22:1 to 29:23. These adjustments are in addition to those uncontested updates contained in the Company's Response to Staff Data Request 143, and the updates to coal prices and the official forward price curves subsequently agreed to.

The Company also shows these adjustments on Page 12.6.4 of Exhibit No. 15C, the Company's Response to Bench Request 3. Please note Staff is not recommending the Commission accept the Company's proposal to treat non-firm transmission costs, as we discuss later.

In addition, two power supply adjustments contested during the hearings have since been resolved, for purposes of this case only and have been included as part of the Company's response to Bench Request 3 Update: PacifiCorp agrees to remove the update to the Chehalis operating reserves, while Staff, Company and ICNU agree to support the Company's SCL Stateline Contract Adjustment per Mr. Duvall's rebuttal. This resolution is reflected in Exhibit 15C, second paragraph.

We do not address these items further. We address the remaining disputed issues below.

Company adjustments on the basis that the costs the Company includes provide no commensurate benefits, such as wind integration costs for non-owned wind projects.

66 Staff correctly applies the matching principle in both types of examples. While the Company urges that some of these adjustments are improper attempts to change the WCA model, that is simply not the case. The Company must demonstrate that each operating expense and investment it seeks to include in rates provides commensurate benefits to ratepayers. The WCA model is not a shield against proper ratemaking.

1. Arbitrage Sales Margins

67 PacifiCorp uses its transmission system to take advantage of “arbitrage” transactions, which are short-term, low, or no risk, transactions buying energy at one delivery point and selling at another.⁷⁹ Though the per-transaction profits may be small, the transactions number in the thousands, and thus generate substantial revenues. The facts show that over the four year period 2006-2009, PacifiCorp made [REDACTED] of these transactions and enjoyed an average of over [REDACTED] per year (WCA level).⁸⁰

68 Staff’s adjustment provides ratepayers most of these benefits, based on 90 percent of this normalized, four-year average level of these transactions. Staff provides the Company a 10 percent incentive to maximize the use of its transmission system.⁸¹ Staff’s inclusion of a reasonable level of revenues from arbitrage transactions reduces Washington allocated Net Power Costs by \$529,467.⁸² ICNU offers the same adjustment, without the 10 percent incentive.⁸³ Staff supports the incentive as better policy.⁸⁴

69 On the other hand, PacifiCorp wants ratepayers to get no benefits from these transactions. The Company suggests GRID fully utilizes the transmission system by making what it calls

⁷⁹ Buckley, Exhibit No. APB-1CT at 6:3-10.

⁸⁰ Buckley, Exhibit No. APB-1CT at 7:11-22.

⁸¹ Buckley, Exhibit No. APB-1CT at 8:6-15.

⁸² Buckley, Exhibit No. APB-1CT at 9:6-8, adjusted for allocation factors.

⁸³ Falkenburg, Exhibit No. RJF-1CT at 6:6 to 10:24.

⁸⁴ Buckley, TR. 600:5-14.

arbitrage transactions through system balancing sales and purchases.⁸⁵ However, while GRID includes some transactions related to balancing the company's loads and resources, the Company has not demonstrated these are the same transactions summarized in Staff's confidential table in Exhibit No. APB-1CT at 7:18-22. In fact, when PacifiCorp was offered the opportunity to defend its position by quantifying the level of arbitrage margins in GRID, it declined.⁸⁶

70 PacifiCorp misses the point when it suggests this adjustment represents "selective and inconsistent departure from normalized NPC modeling".⁸⁷ The point is the ratepayers are paying the cost of the transmission system, and that cost should be matched with the benefits. When the benefits are not modeled, they should be normalized, which is what Staff's adjustment accomplishes. These transactions are of sufficient magnitude every year to warrant normalization, and Staff's four-year average (less the 10 percent incentive) is plainly fair. Zero is plainly unfair.

71 For these reasons, the Commission should accept Staff's Arbitrage Sales margin adjustment.

2. SMUD Contract Shaping

72 PacifiCorp has a sale for resale contract with the Sacramento Municipal Utility District (SMUD). PacifiCorp models the SMUD contract in GRID assuming the highest cost to PacifiCorp, resulting in PacifiCorp making no deliveries to SMUD in the months of April through June; the traditional "low-cost" months for regional utilities.⁸⁸ If SMUD were to actually take energy during these months under the contract, the cost to PacifiCorp would be less, and the Company's normalized net power costs would be reduced.⁸⁹

73 In fact, the historical data show significant deliveries by PacifiCorp to SMUD in the lower cost months of April through June each year.⁹⁰ Consequently, Staff reduced Net Power

⁸⁵ Duvall, Exhibit No. GND-5T at 31:22 to 32:1.

⁸⁶ Duvall, Exhibit No. GND-18.

⁸⁷ Duvall, Exhibit No. GND-5T at 32:4-5.

⁸⁸ Buckley, Exhibit No. APB-1CT at 11:22 to 12:6.

⁸⁹ Buckley, Exhibit No. APB-1CT at 12:6-9.

⁹⁰ Buckley, Exhibit No. APB-1CT at 13:1-4.

Costs by an estimated \$2,499,818 for the total West Control Area, or \$552,137 for Washington.⁹¹ ICNU makes the same adjustment,⁹² though the amounts differ because ICNU used GRID to calculate the amount, while Staff did not.

74 PacifiCorp contests the adjustment, apparently on the basis that modeling should trump experience. The Company says Staff and ICNU violate “reasonable principles of consistency and fairness”, alleging we optimize flexible contracts only when it lowers net power costs.⁹³

75 We suggest it is the Company’s concern that is not fair. The Company should use all available information to carry out modeling. GRID inputs should best represent how the resources and contracts are operated or used. If a particular contract has a definable shape, such as the SMUD contract, that information should be used. Allowing GRID to optimize the contract without considering the history of actual operations is not reasonable, consistent, or fair.

76 In fact, historical operations are used to determine many power supply expenses, such as planned outages, resource availability, wind patterns, and so on. While it is true not all power contracts have a recognizable historical shape to their deliveries, when they do, that information should be modeled.

77 PacifiCorp goes on to suggest the Commission must treat the SMUD contract the same as a BPA purchase contract.⁹⁴ Staff’s point is simply that, if there real and recognizable difference between contracts, they need not be treated the same. That is the case here.

78 Finally, the Company points to part of the SMUD contract called the “provisional” clause, under which energy provided to SMUD is returned to PacifiCorp, and attempt to use Exhibit No. GND-9 to suggest there may be an offsetting sale to PacifiCorp from SMUD.⁹⁵ In fact, this exhibit confirms seasonality of the SMUD contract and why it should be modeled as such.

⁹¹ Buckley, Exhibit No. APB-1CT at 13:12 to 14:8 and Exhibit No. APB-4C.

⁹² Falkenburg, Exhibit No. RJF-1CT at 25:1 to 31:2.

⁹³ Duvall, Exhibit No. GND-5T at 36:13-14.

⁹⁴ Duvall, Exhibit No. GND-5T at 37: 9-12.

⁹⁵ Duvall, Exhibit No. GND-5T at 39:7-19.

3. Colstrip Outage Adjustment

79 PacifiCorp is part owner of the Colstrip 4 coal plant. An unprecedented outage occurred at the plant during the test year 2009, extending from late March to almost the end of October.⁹⁶ Exhibit No. APB-17C shows this unplanned outage was longer than any other outage at Unit 4, or Unit 3, for that matter.

80 The issue is how to treat this anomalous event for ratemaking purposes. Staff proposes the Commission use an outage rate of eight percent, which is generous because it is much higher than the actual outage rates for the last several years at Colstrip 4 (excluding the 2009 anomaly).⁹⁷

81 By contrast, and based on the observation that extraordinary events “do happen”,⁹⁸ PacifiCorp wants to base Colstrip costs using an average of the last four years of outage rates,⁹⁹ thus giving a 25 percent weighting to 2009’s extended outage. The result is an average outage rate of [REDACTED] percent,¹⁰⁰ well above what any common sense review of the data in Exhibit No. APB-17C could justify.

The Company claims it is unfair to remove large outages, but maintain anomalously low outage rates.¹⁰¹ Staff’s agrees.¹⁰² In fact, Staff’s 8% outage figure is not based on anomalously low outage rates. Rather, it is based on a qualitative review of the data, including Colstrip 3, even though the data justifies a reasonable outage rate lower than eight percent, if Colstrip 4 alone was evaluated using a more quantitative approach.¹⁰³

82 The principle underlying normalized power costs is to select an outage rate that best reflects normal, ongoing operations. PacifiCorp violates this principle by advancing an outage that too heavily weights an extreme outage situation. The Commission should accept Staff’s

⁹⁶ Buckley, Exhibit No. APB-1CT at 14:12-16.

⁹⁷ Buckley, Exhibit No. APB-1CT at 17:8 to 18:5.

⁹⁸ Duvall, Exhibit No. GND-5T at 50:4-5.

⁹⁹ Buckley, Exhibit No. APB-1CT at 14:18-19.

¹⁰⁰ Buckley, Exhibit No. APB-1CT at 15:1-2.

¹⁰¹ Duvall, Exhibit No. GND-5T at 50:6-14.

¹⁰² Buckley, TR. 581:20 to 582:6.

¹⁰³ Buckley, TR. 582:1 to 582:12.

more reasonable, eight percent figure, which results in a reduction to Washington Net Power Costs of an estimated \$341,453.¹⁰⁴

4. Idaho Point to Point (PTP) Wheeling Contract

83 PacifiCorp includes the cost associated with its point-to-point wheeling contract with the Idaho Power Company for service between Idaho Power and West Main. This represents that portion of the Idaho Point to Point wheeling contract the Company allocates 100 percent to the Western Control Area. However, because the Company also uses this portion of the contract to provide benefits to both its East and West control areas,¹⁰⁵ the Commission should further split the costs between the two control areas.¹⁰⁶

84 Because the Company has not offered any other quantification of the benefits this contract provides to the East, Staff recommends an even split, which reduces Net Power Costs by \$1,583,040 for the WCA, or \$349,648 for Washington.¹⁰⁷

85 The Company says this is an adjustment outside the approved WCA allocation method.¹⁰⁸ However, that is NOT the issue. The issue is matching costs with benefits, and removing half the allocated costs is simply one way to do that. Alternatively, if the full contract amounts were allocated to the West, the adjustment would be to add normalized positive net revenues in an amount that offsets half those costs. Staff's adjustment is a simpler method, and this demonstrates the fallacy of PacifiCorp's opposition.

5. DC Intertie Adjustment

86 Another adjustment for which it is necessary to match costs with benefits relates to the agreement between PacifiCorp and the Bonneville Power Administration called the DC Intertie and Network Transmission Agreement. This agreement provides the wheeling service necessary for the Company to make purchases from the Nevada-Oregon Border ("NOB").¹⁰⁹ However,

¹⁰⁴ Buckley, Exhibit No. APB-1CT at 18:9-11, adjusted for allocation factors.

¹⁰⁵ Duvall, Exhibit No. GND-13C.

¹⁰⁶ Buckley, Exhibit No. APB-1CT at 20:5-18; Duvall, Exhibit No. GND-13C.

¹⁰⁷ Buckley, Exhibit No. APB-1CT at 20:20 to 21:5, adjusted for allocation factors.

¹⁰⁸ Duvall, Exhibit No. GND-5T at 32:17 to 33:5.

¹⁰⁹ Buckley, Exhibit No. APB-1CT at 18:17-23.

NOB prices are generally high, PacifiCorp rarely uses this contract, and as a result, in normalizing power costs, the Company includes only the costs of this contract and no demonstrated benefits.¹¹⁰

87 At a minimum, the Commission should reasonably expect normalized net power costs to achieve a benefit, in some manner, at least equal to the annualized cost of the contract. However, the lack of a single transaction tied to the DC Intertie over the full range of normalized power costs, belies this expectation.

88 The Commission should simply remove the \$4,766,400 (WCA level) annual cost amount related to this contract until PacifiCorp quantifies and includes the corresponding benefits. This adjustment reduces Washington's Net Power Costs by \$1,052,760.¹¹¹

89 The Company objects to this adjustment on the basis the contract provides a valuable means of securing capacity and energy from California entities to meet retail loads, and alleges Staff and ICNU are improperly applying hindsight to second guess the prudence of this 16 year-old contract.¹¹² However, it was the Company who more recently chose to extend 200MW of DC Intertie rights after the original underlying energy transaction expired.¹¹³ The cost of those rights is the issue in this proceeding.

90 Of course, the Company was free to support its decision to acquire rights to the DC Intertie, but it failed to provide any.¹¹⁴ But the central issue is the fact that GRID treats this contract in such a way as to impose the costs of the contract on ratepayers, yet provides them none of the value. In other words, the issue here is the proper matching of costs and benefits, because under the Company's case, no benefits are quantified.

¹¹⁰ Buckley, Exhibit No. APB-1CT at 19:3-8.

¹¹¹ Buckley, Exhibit No. APB-1CT at 19:15-23, adjusted for allocation factors. Like certain other Staff adjustments, this adjustment removes the costs allocated to Washington by the WCA model. Like those other adjustments, this is simply an appropriate way to make an adjustment; it is not a change to the WCA model. For example, the same result would obtain if the costs of the DC Intertie remain, and offsetting revenues are imputed to match costs with benefits.

¹¹² Duvall, Exhibit No. GND-5T at 41:17 to 42:20.

¹¹³ Duvall, Exhibit Nos. GND-19 & GND-20.

¹¹⁴ Duvall, Exhibit Nos. GND-19 & GND-20.

91 The Company appears to downplay the problems with its position by claiming the costs
are modest compared to the Company's overall transmission strategy or market hedges.¹¹⁵
However, when asked to support this comparison, the Company provided nothing.¹¹⁶

6. Wind Integration Costs

92 PacifiCorp incurs costs to integrate non-owned wind plants into its system. In its rebuttal
case, the Company has agreed to remove the proposed *inter*-hour wind integration costs related
to non-owned wind projects. However, the Company still wants Washington retail ratepayers to
pay the entire costs of *intra*-hour integration of these non-owned wind projects.

93 PacifiCorp is searching for someone to pay these costs, because, while PacifiCorp
charges third-party owners for access to the Company's transmission system pursuant to the
Company's FERC tariff, called the "OATT",¹¹⁷ the rates in that tariff do not recover these wind
integration costs caused by the third-party owners of these plants.¹¹⁸

94 It appears FERC's policy on whether these third-party costs may be included in the
OATT is in a state of flux, and PacifiCorp intends to raise this issue in a case before FERC later
this year.¹¹⁹ In the meantime, however, PacifiCorp expects Washington ratepayers to pay them.
The illogic of forcing Washington retail ratepayers to pay for costs caused by third-parties is
self-evident.

95 Moreover, should FERC decide to allow PacifiCorp to recover these third party costs
through the OATT, then the Company will have double-recovered these costs, if the Commission
also includes these costs in retail rates. Or, should FERC decide not to allow PacifiCorp to
recover these costs from the cost causer, that may provide PacifiCorp a strong basis for a legal
challenge to the sufficiency of its interstate rates contained in its OATT. However, neither
scenario provides a basis for passing these costs on to Washington retail customers.

¹¹⁵ Duvall, Exhibit No. GND-5T at 42:13-15.

¹¹⁶ Duvall, Exhibit No. GND-21.

¹¹⁷ OATT stands for Open Access Transmission tariff. Duvall, Exhibit No. GND-5T at 44:8-11.

¹¹⁸ Duvall, Exhibit No. GND-5T at 44:8 to 45:6.

¹¹⁹ Duvall, Exhibit No. GND-5T at 45:7 to 46:11.

It is not enough for the Company to suggest that because Washington ratepayers get the benefits of the transmission system, they must pay these costs.¹²⁰ The issue here is cost responsibility. It is crystal clear Washington ratepayers are not the ones who caused PacifiCorp to incur these costs, and the Commission should not make Washington ratepayers responsible for these costs.

Assuming PacifiCorp's OATT problem does not resolve the issue, there are other reasons why the Commission should accept Staff's wind integration adjustments. The Company has continued to present a moving target in regard to wind integration costs. For example, the overall wind integration costs in the Company's direct case represent a six-fold increase from the estimates in the last general rate case, approximately one year ago. The wind integration costs in the Company's direct case were based on its 2008 IRP (for wind resources in the Company's control area)¹²¹ and the results of BPA's recent transmission rate case (for wind resources within BPA's control area).¹²² However, the Company warned that it would update those costs based on a study to be completed in early August 2010,¹²³ yet the update did not arrive until September 2010, leaving Staff little time for review.¹²⁴ To add insult to injury, the Company later informed Staff it would seek an even higher wind integration cost level.¹²⁵ As Mr. Buckley summarized:

Clearly, the range of costs presented in various studies in a matter of one year, leads one to question the accuracy and validity any proposed wind integration cost. Staff has had no opportunity to review and analyze the updated study, nor address any proposed changes in the Company's proposed costs for ratemaking purposes.¹²⁶

In effect, the Company has thrown the "known and measureable" standard to the wind here.

If the Commission does not reject the wind integration cost increases PacifiCorp proposes on the basis of reliability of the data, the Commission should accept Staff's adjustments related to those non-owned, intra-hour wind integration costs shown in Exhibit No. APB-6 for the non-

¹²⁰ Duvall, Exhibit No. GND-5T at 46:21 to 47:10.

¹²¹ Duvall, Exhibit No. GND-1T at 6:18-21.

¹²² Duvall, Exhibit No. GND-1T at 6:4-14.

¹²³ Duvall, Exhibit No. GND-1T at 17:9-12.

¹²⁴ Buckley, Exhibit No. APB-1CT at 22:10-12.

¹²⁵ Buckley, Exhibit No. APB-1CT at 22:12-15.

¹²⁶ Buckley, Exhibit No. APB-1CT at 22:15-20.

SCL Stateline, Cambell Wind Farm, and Oregon QF projects, on the grounds that ratepayers should not be burdened with these costs if they do not receive associated revenues, or the third-party wind resource serves another jurisdiction, or the contract is about to expire.¹²⁷ These non-owned, intra-hour wind integration costs that remain at issue reduces Net Power Costs by \$2,348,393 on a WCA basis, or approximately \$518,692 for Washington.¹²⁸

7. Idaho Point to Point (PTP) Wheeling Contract Update

99 This adjustment updates the Idaho PTP contract to reflect known cost changes.¹²⁹ While Staff is not opposing the concept of updating the known contract costs, Staff recommends the Commission treat the same as the original Idaho PTP Wheeling Contract adjustment in ¶¶ 83-85 above, i.e., the Commission should accept Staff's proposal to remove one-half of the updated amount for the same reasons we previously outlined. This results in a reduction to WCA Net Power Costs of \$376,920, and \$83,251 for Washington.

8. ICNU's Non-Firm Transmission Adjustment

100 ICNU offers Adjustment 10 - Non-Firm Transmission, which would include non-firm transmission transactions in GRID, and would reduce Net Power Costs on a WCA basis by \$719,500.¹³⁰ For the first time on rebuttal, the Company includes what it calls short-term firm transmission along with the non-firm transmission, making the net result an overall *increase* to Net Power Costs of \$1,216,293.¹³¹

101 Staff recommends the Commission reject both adjustments because the record contains insufficient evidence to support them. Staff is concerned that these types of transactions are essentially the result of third-party requests for service, and thus may not have a sufficiently dependable historical pattern for inclusion in GRID. Or, as in the case of short-term firm

¹²⁷ Buckley, Exhibit No. APB-1CT at 24-25: Projects where the Company 1) provides wheeling but gets no power for Washington ratepayers: non-SCL owned Stateline project and Cambell wind farm; 2) assigns costs on a situs basis to another state, so the wind integration costs should not follow: Oregon Qualifying Facilities; or 3) the contract is expiring: SCL's Stateline wind farm.

¹²⁸ Buckley, Exhibit No. APB-6, with only non-owned, intra-hour projects, and adjusted for allocation factors.

¹²⁹ The Company initially identified this item in its response to UTC Data Request 143 and carried it though to the rebuttal case (Duvall, Exhibit No. GND-7, line 7) and Exhibit No. 15C; PacifiCorp's to Bench Request 3.

¹³⁰ Exhibit No. RJF-1CT, 34:7-22.

¹³¹ Duvall, Exhibit No. GND-5T at 26:16 to 27:22.

transmission, these transactions may be required to support specific energy transactions to serve load outside the state of Washington and thus should not be paid by Washington ratepayers for that reason. These issues require further investigation.

102 Consequently, the Commission should reject ICNU's adjustment, and remove the \$1,216,293 adjustment proposed by the Company in its rebuttal case, and included in the Exhibit No. 15C. This reduces Washington Net Power Costs by \$268,644.

IV. RATE BASE

103 Apart from the rate base impact of the tax issues, which we address in Section V of this brief, the sole contested rate base adjustment in this case relates to working capital. There are two issues under the working capital banner: 1) selecting the appropriate method for determining working capital; and 2) determining the appropriate treatment of certain current asset accounts: fuel stock and plant materials and operating supplies (Materials & Supplies).

104 There is no apparent issue as to the calculation of working capital. In other words, while there is a dispute as to the proper method, if the Commission accepts the Staff's method or the Company's method, no party has challenged the resulting adjustment amount.

105 The problem of selecting an appropriate working capital calculation method has loomed since the Commission rejected the Revised Protocol inter-jurisdictional allocation methodology in Docket UE-050684. In that case, the Commission also rejected both the Company's lead/lag method and the Staff's investor-supplied working capital method, because there was no accepted inter-jurisdictional allocation method.¹³²

106 In the ensuing rate case, the Commission revisited the issue, and rejected the Company's adjustment because it was based on an allocation methodology the Commission had rejected.¹³³ The Commission also rejected Staff's adjustment because it was not calculated "in a manner consistent with the WCA allocation methodology."¹³⁴

¹³² *Utilities and Transportation Commission v. PacifiCorp*, Docket UE-050684, Order 04 (April 17, 2006) at 66, ¶183.

¹³³ *Utilities and Transportation Commission v. PacifiCorp*, Docket UE-061546 and UE-060817 (consolidated), Order 08 (June 21, 2007) at 42, ¶ 163.

¹³⁴ *Id.* at 42, ¶ 162.

107 In that case, Staff used a total company balance sheet and allocated the resulting working
capital amount using the SO factor, which allocates plant to Washington based on Washington's
share of the total system plant.¹³⁵ The Commission noted Staff was only able to testify that its
adjustment captured the impact on Washington "to a certain degree."¹³⁶

108 The issue back again for Commission consideration. Staff continues to support the
investor-supplied working capital method as an appropriate method, with a refined allocation
methodology consistent with the WCA.¹³⁷ PacifiCorp, which uses the lead-lag method in its
other jurisdictions, proposes the 1/8th method for use in this state.¹³⁸

109 For the reasons that follow, the Commission should adopt Staff's investor-supplied
working capital method and find that PacifiCorp has no need for working capital in this case.
The Commission should also reject PacifiCorp's proposal to include the current assets accounts
for fuel stock and Materials & Supplies in rate base. These are considered part of working
capital; they are not permanent plant accounts and should not be treated as such.¹³⁹

**A. The Commission Should Accept Staff's Adjustment Because the Investor-Supplied
Working Capital Method is Theoretically Sound, and Staff's Adjustment is
Calculated Consistent with the West Control Area Allocation Method**

110 It is elemental that a utility should only be able to earn a return on capital supplied by
investors.¹⁴⁰ Because working capital is a rate base item, any method for calculating working
capital should assure the amount of working capital is investor-supplied.

111 The investor-supplied working capital method qualifies, because it directly measures the
amount of working capital investors provide, by comparing invested capital with investments. If
the amount of invested capital exceeds the amount of investments, that difference is investor-

¹³⁵ Id.

¹³⁶ Id.

¹³⁷ Schooley, Exhibit No. TES-1T at 8:16-19.

¹³⁸ Dalley, Exhibit No. RBD-1T at 21:8-17.

¹³⁹ Schooley, Exhibit No. TES-1T at 23:3-9.

¹⁴⁰ Schooley, Exhibit No. TES-1T at 5:1-11.

supplied working capital.¹⁴¹ In this case, PacifiCorp's the amount of invested capital does not exceed investments, and therefore, PacifiCorp has no working capital supplied by investors.¹⁴²

112 Had PacifiCorp's investors supplied working capital, Staff would have allocated that amount based on Washington's share of each investment account, as shown on Exhibit No. TES-2. Staff developed factors that are "refined and specific to PacifiCorp's Washington operations"¹⁴³ and "consistent with the WCA methodology".¹⁴⁴

113 Staff explained in detail the theoretical foundations for the investor-supplied working capital method, and refuted, point by point, each criticism PacifiCorp has leveled against that method in the past.¹⁴⁵ PacifiCorp did not respond to this part of Staff's case. Instead, PacifiCorp's challenge simply is that Staff's method uses the total company balance sheet. According to PacifiCorp, this violates the Commission's order in Docket UE-061546, because PacifiCorp interprets that decision to say the determination of working capital "must be done on a WCA basis."¹⁴⁶

114 Staff understands the Commission order differently. Staff understands the Commission to mean what it said: the working capital analysis should be "consistent with the WCA methodology."¹⁴⁷ Staff's calculation complies, because Staff developed Washington-specific allocation factors based on the WCA allocation method to allocate to Washington any positive amount of working capital.¹⁴⁸

115 The Commission does not determine capital structure based on the amount of capital PacifiCorp has devoted to Washington, or the amount of debt attributable to Washington. The Commission does not determine the cost of equity based on a Washington, stand-alone basis. Similarly, a company's working capital needs are not determined on a Washington-specific

¹⁴¹ Schooley, Exhibit No. TES-1T at 13:15-22.

¹⁴² Schooley, Exhibit No. TES-2.

¹⁴³ Schooley, Exhibit No. TES-1T at 18:13-14.

¹⁴⁴ Schooley, Exhibit No. TES-1T at 19:6-7.

¹⁴⁵ Schooley, Exhibit No. 23:11 to 26:15.

¹⁴⁶ Dalley, Exhibit No. RBD-4T at 14:21-22.

¹⁴⁷ *Utilities and Transportation Commission v. PacifiCorp*, Docket UE-061546 and UE-060817 (consolidated), Order 08 (June 21, 2007) at 42, ¶ 162.

¹⁴⁸ Schooley, Exhibit No. TES-1T at 9:1-6.

basis, either. The Commission has previously accepted working capital calculations that used a total company balance sheet.¹⁴⁹ The Commission should accept the Staff's method and calculation in this case.¹⁵⁰

B. The Commission Should Reject the Company's 1/8th Method, Because it Does Not Measure Working Capital Supplied by Investors, and it Always Measures Positive Working Capital, Though Working Capital Can be Negative

116 The Company applies the 1/8th method by calculating one-eighth of a year's balance of Operations & Maintenance expenses, less fuel and purchased power expenses.¹⁵¹ Staff can agree with PacifiCorp that the 1/8th method is relatively easy to implement, and it is used in other jurisdictions. However, despite these benefits, the 1/8th method has some problems. First, though working capital can be negative in amount,¹⁵² the 1/8th method invariably produces a positive amount.¹⁵³

117 Second, the Company's 1/8th method assumes without proof that the amount it derives are supplied by investors.¹⁵⁴

118 Finally, if the Company's claim is correct that to garner Commission approval, a working capital adjustment must not include any allocation of total company amounts, the Commission would need to reject the Company's 1/8th method because it does just that: of the \$88 million base which PacifiCorp divided to get Washington's share, nearly \$20 million was derived using total company figures allocated to Washington.¹⁵⁵

¹⁴⁹ E.g., *Utilities and Transportation Commission v. US WEST Communications, Inc.*, Docket UT-950200, 15th Supplemental Order (April 11, 1996) at 68. In that case, the Staff used a total company balance sheet. "The Commission accepts the Commission Staff's approach to working capital in this proceeding. The Commission believes that it is more comprehensive and more accurate than the lead-lag approach. It allows the calculation to take place in the context of a balance sheet analysis of company performance rather than examining limited factors. While we understand the Company's situation, not having an amiable Washington balance sheet to work from, we believe the additional accuracy gained from the effort to prepare the balance sheet outweighs the expedience available in the lead-lag study. Consequently, we accept the Commission Staff methodology."

¹⁵⁰ Further doubt is cast on the Company's interpretation because, consistently applied, that interpretation would also mean the Commission could not use the investor-supplied working capital method for Avista (a multi-jurisdictional utility) either.

¹⁵¹ *Id.* at 21:16-17.

¹⁵² Schooley Exhibit No. TES-1T at 14:15-18 and Exhibit No. TES-2; Meyer, Exhibit No. GRM-1T at 6:23 to 7:1-8.

¹⁵³ Dalley, TR. 355:25 to 356:2; Schooley, Exhibit No. TES-1T at 22:7-9; Meyer, Exhibit No. GRM-1T at 6:4-5.

¹⁵⁴ Staff made this point in its direct testimony (Schooley, Exhibit No. TES-1T at 22:9-11). The Company did not respond on rebuttal.

¹⁵⁵ Dalley, TR. 359:21-24.

C. Because the Current Assets Accounts for Fuel Stock and Materials and Supplies are Inventory Accounts, the Commission Should Remove Them From Rate Base to Avoid Double Recovery

119 PacifiCorp proposes to include in rate base the test year \$5,554,908 worth of fuel stock and \$9,777,775 worth of Materials & Supplies.¹⁵⁶ The only positive rationale offered by PacifiCorp for including these items is that they provide service to customers and other states include them in rate base.¹⁵⁷ Neither argument justifies rate base treatment for these items.

120 First, the fact that a particular item resides on the Company's books and provides service is an insufficient justification for including it in rate base. For example, the Company books meter reading costs and that is part of providing service, but PacifiCorp does not include those costs in rate base.

121 More to the point, fuel stock and Materials & Supplies are current assets, and, as Mr. Dalley testified, these products become consumed or built into permanent plant over the course of the year, perhaps many times over.¹⁵⁸ Because these items are basically inventory items that turn over throughout the year, including them in rate base is tantamount to double recovery; first, as current assets in rate base, and again as expenses or permanent plant assets. Therefore, the Commission should not allow these items in rate base.¹⁵⁹

V. FEDERAL INCOME TAX

A. Overview

122 The Company makes three proposals regarding federal income tax. First, PacifiCorp wants the Commission to allow the Company to normalize all book-tax differences now, but defer consideration to the next general rate case¹⁶⁰ the issue of the accumulated ratepayer benefit from the effects of flow-through from past periods.¹⁶¹ Second, the Company wants the

¹⁵⁶ Schooley, Exhibit No. TES-1T at 22:13-20, citing Dalley, Exhibit No. RBD-3, Tab 2, page 2.2, lines 42 & 43.

¹⁵⁷ Dalley, Exhibit No. RBD-4T at 16:20-21 and at 17:6-7.

¹⁵⁸ Dalley, TR.355:6-12.

¹⁵⁹ Staff notes that Commission acceptance of PacifiCorp's 1/8th method does not necessarily mean the Commission must accept fuel stock and Materials & Supplies as rate base items. The decisions are independent of each other.

¹⁶⁰ Fuller, Exhibit No. RF-8T at 3:6-10; Fuller, Exhibit No. RF-1T at 10:14 to 11:2.

¹⁶¹ The test year includes \$5.4 million embedded by the Company to reflect the cumulative increase for the change to full normalization. Staff removed this amount in Adjustment 7.9 (Exhibit No. KHB-6 page 16 and 18 column y) to reflect flow-through treatment of federal income tax. The ratepayers have not received the benefit of a reduction

Commission to allow the Company to normalize the taxes associated with the Company's accounting method change related to the "Repairs Deduction."¹⁶² Finally, the Company wants the Commission to allow the Company to create a regulatory asset for Internal Revenue Service (IRS) imposed interest, which might exist in the future as a result of a future IRS audit regarding the Repairs Deduction.¹⁶³

123 As we explain below, the Commission should reject PacifiCorp's request for full normalization of all book-tax differences because the Company has not demonstrated any ratepayer benefit from either the change to full normalization, or the transition to full normalization. Furthermore, the book-tax differences underlying the Company's proposal are more suitable to flow-through treatment.¹⁶⁴

124 The Commission should accept Staff's Adjustment 7.9, which reflects certain book-tax differences on a flow-through basis consistent with previous Commission decisions. Staff Adjustment 7.9 increases net operating income by \$323,865, decreases the net rate base by \$5,401,575, and decreases overall revenue requirement by \$1,986,754.

125 For the Repairs Deduction, the Commission should recognize the Company's proposed adjustment due to a change in tax accounting methods for the Repairs Deduction. In doing so, the Commission should accept Staff Adjustment 8.11, to reflect the full rate base effect of this change. Staff Adjustment 8.11 decreases the net rate base by \$14,463,670, and decreases overall revenue requirements by \$1,745,310.

126 The Commission should reject as premature the Company's request for preauthorization to establish a regulatory asset or liability for interest related to the potential outcome of the IRS audit on this change.

to income tax expense that created this rate base adjustment. This would be the regulatory liability PacifiCorp should amortize over a period of time to reflect this change.

¹⁶² Repairs deduction refers to PacifiCorp's request to change its "method of accounting for routine repair and maintenance costs properly deductible under IRC Section 162." Breda, Exhibit No. KHB-1T at 10:19 to 12:2; Fuller, Exhibit No. RF-1T at 2:11 to 3:3.

¹⁶³ Fuller, Exhibit No. RF-1T at 1:1-6 and at 5:11-16; Fuller, Exhibit No. RF-8T at 13:10 to 14:12.

¹⁶⁴ The book-tax differences are listed on Exhibit No. KHB-6 at 16, column y, lines 1 to 43 and 50, plus page 18, column y, lines 55 to 78.

B. Background on Flow-Through and Normalization

127 The Commission has a long-standing policy of flow-through tax treatment.¹⁶⁵ The
Commission describes flow-through as follows:

128 “Flow through” tax treatment is the recognition of tax expense in the period when
the liability to pay the tax is incurred. Flow through treatment implies that in a
historical test period, actual tax liability of the test period is matched with the
level of revenue for the same period.¹⁶⁶

129 Flow-through is a particularly desirable policy for book-tax differences of items that
occur with regularity, are not subject to significant fluctuations between periods and are
associated with assets or liabilities that are not recognized in the rate base.¹⁶⁷ Examples are
employee related accruals, bad debt allowance, injuries and damages, prepaid contracts, and
miscellaneous accrued and current liabilities. Flow-through tax treatment is appropriate because
only the net change in the liability level affects net operating income.

130 By contrast, if these types of items were normalized, the utility would include in the rate
base deferred tax, but not the related liability which gave rise to the tax. This would cause an
inconsistency in the rate base to the detriment of the ratepayers.¹⁶⁸

131 The Commission has recognized normalization as appropriate in certain circumstances,
such as when the Internal Revenue Code requires normalization for the utility to receive the
benefits of accelerated depreciation for tax purposes.¹⁶⁹ Another example involves items such as
regulatory assets and liabilities. Commission-authorized regulatory assets and liabilities are
typically normalized. The utility defers an item and amortizes the balance over a set period of
time. The tax effects are typically deferred over the same period for regulatory purposes.¹⁷⁰ In

¹⁶⁵ Breda, Exhibit No. KHB-1T at 7:10-21.

¹⁶⁶ *Utilities and Transportation Commission, v. Puget Sound Power & Light Co.*, Docket UE-910626, First Supplemental Order (September 25, 1991) at 13..

¹⁶⁷ For items where normalization is required by the IRC, the related asset is included in the rate base and therefore matched with its related deferred tax. Regulatory assets and liabilities are also typically matched with their related deferred tax.

¹⁶⁸ This benefit to the utility is due to the fact that the liability generates a debit to the accumulated deferred income tax, which is not offset directly by its related liability in the rate base.

¹⁶⁹ Breda, Exhibit No. KHB-1T at 5:15 to 6:16 & Exhibit No. KHB-5T at 1:14 to 21.

¹⁷⁰ Exhibit No. RF-9 is Staff's response to PacifiCorp Data Request 1.27 and includes some examples where normalization was specifically addressed in Commission orders.

other words, the tax benefit or burden is normalized to match the amortization. This matching of both the cost and tax provides equity for both the utility and its ratepayers.

C. The Company Has Not Demonstrated Any Ratepayer Benefit From its Full Normalization Proposal

132 The Company requests the Commission adopt a federal income tax accounting policy of normalization for all book-tax differences, with the exception of equity AFUDC,¹⁷¹ beginning January 1, 2011.¹⁷² However, the Company's case deals only with the transition to full normalization. In particular, the Company failed to quantify any ratepayer benefits of either full normalization or the transition to full normalization.¹⁷³

133 In fact, Staff did a comprehensive review of the Company's direct case, and concluded the Company failed to demonstrate any ratepayer benefit.¹⁷⁴ The Company's rebuttal case was no help, either; it just addressed how the transition to full normalization should take place.¹⁷⁵

134 The Company bears the burden of proof on this issue. The Commission should not grant a request for full normalization unless and until the Company presents the full effect of the change and demonstrate ratepayer benefit. The Company has yet to do so.

D. The Types of Items Subject to PacifiCorp's Normalization Request Are More Properly Treated Under the Flow-Through Method

135 Another reason why the Commission should reject PacifiCorp's request for full normalization is because the primary book-tax differences subject to PacifiCorp's normalization request (exclusive of those associated with Repairs Deduction) are related to real liabilities of the Company that continue over time. These liabilities represent a net accumulated deferred income tax impact of \$5.4 million, increasing the rate base for 2009, and include the following categories of obligations:

¹⁷¹ Equity AFUDC has no income impact.

¹⁷² Fuller, Exhibit No. RF-1T at 8:17-19.

¹⁷³ Fuller, Exhibit No. RF-1T at 10:14 to 11:2.

¹⁷⁴ Breda, Exhibit No. KHB-1T at 10:5-13.

¹⁷⁵ Fuller, Exhibit No. RF-8T at 2:13 to 3:17.

Employee Related Obligations	\$ 3,263,654 ¹⁷⁶
Miscellaneous Accrued Liabilities	555,302 ¹⁷⁷
Injuries and Damages	399,449 ¹⁷⁸
Bad Debts Allowance	398,515 ¹⁷⁹
Jim Bridger Mine	922,794 ¹⁸⁰
Other	(158,572) ¹⁸¹
Total Accumulated Deferred Income Tax	<u>\$ 5,381,142</u> ¹⁸²

136 As we explained earlier, these types of items are more appropriately treated under flow-through accounting than normalization accounting, primarily because the Company does not directly include the related liability in rate base.¹⁸³ Under normalization accounting, as presented in the Company case, an inconsistency is created in the rate base because the related liability is not matched with its related deferred tax.

137 Because the deferred tax is related to a liability, the effect is a rate base increase, and indeed, that is the reason why the Company has included an additional \$2.0 million¹⁸⁴ in revenue requirement in this case. This is further proof PacifiCorp's proposal directly benefits only the Company.

E. The Company has Improperly Characterized the Impact of Full Normalization

138 In its analysis of the revenue requirement impact,¹⁸⁵ PacifiCorp has masked the true impact of its proposed change to full normalization by reflecting federal income taxes for certain regulatory assets on a flow-through basis, and netting that impact with the tax effect of the liabilities we discussed in the previous section.¹⁸⁶ Listed below are these regulatory assets with the associated accumulated deferred income tax:

¹⁷⁶ Breda, Exhibit No. KHB-6 at 16, column v, lines 5 to 9, 17, 20, 21, 26, 27 and at 18, column v, line 66.

¹⁷⁷ Breda, Exhibit No. KHB-6 at 16, column v, line 15.

¹⁷⁸ Breda, Exhibit No. KHB-6 at 16, column v, lines 4, 12, and 31.

¹⁷⁹ Breda, Exhibit No. KBH-6 at 16, column v line 11.

¹⁸⁰ Breda, Exhibit No. KBH-6 at 16 and 18, column v, lines 23, 33, 35, 69, 36, 70, 37, 71, 38, 72, 39, 73, 40, 74, 41, 75, 42, 43, 77, 55, 56, 57, 58, and 68.

¹⁸¹ Breda, Exhibit No. KBH-6 at 16 and 18 column v, lines 2, 3, 10, 13, 14, 16, 18, 24, 25, 29, 30, 32, 50, 65, and 67.

¹⁸² Breda, Exhibit No. KHB-6 at 16, column y, continuing to 18, column y. This amount represents the rate base impact for all non-property related book-tax differences.

¹⁸³ Breda, TR. 749:8 to 750:15.

¹⁸⁴ Foisy, Exhibit No. MDF-2 at 6:42.

¹⁸⁵ Fuller, Exhibit No. RF-6.

¹⁸⁶ See Breda, TR. 750:25 to 752:14.

Grid West Loan	\$(33,636) ¹⁸⁷
Powerdale Hydro Plant and Decommissioning Costs	(111,262) ¹⁸⁸
Chehalis Generating Plant	(6,261,915) ¹⁸⁹
Total Accumulated Deferred Income Tax Expense	<u>\$(6,404,813)¹⁹⁰</u>

139 In their revenue requirement models, both Staff and the Company treat these regulatory assets as normalized, for both the cost and related tax, consistent with prior Commission orders.¹⁹¹ For example, the Company established the Chehalis regulatory asset (which accounts for virtually all of this balance) pursuant to RCW 80.80.060(6) and WAC 480-100-435,¹⁹² which expressly state the cost of the investment and the related taxes are deferred.¹⁹³ This is consistent with normalization and inconsistent with flow-through.¹⁹⁴

140 PacifiCorp apparently views the Chehalis asset and the other regulatory assets differently in its analysis of the impact of full normalization,¹⁹⁵ because there, the Company treats the federal income tax associated with these regulatory assets as subject to flow-through accounting for ratemaking purposes.¹⁹⁶ Based on the Company's decision to reflect these regulatory assets on a flow-through basis in its analysis, the effect offsets, and thereby masks, the true ongoing impact of the Company's proposed change to full normalization.

¹⁸⁷ Breda, Exhibit No. KHB-6 at 16, column ab, line 45 plus page 18, column ab, line 87 plus line 89 & Exhibit No. RF-12 at 6. The Grid West Loan was originally deferred based on the Commission's Order in Docket UE-060703, and normalized over a five year period. This was included as an uncontested adjustment in *Washington Utilities and Transportation Commission vs. Pacific Power and Light*, Docket UE-061546, Order 08 (June 21, 2007).

¹⁸⁸ Breda, Exhibit No. KHB-6 at 18, column ab line 93. Powerdale was deferred based on the Commission's Order in Docket UE-070624.

¹⁸⁹ Breda Exhibit No. KHB-6 at 18, column ab line 94. Chehalis is deferred and amortized over a six year period. *Utilities and Transportation Commission, v. PacifiCorp.*, Docket UE-090205, Order 09 (December 16, 2009).

¹⁹⁰ These regulatory assets are normalized in both the Company and Staff case. This chart reflects the total amount the Company has included on a flow-through basis in their analysis of the impact of their request for full normalization. By doing so, the Company has incorrectly portrayed minimal ratepayer impact.

¹⁹¹ Fuller, Exhibit No. RF-9 is Staff's response to PacifiCorp Data Request 1.27 and includes some examples where the Commission specifically referred to normalization in the order.

¹⁹² *Utilities and Transportation Commission v. PacifiCorp*, Docket UE-090205, Order 09 (December 16, 2009), Settlement Stipulation at 4 ¶¶ 12 & 13.

¹⁹³ RCW 80.80.060(6): "An electrical company may account for and defer for later consideration by the commission costs incurred in connection with a long-term financial commitment, including operating and maintenance costs, depreciation, taxes, and cost of invested capital."

¹⁹⁴ Breda, TR. 754:17 to 755:12.

¹⁹⁵ Fuller Exhibit No. RF-6 and the supporting calculation of flow-through in Exhibit No. RF-12.

¹⁹⁶ Fuller, Exhibit No. RF-14T at 2:6 to 3:10; Breda, TR. 750:25 to 752:14..

F. The Company Fails To Address the Transitional Regulatory Asset or Liability

141 As we explained earlier in footnote 161, PacifiCorp embedded a \$5.4 million increase in the rate base to reflect full normalization of federal income taxes, without addressing the corresponding regulatory liability and its amortization in operating results.¹⁹⁷ Instead, PacifiCorp represents this portion of the adjustment as a “Catch-22”, stating the Company cannot address the dollar impact until it finalizes its financial results for 2010.¹⁹⁸

142 Staff is puzzled by this because, while it is true the exact amount of the impact may need to be updated, the test year impact is known and measurable as reflected by the \$5.4 million increase to the rate base included in the Company case.

143 In any event, the key point is that the Company fails to include any request to establish the related regulatory liability, with associated amortization to benefit the ratepayer. Instead, the Company requests that this issue be addressed in the next general rate case.¹⁹⁹ In other words, the Company’s presentation is incomplete because it fails to take into account the ratepayer benefit of the cumulative change.

144 While Staff opposes the Company’s request for full normalization, Staff wants to be sure at this juncture that the Commission understands that PacifiCorp has utterly failed to provide the basic facts related to its request. The Commission should reject PacifiCorp’s attempts to obtain approval of a significant accounting change without explaining in detail all related ratepayer impacts.

G. The Commission Should Approve PacifiCorp’s Request to Normalize Taxes Related to the Repairs Deduction, But Should Give Full Rate Base Effect to the Accounting Change

145 The Company has changed the way it accounts for certain repair costs. The Company now expenses certain repair costs for tax purposes that it previously capitalized for tax purposes. However, the Company continues to capitalize these costs for book purposes, thereby creating a book-tax difference. The Company proposes normalization of this timing difference and Staff is

¹⁹⁷ The \$5.4 million would be the regulatory liability due ratepayers as of December 31, 2009. This amount would need to be updated through December 2010 if the Commission were to approve full normalization.

¹⁹⁸ Fuller, Exhibit No. RF-8T at 3:11 to 4:5.

¹⁹⁹ Fuller, Exhibit No. RF-8T at 3:6-10 & Exhibit No. RF-1T at 10:14 to 11:2.

not opposed to this treatment. However, Staff disagrees with the magnitude of the benefit that the Company reflected.

146 As proposed by the Company, normalization reduces rate base by \$14,463,685.²⁰⁰ In contrast, Staff recommends the Commission reduce rate base by \$28,927,370, for a decrease of \$3,490,623 in revenue requirement.²⁰¹ Staff's recommended amount recognizes the full-year impact of the tax accounting change, while the Company used the average of the accumulated deferred income tax balances recorded for the test-year.

147 The Commission should use the full-year amount because the Repairs Deduction accounting change is a known and measurable change, and therefore ratepayers should receive the full benefit of it in this proceeding. Otherwise, PacifiCorp would get a windfall because the Company has already realized the full tax benefits of the change.²⁰²

148 In fact, this accounting change is ongoing, and, as with any restating or pro forma adjustment that represents an ongoing change, the adjustment should reflect the change as if it were in place for the entire period.²⁰³ Therefore, for ratemaking purposes, the Commission should accept the cumulative effect of this accounting change, as reflected in Staff Adjustment 8.11.

H. The Commission Should Reject as Premature PacifiCorp's Request to Create a Regulatory Liability Account

149 As we noted at the outset, PacifiCorp requests Commission authorization to create a regulatory asset account to book any interest the IRS may impose in the future as a result of a future audit of the Repairs Deduction. Because PacifiCorp currently is not subject to any interest assessment by the IRS from any audit of the Repairs Deduction, the Commission should deny this request as premature.²⁰⁴ If and when the Company actually is subject to such an assessment, it can renew its request.

²⁰⁰ Fuller, Exhibit No RF-5.

²⁰¹ Breda, Exhibit No. KHB-1T at 12:17 to 14:5. Staff Adjustment 8.11 is an incremental increase to achieve the total \$3,490,623 decrease in revenue requirement.

²⁰² Breda, Exhibit No. KHB-1T at 24:1 to 9 and 25:2 to 11

²⁰³ Breda, TR. 757:25 to 758:14.

²⁰⁴ Breda, Exhibit No. KHB-1T at 19:8 to 22:4.

VI. COST OF CAPITAL

A. Overview

150 A reasonable cost of capital for PacifiCorp is 7.48 percent, based on a fair return on
equity of 9.50%, a capital structure that includes a 46.5 percent common equity ratio, and three
percent short-term debt.²⁰⁵ This cost of capital and capital structure balances safety and
economy, and therefore protects both investor and ratepayer interests.²⁰⁶

151 PacifiCorp seeks much more: an overall return of 8.34 percent, achieved by increasing
the ratemaking common equity ratio by over six percentage points, to 52.1 percent,²⁰⁷
eliminating short-term debt, and increasing the cost of equity from 10.2 percent to 10.6 percent.

152 ICNU's proposed cost of capital is 7.66 percent, and although ICNU's proposed cost of
equity is not out of line, its proposed 49.1 percent common equity ratio is too generous, and
ICNU also fails to include short-term debt in the capital structure.²⁰⁸

153 When the Commission carefully weighs the evidence in this case, it will find that only
Staff's case strikes the appropriate balance of investor and ratepayer interests. As Mr. Elgin
testified, that is the bedrock principle underlying cost of capital analysis.²⁰⁹ For the reasons that
follow, the Commission should find the fair rate of return for PacifiCorp is 7.48 percent.

B. Capital Structure

154 An appropriate capital structure for ratemaking should balance safety and economy. For
PacifiCorp, the Commission struck that balance with a 46 percent equity ratio and a three percent
short-term debt ratio the last time this issue was litigated, in the aftermath of significant market

²⁰⁵ These figures are summarized in Mr. Elgin's Exhibit No. KLE-1T at 2:5-15, and defended throughout the remainder of that exhibit.

²⁰⁶ Elgin Exhibit No. KLE-1T at 16: 11-19.

²⁰⁷ Williams, Exhibit No. BNW-1T at 3:6.

²⁰⁸ The figures in this paragraph are found in Mr. Gorman's Exhibit No. MPG-3 at 1.

²⁰⁹ Elgin, Exhibit No. KLE-1T at 5:8-11, citing *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1942) for the principle that regulators should balance consumer and owner interests in determining a fair rate of return.

volatility in 2005.²¹⁰ The Company now insists the Commission must accept the Company's actual capital structure, which contains 52.1 percent common equity, and no short-term debt.²¹¹

155 Ironically, PacifiCorp latches onto volatility from the recent financial crisis to justify this sharp increase in the cost of capital.²¹² In fact, the run-up in the Company's equity ratio is due more to the financial interests of its owners than a reaction to market conditions.

156 The Commission should not grant any increase in equity ratio absent a defensible showing that the resulting capital structure is safe and economical. Neither PacifiCorp nor ICNU has made such a showing in this case.

1. The Commission Should Accept a Ratemaking Capital Structure Containing 46.5 Percent Common Equity Because it is Safe and Economical

157 Only Staff provided any measurable test of its proposed 46.5 percent equity ratio for safety and economy, by considering several different factors including operating income.²¹³ Furthermore, Staff considered the capital structure in the context of objective financial metrics published by S&P for bond ratings. Staff concluded that the capital structure put PacifiCorp squarely within the objective parameters for a BBB rating, which is the "predominance of ratings" for electric utilities in this country.²¹⁴

158 As we explain later, PacifiCorp defends its proposed capital structure using the wrong standard, and therefore its capital structure proposal is wrong as well. For ICNU's part, Mr. Gorman correctly identifies MEHC's policies and efforts to inflate PacifiCorp's common equity ratio,²¹⁵ and he correctly notes that a ratemaking capital structure should balance safety and economy.²¹⁶ However, he failed to follow through and demonstrate that his 49.1 percent common equity ratio recommendation²¹⁷ strikes the appropriate balance of safety and economy.

²¹⁰ Hadaway, TR. 245:5-14.

²¹¹ Williams, Exhibit No. BNW-7T at 3:12-15.

²¹² Hadaway Exhibit No. SCH-1T at 20:4-6.

²¹³ Elgin, Exhibit No. KLE-1T at 16:11-19 and 18:6-10.

²¹⁴ Elgin, Exhibit No. KLE-1T at 15:10-20; S&P *Global Credit Portal* (September 29, 2010), Exhibit No. BNW-17 at 2, first paragraph.

²¹⁵ Exhibit MPG-22T at 2:8-13.

²¹⁶ *Id.* at 2:17-23.

²¹⁷ Exhibit MPG-1T at 1:19-20. In this case ICNU also accepts the preferred equity ratio of 0.3% for a total equity ratio of 49.4%.

For that reason, the Commission should reject his recommended 49.1% common equity ratio too.²¹⁸

2. The Burden of Proof is on the Company to Demonstrate its Proposed Capital Structure is Safe and Economical

159 The Commission should require every utility to demonstrate that its ratemaking capital structure properly balances safety and economy. This is not just an elementary application of the statutory burden of proof,²¹⁹ and good public policy, but it has its foundation in the Supreme Court's decision in the *Hope* case, where the Court admonished regulators to balance ratepayer and investor interests when determining the fair return.²²⁰ There is no case that justifies that policy more than this one, where the utility is seeking to increase Residential and Industrial rates over 20 percent; largely the result of its quest for higher profits for the benefit of its owner, MEHC.²²¹

160 However, PacifiCorp says it is entitled to be regulated on a capital structure laden with 52.1 percent equity, because that is the Company's actual capital structure. According to the Company, "[t]he Commission has made it clear that a company's capital structure should be based on its own capital structure, absent a clear and compelling reason to impute other data."²²²

161 Curiously, the Company does not rely on the Commission's order in Docket UE-050684, which actually applies to PacifiCorp. In that order, the Commission was crystal clear in saying it uses a hypothetical capital structure "when our fundamental objective to balance safety and economy [require] that we do so."²²³ Instead, PacifiCorp relies on language in two rate orders

²¹⁸ To develop his 49.1 percent equity ratio, Mr. Gorman simply makes adjustments to the Company's actual equity ratio, but only to the extent he believes the Company is not putting that additional equity to productive use by investing in new facilities. Gorman, Exhibit No. MPG-1T at 12;1 to 14:18. In effect, he accepts the Company's actual capital structure, but just defines "actual" differently.

²¹⁹ RCW 80.04.130(4).

²²⁰ *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1942).

²²¹ Put another way, this case is emphatically NOT a "make-whole" case, as the Company seeks to characterize it. Reiten, Exhibit No. RPR-1T at 6:3.

²²² Williams, Exhibit No. BNW-1T at 8:13-15.

²²³ *Utilities and Transportation Commission v. Puget Sound Energy*, Dockets UE-060266 and UG-060267, Order 8 at ¶76 (Jan. 5, 2007)

involving Puget Sound Energy (PSE).²²⁴ The Company goes on to inexplicably equate “clear and compelling reason” with “good reason”.²²⁵

162 As a matter of policy, burden of proof and common sense, the Commission should reject the Company’s proposal because it is based on the wrong standard. However, as we discuss next, even if the Commission were to apply a more strict standard than necessary, the record provides “compelling” reasons to use a hypothetical capital structure, because MEHC’s decision to increase PacifiCorp’s equity ratio unfairly burdens ratepayers with excessive costs.²²⁶

3. In any Event, There are “Compelling Reasons” Not to Use the Company’s 52.1% Capital Structure for Ratemaking Purposes

163 Even if the Commission was to require either “good reason” or “clear and compelling” reason in this case as a predicate to examining an alternative to PacifiCorp’s actual capital structure, such reasons abound on this record.²²⁷

164 First, and foremost, PacifiCorp’s capital structure is controlled by its owner, MEHC. MEHC’s economic incentive is to capitalize PacifiCorp’s operations with as much equity as possible, because that provides greater equity returns to MEHC.²²⁸ In this circumstance, the Commission should never accept the utility’s actual capital structure at face value, especially when the capital structure is controlled by a parent to achieve its own financial objectives.

165 Notably, MEHC has acted on this incentive by infusing over \$990 million of equity into PacifiCorp,²²⁹ eliminating the payment of dividends to MEHC,²³⁰ and paying off short-term debt

²²⁴ Williams Exhibit No. BNW-13, part (a), quoting *Utilities and Transportation Commission v. Puget Sound Energy, Inc.*, Dockets UE-060266 and UG-060267 (consolidated), Order 08 (January 5, 2007) at 27, ¶76.

²²⁵ Williams, Exhibit No. BNW-13, part c & TR. 273:11 to 274:7.

²²⁶ Nonetheless, some clarity from the Commission would be useful. As Staff testified, the safety and economy standard is soundly supported by “a fundamental principle of finance: a properly balanced capital structure ensures the Company efficiently finances its long-lived assets dedicated to public service to achieve the lowest possible cost.” Elgin, Exhibit No. KLE-1T at 13:3-5. The Commission should reaffirm that standard in this case, and place the burden on the utility to satisfy that standard.

²²⁷ Staff submits these reasons not only pass a “good reason” threshold, but a “clear and compelling threshold, too, assuming PacifiCorp is wrong that these standards are equivalent.

²²⁸ Id at 13-16-21.

²²⁹ Gorman, Exhibit No. MPG-1T at 12:3-7.

²³⁰ Id.

balances.²³¹ The inexorable result: PacifiCorp's equity ratio has ballooned from 46 percent in 2006, after PacifiCorp was acquired by MEHC,²³² to 52.6 percent now,²³³ and it is climbing.²³⁴

166 The Commission cannot order MEHC to change its policies on equity capital infusion, no dividends, and no short-term debt, but the Commission must protect ratepayers from the higher costs these policies impose on ratepayers, for the benefit of PacifiCorp's owners. The Commission should use a ratemaking common equity ratio of no more than 46.5 percent.

4. The Commission Should Include Short-Term Debt in the Ratemaking Capital Structure, Despite the Company's Policy Not to Use it

167 As the Commission stated in PacifiCorp's last contested rate case, Docket UE-050684, an appropriate capital structure examines "...all the sources of capital available to a company."²³⁵ One ready and available source of capital is short-term debt.

168 In fact, a prudent utility should have a 3-5 percent level of short term debt in its ratemaking capital structure,²³⁶ because short-term debt is a very low-cost source of funds,²³⁷ and it provides the utility more flexibility in managing the cash needs of the company.²³⁸ For example, Avista recently made use of this flexibility essentially by "locking in" a 1.68 percent rate to create a very short-term bond (i.e., less than three years maturity).²³⁹

169 Staff recommends the Commission include a three percent layer of short-term debt in the ratemaking capital structure for PacifiCorp, representing just \$500 million, at a cost of 3.00%.²⁴⁰

170 PacifiCorp does not dispute Staff's cost rate, but opposes including short-term debt in the first place, because the Company has effectively eliminated short-term debt from its actual capital structure.²⁴¹ As Mr. Williams explains, the large amount of long-term debt PacifiCorp

²³¹ Williams Exhibit Nos. BNW-15 & BNW-22 and Cite to 050684 rate order????

²³² Williams, TR. 277:19-23.

²³³ Williams, Exhibit No. BNW-7T at 4:5-8.

²³⁴ Williams, Exhibit No. BNW-7T at 4:10-12.

²³⁵ *Utilities and Transportation Commission v. PacifiCorp*, Docket UE-050684, Order 04 (April 17, 2006) at 79, ¶224.

²³⁶ Elgin, Exhibit No. KLE-1T at 18:19-21.

²³⁷ Elgin, Exhibit No. KLE-1T at 19:2-6.

²³⁸ Elgin, TR. 732:21 to 733:7 and TR.744:14 to 745:2.

²³⁹ Exhibit BNW-20 at 1, last ¶, and at 4.

²⁴⁰ Elgin, Exhibit No. KLE-1T at 19:14-16 and at 2:11-12.

²⁴¹ Williams, Exhibit No. BNW-7T at 3:20 to 4:2.

issued in 2009, and the large equity infusions the Company received from its parent have left the Company no longer in need of short-term debt.²⁴²

171 While we appreciate the honesty, there is no reason to burden ratepayers with higher capital costs because MEHC's policies have effectively reduced PacifiCorp's short-term debt ratio to zero. It is revealing that while PacifiCorp says it does not use short-term debt, it still maintains short-term credit lines of around \$1.4 billion,²⁴³ and includes the costs of maintaining those credit lines in its books of account for recovery in rates.²⁴⁴

172 PacifiCorp goes on to argue that short-term debt funds construction work in progress (CWIP), and short-term debt should only be included in the capital structure to the extent the balances persistently exceed CWIP balances.²⁴⁵ However, PacifiCorp's argument violates the principle that capital is fungible, i.e., no specific source of capital is used to finance specific assets.²⁴⁶ In fact, as shown in Exhibit No. BNW-16, page 3, the Company reported to the Commission that it uses short-term debt in 2009 for "general corporate purposes."

173 Next, PacifiCorp recycles an old argument that including short-term debt would constitute "double-counting", based on a confusing argument about how FERC treats CWIP in calculating the AFUDC rate.²⁴⁷ The Commission will recall it flatly rejected this "double-counting" argument first time the Company came up with it several years ago.²⁴⁸ PacifiCorp offers nothing new, so the Commission should reject it again now.

174 In sum, it is fair, reasonable and fully appropriate for the Commission to include 3.00 percent short-term debt in PacifiCorp's capital structure, at a cost of 3.00 percent.

²⁴² Williams, Exhibit No. BNW-7T at 4:17-19.

²⁴³ Williams, Exhibit No. 14C at 2, and TR. 276:12 to 277:11.

²⁴⁴ Williams, Exhibit No. 14C at 1, part (b). No party recommended removal of these costs.

²⁴⁵ Williams, Exhibit No. BNW-7T at 5:18-21 (original version cited at 5:14 to 6:23).

²⁴⁶ Williams, Exhibit BNW-16 at 2 & 3.

²⁴⁷ Williams, Exhibit No. BNW-7T at 6:11 to 12:18. The Company even goes so far as to say it would calculate AFUDC differently should the Commission include CWIP in rate base. *Id.* In any event, what FERC thinks about AFUDC is of no moment here, because the Commission requires the Company to accrue AFUDC at the overall fair rate of return. *Utilities & Transportation Commission v. Pacific Power & Light Co.*, Dockets U-82-12 and 35, Fourth Supplemental Order (February 2, 1983) at 26: "We reiterate the order that the Company utilize its fair rate of return for calculation of AFUDC ..." Note also that WAC 480-100-203 adopts FERC accounting rules, but that "does not supersede any Commission order regarding accounting treatments." WAC 490-100-203(4).

²⁴⁸ *Utilities & Transportation Commission v. PacifiCorp*, Docket UE-050684, Order 04 (April 17, 2006) at 79, ¶224.

C. Cost of Common Equity

1. Introduction

175 Perhaps the most significant cost of providing electric service is the cost of common equity. Not only is the cost significant in magnitude, but it requires the most analysis and judgment to properly determine. The task is made more difficult because there is no direct market evidence for PacifiCorp's common stock: PacifiCorp is not a publicly traded company.²⁴⁹ This makes using a proxy group of companies an even more critical part of the analysis.

176 The fundamental areas of disagreement between the parties that lead to their different cost of equity estimates concern the selection of the proxy group, and the estimate of the dividend growth element of the Discounts Cash Flow (DCF) formula. As we explain below, Staff's proxy group is the only one that contains companies comparable to PacifiCorp, and Staff's dividend growth analysis is transparent and sound.

177 For the reasons that follow, the Commission should accept the Staff's cost of common equity of 9.5 percent as the best-supported estimate on this record.

2. Staff's ROE Analysis is Based on a Proxy Group Comprised of Companies Comparable to PacifiCorp

178 The principle of comparable risk underlies the proxy group selection process, and that principle was laid down by the Supreme Court in *Bluefield Water Works and Improvement Co. v. Public Service Commission of West Virginia*, 262 U.S. 679, 692 (1923):

A public utility is entitled to such rates as will permit it to earn a return on the value of the property it employs for the convenience of the public equal to that generally being made ... on investments in other business undertakings which are attended by corresponding risks and uncertainties ...

179 Consequently, a primary role of the cost of capital analyst is to assure the proxy group presents companies of similar risk to PacifiCorp. Staff fulfilled that role by carefully selecting a proxy group of companies with similar risk characteristics to PacifiCorp.²⁵⁰ Staff's selection

²⁴⁹ Elgin, Exhibit No. KLE-1T at 21:16-19.

²⁵⁰ Elgin, Exhibit No. KLE-1T at 10:10-19.

criteria is consistent with the standards of *Hope* and *Bluefield*: Mr. Elgin selected companies similar to PacifiCorp, with nominal amounts of revenue from unregulated operations, serve similar markets, have fully integrated electric operations, and have no nuclear construction risk.²⁵¹ The result was a proxy group containing seven companies;²⁵² a group that compares favorably to PacifiCorp, and thus it provides an appropriate basis for analysis.

3. Staff's DCF Analysis is Reasonable and Transparent, Focusing on the Expectations of Investors Making Rational Investment Decisions

180 The goal of determining the cost of equity is to measure the investors' required rate of return. As Staff correctly observed, estimating investors' expected dividend yield and growth is not a matter of applying mechanical calculations to the relevant data. Rather, it is a process that requires the analyst to use judgment and carefully consider the data supporting the recommendations.²⁵³ Applying informed judgment to published financial data is precisely what rational investors do when evaluating comparable utility stocks, and only Staff's cost of capital analysis carefully replicates this decision making process.

181 Staff's analysis of the cost of equity relied primarily upon the Discounted Cash Flow ("DCF") methodology.²⁵⁴ To estimate the cost of equity, the DCF model relies upon the direct evidence of stock prices trading in highly competitive markets. In its most basic form, the DCF model states that the cost of equity is the sum of a stock's expected dividend yield, and investor's future expectations for long-term growth in dividends.

182 In calculating the dividend yield component of the DCF analysis, Staff considered a reasonable range of market prices for the common stock of each utility in the proxy group, and then estimated the dividend yield based upon actual dividends paid. Staff's dividend yield range compares favorably to the dividend yield range derived by both Dr. Hadaway and *Value Line* for

²⁵¹ Elgin, Exhibit No. KLE-1T at 2:8-12.

²⁵² Staff selected six of the comparable utilities from Dr. Hadaway's proxy group of 22, and then added Avista Corporation.

²⁵³ Elgin, Exhibit No. KLE-1T at 26:4-10.

²⁵⁴ Elgin, Exhibit No. KLE-1T at 6:9-18.

the same utilities in Staff's proxy group.²⁵⁵ The result is a range of expected dividend yield for the proxy group between 4.50 to 4.75 percent.²⁵⁶

183 Estimating investor expectations for long-term sustainable growth in dividends is a much more complex process, because there are many relevant variables an analyst or investor may consider. Staff analyzed investors' long-term dividend growth expectations using several key financial indices: dividends, including dividend policy, book value, retained earnings and earnings per share.²⁵⁷

184 The importance of these indices is readily apparent, because investors know utility returns are primarily a function of historical investment; i.e., the rate base.²⁵⁸ Therefore, Staff properly gave the most weight to both growth in book value and growth in retained earnings to inform its judgment about reasonable investor expectations for dividend growth.²⁵⁹

185 In the process of estimating expected growth in dividends, book value, retained earnings and earnings per share, Staff carefully analyzed the financial data published by Value Line and other earnings reporting services. This is because a competent DCF analysis should reflect how a rational investor would evaluate the data to inform their future expectations. For example, any rational investor would consider a company's dividend growth in light of any change in the company's dividend policy. Moreover, a rational investor would evaluate a utility's historic returns on book equity in light of unreasonably high or low results, and, by the same token, evaluate exceptionally high or low growth rates in book value.

186 In other words, Staff did what investors would do: evaluate the data, not simply take highly dispersed data and "just average everything," as the Company did.²⁶⁰ As Mr. Elgin testified, each adjustment he made was consistent with DCF theory,²⁶¹ and fully explained:

²⁵⁵ Elgin, Exhibit No. KLE-1T at 27:10-20.

²⁵⁶ Id.

²⁵⁷ Elgin, Exhibit No. KLE-1T at 29:6-7.

²⁵⁸ Elgin, Exhibit No. KLE-1T at 15-16.

²⁵⁹ Elgin, Exhibit No. KLE-1T at 27:15-20.

²⁶⁰ Elgin, TR. 721:23 as part of Mr. Elgin's overall discussion of the point at TR. 720-722.

²⁶¹ Elgin, TR. 705:1-14 & TR. 708:8 to 707:2.

The process is extremely transparent. You can see precisely which data I used. I explained precisely what my judgments were and the rationale for them. They are designed to inform the Commission and give the Commission a good foundation for what significant financial parameters go to making judgments about dividend yield and long term growth under the DCF methodology.²⁶²

187 In short, Staff performed its DCF analysis as it should, by carefully considering all the published data, similar to what investors do when making an investment decision.²⁶³ After a thorough and careful consideration of the data, Staff concluded that a reasonable estimate of investor's long-term expectations of dividend growth to be in the range of 4.5 to 5.0 percent.²⁶⁴ Combined this dividend yield range with Staff's range for the dividend produces a cost of common equity range of 9.00 percent to 9.75 percent.²⁶⁵

188 While Staff placed the greatest reliance upon its DCF results for estimating return on equity, Mr. Elgin checked that estimate by using both the capital Asset Pricing Model (CAPM) and a risk premium analysis.²⁶⁶ Each of these studies corroborated his DCF results,²⁶⁷ and they provide additional support that the cost of capital is lower in today's capital markets,²⁶⁸ not higher, as PacifiCorp posits.²⁶⁹

189 In sum, Staff based its analysis on a group of comparable companies, and provided the Commission transparent and logical analysis of the relevant available financial data for each company in the proxy group. The Commission should find PacifiCorp's cost of equity to be 9.5 percent, consistent with Staff's analysis.

4. PacifiCorp and ICNU's Analyses are Based on a Proxy Group Not Comparable to PacifiCorp

190 PacifiCorp selects a proxy group of 22 utilities to estimate PacifiCorp's cost of equity.²⁷⁰ Dr. Hadaway created this proxy group by applying broad criteria, many of which fail to reflect

²⁶² Elgin, TR. 739:22 to 740:3.

²⁶³ Elgin, TR. 720:15 to 721:6.

²⁶⁴ Elgin, Exhibit No. KLE-1T at 38:2-10.

²⁶⁵ Elgin, Exhibit No. KLE-1T at 38:15.

²⁶⁶ Elgin, Exhibit No. KLE-1T at 38:20 to 46:16.

²⁶⁷ Elgin, Exhibit No. KLE-1T at 43:19 to 44:5 and at 46:10-16.

²⁶⁸ Elgin, Exhibit No. KLE-1T at 10:1-6.

²⁶⁹ Hadaway, Exhibit No. SCH-1T at 26:5-7.

²⁷⁰ Hadaway, Exhibit No. SCH-1T at 3:1-13.

the risk profile of PacifiCorp. For proof, the Commission need look no further that his selection criterion that a “comparable” company can earn as much as 30 percent of its revenue from unregulated operations.²⁷¹ The result is exactly what one would expect; his proxy group is a highly disparate group, with many utilities that bear no resemblance to PacifiCorp.

191 For example, Progress and Southern Company was welcomed to Dr. Hadaway’s proxy group, yet, unlike PacifiCorp, Progress and Southern Company has investments in nuclear plants and is exposed to nuclear construction risk.²⁷² It is difficult to imagine a utility presenting a risk profile less similar to PacifiCorp. However, Dr. Hadaway found one: Black Hills Corp., which is predominantly a gas distribution company (it has 557,000 gas customers and only 202,000 electric customers), plus, Black hills Corp. features a gas exploration and production business.²⁷³

192 ICNU’s witness Mr. Gorman relied on Dr. Hadaway’s proxy group.²⁷⁴ For example, Mr. Gorman assumes that comparable average bond ratings equated to similar risks for equity owners.²⁷⁵ However, investment risk is not the same as business risk, as Staff correctly pointed out.²⁷⁶ Mr. Gorman also asserts that the proxy group has the same business risk, but in fact, S&P rates 7 of the 22 companies in Mr. Gorman and Dr. Hadaway’s proxy group as “Strong”, not “Excellent”.²⁷⁷

193 The wide disparity between the utilities in Dr. Hadaway’s and Mr. Gorman’s proxy group translates directly to unhelpful, widely disparate ROE estimates under their constant growth DCF analyses: from 7.5 percent to 13.2 percent for Dr. Hadaway,²⁷⁸ and from 7.56 percent to 14.07 percent for Mr. Gorman.²⁷⁹ These ranges are far broader than the already too broad 8.4 percent to 12.3 percent range Dr. Hadaway first produced,²⁸⁰ which Mr. Elgin testified was “simply too

²⁷¹ Hadaway, Exhibit No. SCH-1T at 3:8-9.

²⁷² Elgin, Exhibit No. KLE-1T at 24:5-7.

²⁷³ Hadaway, TR. 238:9-11; Elgin, Exhibit No. KLE-1T at 23:23 to 24:1 & TR. 736:19 to 737:5.

²⁷⁴ Exhibit No. MPG-1T at 17:4.

²⁷⁵ Id. at 17:12-13.

²⁷⁶ Elgin, TR 723:13 to 724:2.

²⁷⁷ Exhibit No. MPG-4 at 1: last column.

²⁷⁸ Hadaway Exhibit No. SCH-12 at 1, column entitled “Constant Growth DCF Model Analysts’ Growth Rates.”

²⁷⁹ Exhibit No. MPG-6 at 1: last column.

²⁸⁰ Hadaway Exhibit No. SCH-6, page 1 shows a range of 8.4 percent to 12.3 percent.

broad a range for a group of companies that are supposed to be 'comparable'.²⁸¹ As he succinctly summarized: these results are "simply too variable and not credible".²⁸²

194 In a prior PacifiCorp rate case, the Commission said, "We note that the divergence in the extremes of analytical results presented by cost of capital witnesses had been growing in our recent proceedings. We find these extreme values to be of little practical use."²⁸³ That statement applies here. Both Dr. Hadaway's and Mr. Gorman's constant growth DCF results reflect a very high variability, which proves the proxy group is not representative, and renders them of little practical use to the Commission.²⁸⁴

195 Dr. Hadaway tried to explain away this core deficiency in his case by offering solace that these disparate characteristics because "one company's problem data tends to be balanced out by ... high numbers balance the low numbers, and vice versa."²⁸⁵ This testimony begs the obvious question why the Commission would accept as comparable a group with such widely disparate data in the first place. In any event, there is no evidence this "problem data balancing" phenomenon accurately accounts for the fundamental risk differences in his proxy group. If it did, that would be serendipity.²⁸⁶

²⁸¹ Elgin, Exhibit No. KLE-1T at 54:23 to 55:5.

²⁸² Elgin, TR. 745:24-25.

²⁸³ *Utilities and Transportation Commission v. PacifiCorp*, Docket UE-050684, Order 04 (April 17, 2006) at page 94, ¶ 260.

²⁸⁴ Elgin, TR. 745:13 to 746:3. Dr. Hadaway's 6.00 percent GDP growth has a significant impact of in his DCF study. Indeed, it tames the high variability of his constant growth DCF estimates. Dr. Hadaway's Exhibit No. SCH-12, page 1, shows this muting effect. For his constant growth DCF results ("Constant Growth – DCF Model - Analysts' Growth Rates"), his range of ROE estimates is over 700 basis points: 5.9 percent to 13.2 percent. As the note to this exhibit page indicates, Dr. Hadaway eliminated the 5.9 percent result for Edison International. Even if this result is eliminated, the range is still 500 basis points: 7.5 percent to 12.5 percent. The muting effect of Dr. Hadaway's GDP growth figure is shown in the second column ("Constant Growth – DCF Model – Long Term GDP Growth"). There, the variability in his ROE estimates is reduced to 320 basis points: from 9.3 percent to 12.5 percent. In the last column ("Low Near-Term Growth – Two-Stage Growth – DCF Model") Dr. Hadaway uses what amounts to a virtually 100% weighting of his six percent GDP growth figure, which reduces the variability even further, to 250 basis points: 9.3 percent to 11.8 percent.

²⁸⁵ Hadaway, TR. 255:10.

²⁸⁶ To be sure, in recent cases, Staff's own cost of capital consultants have agreed to use whatever proxy group the utility has advanced. However, they did so to reduce or avoid controversy. E.g., Elgin, Exhibit No. KLE-5 at 4:3-4 (testimony of Staff consultant Parcell, selecting a proxy group so as "not [to] form a major controversy in the cost of equity estimation process"); Elgin, Exhibit No. KLE-6 at 3:7-8, (using Dr. Hadaway's group "to reduce controversy.") Suffice it to say, the proxy group issue is in controversy in this docket. Elgin, TR. 738:5 to 739:4.

196 The Commission deserves better. The bottom line is that the proxy group used by
PacifiCorp and ICNU are not of comparable risk to PacifiCorp. The Commission should reject
the proxy group of PacifiCorp and ICNU and the results they generate.

5. PacifiCorp's DCF Results are Driven by Dr. Hadaway's Undefended Choice of Weighting Historical GDP Data

197 Even if the Commission were to ignore Dr. Hadaway's defective proxy group, the
Commission would still find his ROE estimate to be excessive, because his ROE
recommendation is principally supported by another proxy for long-term dividend growth:
Gross Domestic Product (GDP).

198 While the Commission has ruled that if GDP is used, "it should be a forward-looking, *not*
an historical average,"²⁸⁷ Dr. Hadaway insisted on using an historical average; he used no
credible forecast of GDP growth whatsoever.²⁸⁸ Moreover, his future GDP growth estimate is
based on his own notion of a weighting scheme using 60 years of historical GDP growth data.²⁸⁹
The Commission will search the record in vain for any explanation why his choice of weighting
the data is better than another weighting choice.

199 Notably, had Dr. Hadaway used the available long-term GDP forecasts, his alternate DCF
analyses would have produced an ROE estimate of 9.6 percent, consistent with Staff's
recommendation.²⁹⁰

6. Conclusion

200 Staff's cost of equity of 9.50 percent is reasonable, and based on proper financial
analysis. Staff's DCF results are founded on reliable published data for a proxy group of utilities
that are comparable to PacifiCorp. Staff fully explained how it selected its proxy group and

²⁸⁷ *Utilities & Transportation Commission v. PacifiCorp*, Docket UE-050684, Order 04 (April 17, 2006) at 94, ¶ 261 (emphasis added).

²⁸⁸ Hadaway, Exhibit No. SCH-14.

²⁸⁹ Hadaway, Exhibit No. SCH-5.

²⁹⁰ Elgin, Exhibit No. KLE-1T at 56:21-23. Mr. Gorman proceeds with a multi-stage DCF analysis similar to that prepared by Dr. Hadaway. The difference between the two analyses boils down to the figure used for long-term GDP growth as a proxy for dividend growth. Mr. Gorman relies upon forecasted growth rather than an arbitrary weighting of historical GDP growth, such as Dr. Hadaway used. Dr. Gorman's results are more reasonable as a result.

analyzed the data for each company, resulting in a transparent analysis that is fully consistent with DCF theory and how a rational investment decision is made. Staff's corroborated its DCF results by CAPM and risk premium analysis. The Commission should find PacifiCorp's cost of common equity to be no more than 9.5 percent.

D. Cost of Long-Term Debt

201 Commission Staff accepted the Company's proposed 5.89 percent cost of long-term debt as a reasonable.²⁹¹ Nonetheless, the Company claims Staff's acceptance of this cost rate is unfair. As we explain below, PacifiCorp failed to make a case that its debt cost should be any higher than 5.89 percent. The Commission should accept that cost rate for ratemaking purposes.

1. The Commission Should Make No Adjustment to the Cost of Long-Term Debt to Account for the Alleged "Rating Downgrade"

202 PacifiCorp posits that its long term debt cost would increase fully 88 basis points, to 6.91 percent, under Staff's equity ratio proposal.²⁹² Among other things, the Company's position assumes PacifiCorp would be rated BBB. Of course, this is pure speculation, because the rating agencies' "black box" process for determining a specific rating features many subjective considerations.²⁹³ In other words, no one can be certain that PacifiCorp would incur higher debt costs due to a higher debt ratio, because no one can predict if PacifiCorp's bond rating would be lower if the Commission accepted Staff's 46.5 percent common equity ratio recommendation.

203 In any event, and to borrow a phrase from Dr. Hadaway, PacifiCorp's 6.91 percent cost of debt idea "doesn't pass the smell test", because when PacifiCorp issued \$1 billion of debt at the height of the financial crisis, its equity ratio decreased to 46.5 percent, yet the Company's rating did not change.²⁹⁴

²⁹¹ Elgin, Exhibit No. KLE-1T at 47:14.

²⁹² Williams, Exhibit No. BNW-7T at 12:3-7.

²⁹³ Elgin, TR. 725:7-16 (with colloquy).

²⁹⁴ Exhibit No. BNW-23, page 10, as discussed by Mr. Elgin at TR. 726:20 to 727:9.

204 For another real life example, consider Avista, a BBB-minus rated utility.²⁹⁵ Yet, Avista
proposed a cost of debt of 6.08 percent in its last rate case,²⁹⁶ well below the 6.91 percent
PacifiCorp wants us to believe.

205 Moreover, when the Commission examines the “study” the Company put up to support
its alleged 88 basis point cost of debt increase, it will find several debt issues with spreads
between A-rated debt and BBB rated debt nowhere close to 88 basis points.²⁹⁷ In fact,
PacifiCorp’s alleged 88 basis point premium is based on speculating what it would have paid as a
BBB rated utility when it issued two new tranches of long-term debt totaling \$1 billion in 2009,
at the apex of the energy crisis.²⁹⁸

206 The Commission should not evaluate a reasonable cost of long-term debt using such
extreme and myopic conditions, particularly when PacifiCorp failed to demonstrate it was
compelled to sell debt at that time.²⁹⁹ It is instructive that both Avista and PSE issued long-term
debt later in 2009 at a lower cost than PacifiCorp,³⁰⁰ and they are both rated lower than
PacifiCorp.

207 In short, there is no reason to make any post hoc adjustments for alleged higher debt costs
should the Commission use a ratemaking equity ratio of 46.5 percent. The record fully supports
5.89 percent as the cost of long-term debt for PacifiCorp.

VII. COST OF SERVICE

208 PacifiCorp performed a cost of service study designed to analyze how each rate schedule
contributes to the Company’s costs. The contested issue is how to allocate demand costs.

²⁹⁵ Elgin, TR. 722:17-22.

²⁹⁶ Williams, Exhibit No. BNW-21, first sentence.

²⁹⁷ Williams, Exhibit No. BNW-19 and TR. 285:4-19.

²⁹⁸ Williams, Exhibit No. BNW-19 and TR. 279:11-16.

²⁹⁹ Staff asked PacifiCorp to document its decisions in financing its capital budget. Nowhere in the Company’s initial response or its supplemental response (when Staff asked for it again) does PacifiCorp indicate it considered deferring any projects, or using the flexibility of its short-term borrowing capacity. See Reiten, Exhibit No. RJR-3C. It is perplexing to consider that PacifiCorp issued \$1 billion of new debt to fund new capital additions, yet the Commission has no information about management’s decision making process to undertake those investment funding decisions.

³⁰⁰ Williams, Exhibit No. BNW-21, last sentence.

A. The Commission Should Allocate Demand Costs Using the Top 100 Hours From Each Winter and Summer; ICNU's 71 Hour Proposal is Too Restrictive

209 The Company's study uses 100 winter hours and 100 summer hours (or 200 w/s hours) to allocate demand costs between the rate schedules.³⁰¹ Staff reviewed and accepted this demand allocation³⁰², because it fairly presents customer use during periods of sustained high demand in the Western Control Area (WCA).³⁰³ This approach strikes a fair balance between the shift in demand expense to the Residential schedule and the use of the 200 w/s demand allocation.

210 Only ICNU opposes this demand cost allocation.³⁰⁴ As an alternative, ICNU wants to use 71 hours, and claims these hours are within 95 percent of the system peak hour.³⁰⁵ However, the record remains unclear on exactly how ICNU determined those 71 hours. If those 71 hours are within 95 percent of the *system* peak hour, ICNU's argument is irrelevant, because the Commission uses the WCA method to allocate power-related costs.

211 In any case, 71 hours represents only eight tenths of one percent of the hours in a year,³⁰⁶ and it is poor policy to restrict demand cost allocations to such a small time window. The system is used by all customers all the time. The Company's method, which measures demand across more than two percent of the hours, is more reasonable and reflective of use during times of sustained high demand.³⁰⁷

212 Moreover, the evidence shows that even if one allocates demand to customer classes based on fewer peak hours, the customer on Schedule 48T, Dedicated Facilities, does not reach parity.³⁰⁸ The Commission should accept the Company's 200 w/s hours for allocating demand costs among the rate schedules as reasonable, and reject ICNU's overly narrow proposal.

³⁰¹ Paice, Exhibit No. CCP-1T at 6:6-9.

³⁰² Schooley, Exhibit No. TES-1T at 29:13-14.

³⁰³ Schooley, Exhibit No. TES-4T at 7:14-16 and 10:5-8.

³⁰⁴ Schoenbeck, Exhibit No. DWS-1T at 2:21-23.

³⁰⁵ Schoenbeck, Exhibit No. DWS-1T at 3:17.

³⁰⁶ $71 \text{ hours} \div 8760 \text{ hours per year} = .00081$.

³⁰⁷ Schooley, Exhibit No. TES-4T at 7:12-21.

³⁰⁸ Schooley, Exhibit No. TES-4T at 9:22 to 10:2.

VIII. REVENUE ALLOCATION/RATE SPREAD

213 PacifiCorp's cost of service study provides a primary guide to the Commission for determining how to spread the revenue requirement over the rate schedules. Staff proposes a rate spread that is consistent with the results of the cost of service study because it moves schedules closer to the cost to serve those customers, as follows:

114% of average increase:³⁰⁹ Schedule 16, Residential customers
Schedule 48T, Large General Service >1000 kilowatts
Schedule 48T, Dedicated Facilities

83% of average increase:³¹⁰ Schedule 24, Small General Service
Schedule 36, Large General Service <1000 kilowatts
Schedule 40, Agricultural Pumping

1% increase:³¹¹ Schedules 15, 52, 54, 57, Street and Area Lighting

214 The Company accepts and supports Staff's methodology to allocate greater than average increases to Residential and Industrial schedules, less than average increases to Commercial and Irrigation schedules, and a one percent increase to Lighting schedules.³¹² Staff's proposal is also consistent with Wal-Mart's proposal, which also moves rate schedules closer to cost.³¹³

215 Only ICNU objects. ICNU wants to use an equal percentage increase to all schedules except Lighting.³¹⁴ ICNU opposes moving rate schedules closer to cost on the basis that "most major classes are within a few percentage points of a cost-based level under the Company's [cost of service] study,"³¹⁵ and also, ICNU fears the Commission would be moving to "a policy where it will use a single cost study" to determine rate spread.³¹⁶

216 The Commission should reject ICNU's position. First, Staff's proposed revenue allocation gives effect to the revision in the peak credit method.³¹⁷ This revision all by itself

³⁰⁹ Schooley, Exhibit No. TES-1T at 31:8.

³¹⁰ Schooley, Exhibit No. TES-1T at 31:11.

³¹¹ Schooley, Exhibit No. TES-1T at 31:13.

³¹² Griffith, Exhibit No. WRG-7T at 2:9-11.

³¹³ Criss, Exhibit No. SWC-1T at 6:19-23. Wal-Mart proposes a minimal increase for the Lighting schedule; the jurisdictional average increase for the Commercial schedules 24, 36, and 40; and "the difference to the rate schedules that include rates that are less than the costs incurred to provide service."

³¹⁴ Schoenbeck, Exhibit No. DWS-1T at 6:7-8; Schoenbeck, Exhibit No. DWS-3T at 20-22 & Exhibit No. DWS-4.

³¹⁵ Schoenbeck, Exhibit No. DWS-3T at 3:10-12.

³¹⁶ Schoenbeck, Exhibit No. DWS-3T at 3:16.

³¹⁷ Schooley, Exhibit No. TES-4T at 12:10-12 and TR. 777:3-6.

justifies the above average increase to the Residential schedule and mitigates the potential for even greater increases to the Industrial schedules.³¹⁸ By contrast, ICNU's equal percentage proposal not only fails to reflect the impact of this change in allocation, but it also fails to address the notable and chronic under-recovery of costs by Schedule 48T customers.³¹⁹

217 As for ICNU's fears, while Staff is unaware of any Commission mandate to use multiple cost-of-service studies, the Commission needs to base its decisions on the record before it, and ICNU had ample opportunity to contribute to that record. For its part, Staff carefully analyzed the large amount of evidence in this case, and performed its own test of the sensitivity of allocating demand by varying the peak hours.³²⁰ The results show that even under the extreme case of the two peak winter hours, Schedule 48T, Dedicated Facilities, remains below parity.³²¹

218 In sum, Staff's proposed revenue allocation is reasonable, fair, balanced and cost-based, and the Commission should accept it. The Commission should reject ICNU's non-fact based arguments for keeping existing rate relationships intact and ignoring changes in cost responsibility.³²²

IX. RATE DESIGN

219 There is one contested rate design issue, and it involves the customer basic charge. For the reasons that follow, the Commission should raise the basic charge from \$6.00 to \$7.50.

A. The Commission Should Accept a \$7.50 Residential Basic Charge Because it is Cost-Based

220 The basic charge includes the cost of the meter, service drop, billing and meter reading.³²³ It is entirely consistent with cost causation principles to use a flat charge to recover those costs that vary by the addition or subtraction of customers.³²⁴ Staff supports a \$7.50 basic

³¹⁸ The result of the new method is to allocate 33 percent of generation costs to demand, rather than 12 percent under the prior method. Paice, Exhibit No. CCP-1T at 6:1-5. This change increases the costs allocated to the Residential schedule and decreases the costs allocated to the Industrial schedules. Schooley, Exhibit No. TES-1T at 30:15-19.

³¹⁹ Schooley, Exhibit No. TES-4T at 11, Table 2.

³²⁰ Schooley, Exhibit No. TES-4T at 8:22, Table 1.

³²¹ Schooley, Exhibit No. TES-4T at 8:27 to 10:8.

³²² E.g., Schoenbeck, Exhibit No. DWS-3T at 3:18-20.

³²³ Griffith, Exhibit No. WRG-1T at 4:15-16.

³²⁴ Schooley, TR. 778:21 to 779:2.

charge, which, although well below the cost of \$9.68 (based on Staff's case), is a reasonable movement towards appropriately recovering the costs that vary by the number of customers.³²⁵

221 PacifiCorp wants to increase the basic charge to \$8.50, which is also below the cost of \$10.27 (based on the Company's rebuttal case³²⁶). Staff supports its own proposed \$7.50 charge, but can support PacifiCorp's proposed \$8.50 charge for much the same reasons.

B. The Energy Project's Proposal to Have No Increase in the Residential Basic Charge Violates Cost Causation Principles; In Any Event, Recovering These Costs Through Volumetric Charges Sends No Meaningful Price Signal

222 The Energy Project objects to any increase to the basic charge, claiming it "sends the wrong price signal".³²⁷ Instead, The Energy Project would increase volumetric usage rates only. This is plainly wrong, because using volumetric rates to recover costs that do not vary with volume violates cost causation principles. If The Energy Project truly believes an additional price signal is needed to encourage more efficient use of electricity, it could propose a redesign of the two-block rate structure.³²⁸

223 Moreover, customers do not need any additional price signal, given the tail block rate already is over nine cents per kilowatt-hour.³²⁹ In any event, the incremental increase to the tail block rate reflecting the additional revenue from a basic charge of \$7.50 is a mere 0.135 cents per kWh,³³⁰ which is no signal at all.

224 Staff's basic charge of \$7.50 is reasonable, cost-based, and otherwise well-supported.

X. LOW INCOME ISSUES

225 The contested low income issues in this case include programmatic changes to the Low Income Bill Assistance Program (LIBA) and a proposal by The Energy Project to increase low income weatherization funding by half a million dollars annually.

³²⁵ Based on Staff's lower rate of return. Schooley, Exhibit No. TES-4T at 16:1-2 and Exhibit No. TES-5.

³²⁶ Griffith, Exhibit WRG-7T at 3:18-23.

³²⁷ Eberdt, Exhibit No. CME-5T at 3:6.

³²⁸ See TR. 780:23-25 and 781:11-15.

³²⁹ Schooley, Exhibit No. TES-4T at 14:10 to 15:2.

³³⁰ Schooley, Exhibit No. TES-4T at 14:14-17.

A. Low Income Bill Assistance (LIBA)

226 Ratepayers subsidize the payment of low income ratepayer's bills via the Company's the Bill Assistance Surcharge, contained in Schedule 91. PacifiCorp proposes several changes to LIBA.³³¹ The contested changes to LIBA are PacifiCorp's proposals to: 1) increase the number of participating customers by applying 30 percent of the surcharge increase to additional households, and 70 percent to increasing the rate subsidy; and 2) improve efficiencies by recertifying participants every other year, rather than each year.³³² Also, The Energy Project proposes to increase the certification fee paid to low income agencies to \$65.00 per household.³³³

227 For the reasons below, the Commission should accept these PacifiCorp proposals and reject The Energy Project's proposal. While The Energy Project objects to the above programmatic changes the Company proposes and boldly claims they "endanger the ability of the agencies to provide service"³³⁴ the evidence simply does not back that up.

1. The Increase in LIBA Funding Should be Used to Welcome More Needy Households Without More of an Increase in Funding Than PacifiCorp Proposes

228 PacifiCorp proposes applying 30 percent of the increased funds raised by the surcharge to increasing the number of qualifying customers, and 70 percent to increase the amount of rate

³³¹ The uncontested changes are to increase the subsidy by 21 percent, in line with the level of the Company's initial proposed revenue increase (Griffith, Exhibit No. WRG-1T at 6:11-13; Eberdt, Exhibit CME-5T at 5:24 to 6:1) and to maintain the income eligibility cap at 125 percent of the federal poverty level. PacifiCorp initially proposed to increase the income eligibility cap under LIBA to 150 percent of the federal poverty level (FPL). Griffith, Exhibit No. WRG-1T at 7:7-10. Staff supported that proposal (Schooley, Exhibit No. TES-1T at 42:21 to 43:11), but The Energy Project opposed it on the grounds that many households at the current 125 percent FPL are not being served. Eberdt, Exhibit No. CME-1T at 8:10-13. PacifiCorp now agrees to maintain the income eligibility at 125 percent of the FPL. Eberle, Exhibit No. RME-1T at 5:3-6. Staff accepts this outcome.

In particular, Staff supports increasing the bill assistance surcharge at 21 percent, regardless of the ultimate rate increase determined by the Commission. Schooley, Exhibit No. TES-1T at 40:4-6. This will bring the surcharge more in line with the similar exactions of Puget Sound Energy and Avista. Schooley, Exhibit No. TES-1T at 41:10-14. Staff notes that the goal here is not parity between PacifiCorp and the others, because PacifiCorp's rates are considerably lower. Griffith, TR. 562:15-18.

³³² Griffith, Exhibit No. WRG-1T at 7:3-16.

³³³ Eberdt, Exhibit No. CME-1T at 10:18-20.

³³⁴ Eberdt, Exhibit No. CME-1T at 3:12.

subsidy.³³⁵ Staff accepts this proposal because it extends the reach of the bill assistance program to 245 more households.³³⁶

229 Only The Energy Project opposes this idea. The Energy Project agrees more people would be served, but notes the increase in the bill discounts would be less.³³⁷ The Energy Project's solution? Use more ratepayer money to fund both an increase in participants and an increase in the level of subsidy. However, The Energy Project failed to provide any evidence showing how much the increased subsidy would be on a monthly usage basis,³³⁸ so the Commission cannot test whether The Energy Project's proposal would make a material difference or not. What we do know is that increasing the participation in the LIBA program by 245 households will make a material difference to those households.

230 The Commission should accept PacifiCorp's proposal to increase the number of participants in the LIBA program. More people in need will be served, and the rate subsidy will increase to 4.7 cents per kWh from the current 4.07 cents (a 15.5 percent increase), which is greater than Staff's proposed overall revenue increase percentage. This proposal is just, reasonable and more than fair, and the Commission should accept it.

2. **The Commission Should Change the Low Income Customer Certification Process to Improve Efficiency**

231 PacifiCorp proposes that the low income agencies certify participants in LIBA every other year, rather than every year, to reduce administrative costs and free up dollars to provide greater benefits to those in need.³³⁹ Staff accepts the concept, but recognizes the low income agencies would see a reduction in revenues.

232 Once again, The Energy Project objects, charging this proposal would "crippl[e] the ability of the agencies to provide income certification,"³⁴⁰ and create "logistical nightmares."³⁴¹

³³⁵ Griffith, Exhibit No. WRG-1T at 7:3-6.

³³⁶ Schooley, Exhibit No. TES-1T at 42:21 to 43:11.

³³⁷ Eberdt, Exhibit No. CME-1T at 6:11-14.

³³⁸ Eberdt, Exhibit No. CME-1T at 7:7-16.

³³⁹ Griffith, Exhibit No. WRG-1T at 7:13-16.

³⁴⁰ Eberdt, Exhibit No. CME-1T at 9:11-12.

³⁴¹ Eberdt, Exhibit No. CME-1T at 10:23.

Although The Energy Project's support for this claim is somewhat obtuse,³⁴² their point seems to be that under the Company's proposal, in Year 1, every client would be recertified for two years, so that in Year 2, the low income agencies would have virtually nobody to recertify.

233 Staff ignored the hyperbole, recognized the problem and offered a creative solution: the low income agencies would certify one-half the participants for two years in Year 1, and the other half for two years in Year 2. Thereafter, each participant would be recertified every two years, thereby resolving the "nightmares" that seem to concern The Energy Project.³⁴³ The Commission should adopt this solution so the program can move forward more successfully.

3. There is No Justification for Increasing the Low Income Customer Certification Fee

234 The Energy Project proposes a certification fee of \$65 per household.³⁴⁴ However, the Commission will find no reliable support for this proposal. The Energy Project offers only Exhibit No. CME-4, which purports to justify a \$73.14 certification fee, which is over 52 percent more than the current \$48.00 fee.³⁴⁵ As Staff pointed out, that exhibit proves nothing, because it reflects just one month of expense for just one of the three low income agencies.³⁴⁶ That is no way to carry the burden of proof in any context, let alone this one.

235 Moreover, PacifiCorp presents evidence that the administrative costs of low income agencies in its Washington service area are 21 percent of the total program costs, while the costs of similar programs in its other states are at a much lower percentage.³⁴⁷

236 While certainly, the low-income agencies should receive fair compensation for their work,³⁴⁸ The Energy Project's evidence for a higher fee clearly misses the mark.

237 More analysis and more understanding on all sides of this issue are needed. PacifiCorp offers further discussions among interested parties on how the certification process can be

³⁴² Eberdt, Exhibit No. CME-1T at 9:15 to 10:20.

³⁴³ Schooley, Exhibit No. TES-4T at 17:1-10.

³⁴⁴ Eberdt, Exhibit No. CME-1T at 10:18-20.

³⁴⁵ Eberdt, Exhibit No. CME-1T at 10:1-20.

³⁴⁶ Schooley, Exhibit No. TES-4T at 17:21-18:1.

³⁴⁷ Eberle, Exhibit No. RME-1T at 6:19 to 7:6.

³⁴⁸ Schooley, Exhibit No. TES-4T at 17:20-21.

streamlined to lower administrative expenses.³⁴⁹ That is a reasonable suggestion. In the meantime, the Commission should not increase the certification fee.

B. Low Income Weatherization Issues are Not Properly Before the Commission

238 PacifiCorp's low-income weatherization program is funded by ratepayers through the Schedule 191 system benefits surcharge. The Energy Project proposes increasing the funding for low-income weatherization programs³⁵⁰ "by \$500,000, regardless of whatever rate increase the Commission might ultimately approve".³⁵¹

239 However, PacifiCorp did not file any revisions to Schedule 191 when it initiated this case. Under the Commission's suspension authority in RCW 80.04.130(1), the Commission may determine the justness and reasonableness of "such proposed change", and that phrase refers back to the changes made by the tariffs the utility files and the Commission suspends. Because PacifiCorp filed no change to the low income weatherization tariff, the funding issue is not properly before the Commission, and the Commission should not consider it.³⁵²

240 The Commission reached the same conclusion in PSE Docket UE-090704. In that case, the Commission did not allow a change in PSE's low income Schedule 129:

PSE did not file any proposed revisions to Schedule 129 and, therefore, the Commission's suspension order and notice of hearing cannot be considered to have given due and proper notice that it might make a determination in this proceeding that would lead to a change in that tariff schedule either now or in the future.³⁵³

The same result should obtain here.

241 If the Commission elects not to decide this legal issue, the Commission should reject The Energy Project's proposal on the merits. First, the low income agencies currently are not even spending the current levels of monies budgeted for low-income weatherization.³⁵⁴ Second, The Energy Project has provided no reason why PacifiCorp's Washington customers should bear the

³⁴⁹ Eberle, Exhibit No. RME-1T at 7:16-19.

³⁵⁰ Eberdt, Exhibit No. CME-1T at 3:16-17.

³⁵¹ Eberdt, Exhibit No. CME-1T at 16:8-9.

³⁵² Schooley, Exhibit No. TES-4T at 19:3-5.

³⁵³ *Utilities and Transportation Commission v. Puget Sound Energy, Inc.*, Docket UE-090704, Order 13 (April 29, 2010) at 4, ¶ 10.

³⁵⁴ Eberle, Exhibit No. RME-1T at 8:5-6.

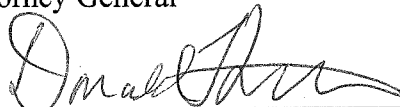
burden of replacing funding from the federal government.³⁵⁵ Finally, before more money is generated by Schedule 191, there should be a thorough review of the entire system benefit charge and the programs it funds. That review was not done in this case.

XI. CONCLUSION

242 For the reasons stated in this brief, the Commission should reject the tariffs PacifiCorp filed in this docket and permit the Company to file tariffs reflecting an overall rate increase of 9.5 percent, and consistent with Staff's rate spread and rate design recommendations described in detail above.

DATED this 11th day of February 2011.

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³⁵⁵ Schooley, Exhibit No. TES-4T at 19:11-13.