

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND  
TRANSPORTATION COMMISSION,

Complainant,

v.

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

Respondent.

DOCKET NO. UE-100749

**POST-HEARING BRIEF OF PUBLIC COUNSEL**

**FEBRUARY 11, 2011**

**REDACTED VERSION**

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## I. INTRODUCTION

1. In this case, PacifiCorp seeks a 17.85 percent overall increase and a 20.20 percent increase to residential rates. This request is PacifiCorp's *fifth* request for a general rate increase since 2005<sup>1</sup> and is also the largest increase requested by the Company in the last decade.<sup>2</sup> The Company requests this increase during the worst economic downturn since the Great Depression.<sup>3</sup>
2. Throughout this case, PacifiCorp has repeatedly stated that it is sensitive to the financial pressures facing its customers and is cutting costs to minimize the impact of any rate increase.<sup>4</sup> However, these statements do not square with the Company's actual practices. First, PacifiCorp is seeking millions of dollars in increased profits. In fact, the majority of the requested increase is attributable to the Company's request for a higher rate of return.<sup>5</sup> Furthermore, PacifiCorp presented no evidence that it has deferred any capital projects.<sup>6</sup> The Company has also given "no directive for workforce reductions or reducing costs or employee head count."<sup>7</sup> Instead, PacifiCorp has consistently increased wages and bonuses for all levels of employees, paying its

<sup>1</sup> Reiten, TR. 212:7-18. Surprisingly, PacifiCorp CEO, Mr. Patrick Reiten, could not recollect the correct number of rate cases the Company had filed in his tenure, nor could he recall how much the Company requested in its past cases. See TR. 212:5-213:2.

<sup>2</sup> PacifiCorp Electric Rate Increases since 2000, *available at* <http://www.wutc.wa.gov/webimage.nsf/e827858488fbd8aa88256efc00506bb3/dcf99908409a29448825709700726f24!OpenDocument> (last visited Feb. 5, 2011).

<sup>3</sup> Shell, Adam, "Comparisons to the Great Depression keep popping up," *USA Today*, July 19, 2010, *available at* [http://www.usatoday.com/money/markets/2010-07-19-1930smarket19\\_CV\\_N.htm](http://www.usatoday.com/money/markets/2010-07-19-1930smarket19_CV_N.htm) (last visited Feb. 8, 2011).

<sup>4</sup> See e.g., Exh. No. RPR-1T, p. 5:5-7 (Reiten Direct) (stating, "[t]he Company continues to proactively and aggressively control operations and maintenance (O&M) and administrative and general (A&G) costs"); TR. 230:15 (Reiten testifying, "we're attempting in these times to manage our company very, very conservatively"); and, TR. 231:15-20 (Reiten answering Chairman Goltz's question of whether the Company is "cutting costs in response to the overall economic situation," by stating, "Absolutely. We're looking for efficiencies everywhere we can").

<sup>5</sup> Reiten, TR. 207:22 – 208:1.

<sup>6</sup> Reiten, TR. 203:10 – 206:19.

<sup>7</sup> Wilson, TR. 423:10-15.



CEO, Gregory Abel, a \$1,105,460 bonus in 2009.<sup>8</sup> Finally, unlike many private and public sector employers, PacifiCorp has not put any travel restrictions in place.<sup>9</sup> Thus, while the Company has repeatedly made broad statements about reducing costs and creating efficiencies, the evidence in this case does not substantiate these claims.

3. Accordingly, Public Counsel urges the Commission to carefully scrutinize PacifiCorp's rate increase request. The Company's customers have seen substantial rate increases year after year, and should not be asked to bear the costs of PacifiCorp's extraneous expenses and higher profits yet again.

**A. Economic Conditions in PacifiCorp's Service Territory.**

4. The recent economic downturn has devastated the U.S. economy and Washington has not been spared its effects. For the first time on record, the nominal median income of U.S. households actually decreased.<sup>10</sup> Between 2008 and 2009, the national unemployment rate increased by 3.5 percent, the largest one-year increase ever.<sup>11</sup> Moreover, the portion of the population living below half of the poverty threshold reached an all-time high of 6.3 percent.<sup>12</sup>

5. Washington has by no means been immune to the recession. In 2009, total personal income in Washington fell by over one percent, the first decrease on record.<sup>13</sup> Washington's per-capita income fell by a steeper margin, declining by 2.4 percent in 2009.<sup>14</sup>

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<sup>8</sup> Exh. No. RBD-22, p. 2.

<sup>9</sup> Reiten, TR. 217:13-15.

<sup>10</sup> Exh. No. RPR-4, p. 1.

<sup>11</sup> *Id.*

<sup>12</sup> *Id.* at p. 2. This statistic is compounded by the fact that, *for the first time since the measure has existed*, the poverty threshold for a family of four decreased, and is now less than \$22,000. *See id.*

<sup>13</sup> Exh. No. EDW-6, p. 2.

<sup>14</sup> *Id.*

6. PacifiCorp serves some of the most economically disadvantaged parts of our state—the vast majority of its service territory is in Yakima and Walla Walla counties.<sup>15</sup> Both counties suffer from median household incomes \$13,000 below the state average, as well as some of the greatest amounts of people living below the poverty line. Indeed, out of Washington’s 39 counties, Yakima has the fifth highest rate of adult poverty, while Walla Walla has the seventh.<sup>16</sup> Furthermore, Yakima County, which makes up the majority of PacifiCorp’s Washington service territory, is one of four counties in Washington where it is estimated that more than 25 percent of children under 18 live in poverty.<sup>17</sup>

7. Compounding these struggles are the numerous cuts that have been made to government assistance in recent years. For example, state Medicaid benefits have been greatly reduced for all recipients.<sup>18</sup> In addition, it is highly likely that both the Basic Health Plan and Disability Lifeline will be eliminated this biennium.<sup>19</sup> Based on the proportion of their populations that are eligible for these government services, Yakima and Walla Walla counties are both likely to face considerable new challenges as these services are cut.

8. The severe economic conditions that exist in PacifiCorp’s service territory should be weighed on balance in the Commission’s determination of whether the rates requested by the Company are fair, just, reasonable and sufficient.

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<sup>15</sup> As of October, 2010, PacifiCorp had a total of 103,302 residential customers in Washington State. Of these customers, 20,217 were in Walla Walla County and 80,740 were in Yakima. *See* Exh. No. RPR-6, p. 1.

<sup>16</sup> Exh. No. CME-1T, p. 6-19-22 (citing 2009 U.S. Census data) (Eberdt Responsive).

<sup>17</sup> *Id.* at p. 7:1-8 (The percent of children living in poverty in Yakima has increased since 2000) (Eberdt Responsive).

<sup>18</sup> *See* Washington State Department of Social and Health Services, News Release (Dec. 30, 2010), *available at* <http://www.dshs.wa.gov/mediareleases/2010/pr10109.shtm> (last visited Feb. 2, 2011).

<sup>19</sup> Garber, Andrew, “The budget breakdown: How will state lawmakers slash the budget when much of it is untouchable?” *The Seattle Times*, Jan. 28, 2011, *available at* [http://seattletimes.nwsourc.com/html/localnews/2013884824\\_budgetprimer09m.html](http://seattletimes.nwsourc.com/html/localnews/2013884824_budgetprimer09m.html) (last visited Feb. 2, 2011).

## **B. Summary of Public Counsel Argument.**

9. Public Counsel addresses the following issues in this brief: compensation-related expenses (2009 and 2010 wage increase adjustments, incentive compensation, and MEHC bonuses); cash working capital; outside legal expenses; residential revenue normalization; renewable energy credit (REC) sales revenues; rate spread; and the residential fixed customer charge. Public Counsel supports but does not address the reductions in net power costs recommended by Commission Staff and ICNU and the rate of return proposal of Commission Staff.

## **II. PUBLIC COMMENT**

10. The Commission held a public comment hearing on this matter on October 21, 2010, in Yakima, Washington. The meeting was well attended with twenty-nine individuals testifying on the rate increase. The Commission heard comments from representatives of industrial customers such as Boise-Cascade and Tree Top Inc., assisted living communities, as well as individual customers. Lori Crow, who testified at the hearing on behalf of Ponderosa Assisted Living Community, expressed the impact this increase would have on the seniors she represents at Ponderosa:

I know this is a simple business proposition, but it's really not simple—I ask you to look at the people you're going to be hurting. They are salt of the earth people, have worked all their lives, thought they were doing the right thing, cut coupons, used leftovers, and paid their bills, and this is going to really hurt so I really, I not only beg you, I implore you to please think twice before you do this.<sup>20</sup>

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<sup>20</sup> TR. 043:15-23.

11. Customers submitted a total of six hundred ninety-three written comments to the Commission and to Public Counsel, the overwhelming majority in opposition to the rate request.<sup>21</sup> One customer expressed the following reaction, common among many customers:

As senior citizens on a fixed income, my husband and I have tried to reduce our power bill. We even purchased a new refrigerator and freezer per information advertised by PP&L. They have helped lower our bill but if another rate increase is allowed, we'll be right back where we started. We keep our heat temp lower and air conditioning temp higher. What more are we expected to do? We need electricity. Please consider the customers and the economy and do not allow another increase.<sup>22</sup>

Another customer, Berit Ing, provided a similar comment:

I am writing in protest to the proposed rate increase requested by Pacific Power. Our rates have already increased due to the expiration of the Bonneville Power discount. In light of this, coupled with a time when employers are freezing wage and laying off employees, a 21% increase is untenable. Then there are those such as me who live on a limited/low income. I am sure neither the employers nor Social Security are going to increase our incomes by anywhere near 21% (probably no increase for most). Can Pacific Power explain just what other necessity we are to do without in order to pay their increase?<sup>23</sup>

As is evident from these comments, the rate increase requested by PacifiCorp will have a devastating impact on the Company's residential customers, as well as the communities in which these customers reside.

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<sup>21</sup> Exh. No. 8 (Public Comment Exhibit).

<sup>22</sup> Exh. No. 8 (Joyce Rouse, PDF File "Comment Received by Public Counsel," p. 20).

<sup>23</sup> Exh. No. 8 (Berit Ing, PDF File "Comment Received by Public Counsel," p. 1).

### III. APPLICABLE LAW

12. The “ultimate determination” which must be made by the Commission in a rate case proceeding is “whether the rates and charges proposed in the revised tariffs are fair, just, reasonable and sufficient, pursuant to RCW 80.28.020.”<sup>24</sup> As stated by this Commission:

These questions are resolved by determining the Washington intrastate adjusted results of operations during the test year, establishing the fair value of the Company’s property-in-service for intrastate service in the state of Washington (rate base), determining the proper rate of return permitted the Company on that property, and then ascertaining the appropriate spread of rates charged various customers to recover that return.<sup>25</sup>

13. As a general matter, the Commission must regulate in the public interest.<sup>26</sup> The burden of proof is on PacifiCorp to establish that the proposed rates are fair, just, reasonable, and sufficient.<sup>27</sup> Costs that do not provide a benefit to customers are not recoverable.<sup>28</sup>

### IV. UNCONTESTED ADJUSTMENTS

14. In its rebuttal case, PacifiCorp agreed to three adjustments by ICNU and Public Counsel. The Commission should accept these adjustments.

15. First, ICNU and Public Counsel joint witness, Mr. Gregory Meyer, proposed that SO<sub>2</sub> emission allowance sales revenues be amortized over five years instead of fifteen.<sup>29</sup> PacifiCorp

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<sup>24</sup> *WUTC v. Avista Corp.*, Docket Nos. UE-991606 & UG-991607 (consolidated), Third Suppl. Order, ¶ 14.

<sup>25</sup> *Id.*, ¶ 14.

<sup>26</sup> RCW 80.01.040(3).

<sup>27</sup> RCW 80.04.230(2).

<sup>28</sup> See *U.S. West v. WUTC*, 134 Wn.2d 74, 126-27 (1997); *WUTC v. Avista Corp.*, Docket Nos. UE-080416 & UG-080417 (consolidated), Final Order (Order 08), ¶ 29.

<sup>29</sup> Exh. No. GRM-1CT, p. 19:11-15 (Meyer Responsive).

accepted the adjustment, stating:

The Company is willing to accept the five-year amortization period to flow back the revenues associated with these transactions to customers in a timely manner. This change also helps to reduce the proposed rate increase in this proceeding.<sup>30</sup>

The adjustment reduces PacifiCorp's Washington revenue requirement by approximately \$850,000.<sup>31</sup>

16. Mr. Meyer also proposed an adjustment to remove all costs associated with PacifiCorp's supplemental executive retirement plan (SERP). Mr. Meyer noted that all but one SERP beneficiary are retired employees who no longer provide service to Washington ratepayers, and that since PacifiCorp does not intend to add additional participants, the Company could not argue that the program was necessary to attract or retain employees.<sup>32</sup> Mr. Meyer also pointed out that Washington's two other electric IOUs do not recover SERP costs.<sup>33</sup> On rebuttal, PacifiCorp witness, Mr. R. Bryce Dalley, accepted Mr. Meyer's adjustment, stating: "[T]he Company is willing to exclude SERP expenses from customer rates in Washington."<sup>34</sup> The removal of SERP costs reduces the Washington revenue requirement by approximately \$178,000.<sup>35</sup>

17. Finally, Mr. Meyer recommended that three portions of the MEHC management fee be disallowed from rates.<sup>36</sup> On rebuttal, PacifiCorp accepted removing two of these portions—SERP and legislative costs—but recalculated the amount of the adjustments to reflect the amount the Company had already removed pursuant to the cap on the management fee mandated by

<sup>30</sup> Exh. No. RBD-4T, p. 4:19-22 (Dalley Rebuttal).

<sup>31</sup> *Id.* at p. 5:12-13.

<sup>32</sup> Exh. No. GRM-1CT, p. 27:14-21 (Meyer Responsive).

<sup>33</sup> *Id.* at p. 28:1-5.

<sup>34</sup> Exh. No. RBD-4T, p. 5:18-21 (Dalley Rebuttal).

<sup>35</sup> *Id.* at p. 6:4-5.

<sup>36</sup> Exh. No. GRM-1CT, p. 34:1-11 (Meyer Responsive).

MEHC acquisition commitment WA4(b)(i).<sup>37</sup> Public Counsel does not contest the Company's rebuttal adjustment for these two portions. Combined after PacifiCorp's recalculation, removing SERP and legislative costs from the management fee reduces PacifiCorp's revenue requirement by \$96,000.<sup>38</sup> The third portion of Mr. Meyer's recommendation regarding the MEHC management fee—the recommendation to remove MEHC bonuses—remains contested and is discussed later in this brief.

## V. COMPENSATION-RELATED EXPENSES

### A. PacifiCorp's 2009 Wage Increase Adjustment for Office/Exempt Employees Should be Reduced to a Level Commensurate with the Average Increase for All Other PacifiCorp Employees.

18. PacifiCorp is seeking to recover the cost of a 3.5 percent increase to Officer/Exempt wages made in 2009.<sup>39</sup> Mr. Meyer proposed that the wage increase applicable to the Officer/Exempt labor group be decreased to the level of the average increase granted to other labor groups, which was 2.07 percent.<sup>40</sup> Mr. Meyer testified that the Officer/Exempt labor group represented PacifiCorp's most highly compensated employees and that, especially in light of current economic and labor market conditions and efforts of other Washington utilities to limit or eliminate executive wage increases, PacifiCorp had not adequately justified providing its highest-paid employees a markedly larger wage increase.<sup>41</sup> Mr. Meyer's adjustment reduces PacifiCorp's Washington test year expenses by \$128,366.<sup>42</sup>

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<sup>37</sup> Exh. No. RBD-4T, pp. 6-9 (Dalley Rebuttal).

<sup>38</sup> *Id.* at p. 9:14.

<sup>39</sup> Exh. No. GRM-1CT, p. 29:1-6 (Meyer Responsive).

<sup>40</sup> *Id.* at p. 29:7-11.

<sup>41</sup> *Id.* at p. 31.

<sup>42</sup> *Id.* at p. 29:11-14.

19. PacifiCorp responded to Mr. Meyer's proposal by stating that the Officer/Exempt labor group includes some employees who are not among the Company's "top executives."<sup>43</sup> Nevertheless, Mr. Meyer's adjustment for the Officer/Exempt labor group is reasonable because the Company did not provide any means by which the wages of top executives could be more specifically identified. When asked in discovery for test-year executive compensation, PacifiCorp only provided information regarding its named executive officers (NEOs),<sup>44</sup> which covers as few as *three* employees, and therefore does not represent all of the Company's executive-level employees.<sup>45</sup> The Officer/Exempt labor group, on the other hand, consists of a broader group of highly-compensated employees, including non-NEOs who received base salaries ranging from [Begin Confidential] XXXXXX [End Confidential] to [Begin Confidential] XXXX [End Confidential].<sup>46</sup> PacifiCorp confirmed that this category of employees includes a considerable portion of the highest paid non-union workforce, as evidenced by the fact that only 23 percent of the Officer/Exempt labor group earns wages below the rest of the non-union PacifiCorp workforce.<sup>47</sup> The wages of the highest-paid employees of the Company should not avoid scrutiny simply because PacifiCorp failed to provide detailed information regarding employee salaries.

20. PacifiCorp also responded to Mr. Meyer's proposal by stating that he erroneously considered union wages in his analysis. This argument should be disregarded. A large portion of PacifiCorp's employees *are* union employees. Excluding data for these employees from an

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<sup>43</sup> Exh. No. EDW-3T, p. 13:11-17 (Wilson Rebuttal).

<sup>44</sup> Exh. No. EDW-16.

<sup>45</sup> Wilson, TR. 405:4-7.

<sup>46</sup> Exh. No. EDW-15C, p. 2.

<sup>47</sup> Exh. No. EDW-18.



evaluation of reasonable wage increases would summarily dismiss useful information regarding much of the Company's workforce. PacifiCorp also argues that union workers may receive other non-wage benefits that are not taken into account in Mr. Meyer's analysis. However, the Company did not attempt to provide an estimate of the value of the union benefits. Moreover, non-union employees also receive non-wage benefits, as well as bonuses and incentives, all of which are not included in standard wages.

21. PacifiCorp further argued that Mr. Meyer's reduction to Officer/Exempt wage increases was improper due to the "thorough assessment of the market and reviews practices being undertaken by its competitors" that PacifiCorp completes.<sup>48</sup> However, a closer look at the information presented by the Company shows that its assessment was anything but thorough and does not capture the practices of companies that it actually competes with for labor. PacifiCorp's purported "competitors" include no Pacific Northwest utilities, no public utility districts or municipal utilities, nor the Bonneville Power Administration, all of whom PacifiCorp actually compete with for high-level employees.<sup>49</sup> PacifiCorp also does not include any non-utility companies in its comparator group, even though the Company's Director of Human Resources, Mr. Erich Wilson, testified at hearing that including non-utilities in its assessment would provide a more accurate justification for its compensation packages.<sup>50</sup> Moreover, PacifiCorp confirmed at hearing that it does no analysis of regional cost of living standards when determining wage increases.<sup>51</sup> Finally, and perhaps most revealing, PacifiCorp excluded any companies from its

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<sup>48</sup> Exh. No. EDW-3T, p. 13:20-22. (Wilson Rebuttal).

<sup>49</sup> Exh. No. EDW-5C.

<sup>50</sup> Wilson, TR. 421:1-4.

<sup>51</sup> Wilson, TR. 418:10-419:17.

analysis that did *not* increase wages in 2009, even though Mr. Wilson testified at hearing that many private and public sector employers “were holding back” on salary increases.<sup>52</sup>

22. PacifiCorp’s wage increases for highly-compensated employees are also out of step with the practices of Washington’s two other electric IOUs, both of which limited executive wage increases in 2009. Namely, Avista did not grant its executives *any* pay increase in that year. Similarly, Puget Sound Energy’s NEOs saw an average wage increase of less than 2 percent, with two executives, including the CEO, receiving only 0.6 percent.<sup>53</sup>

23. PacifiCorp’s 2009 wage increases are also unreasonably high when viewed in the context of executive compensation trends on a national level. In early 2010, *The Wall Street Journal* reported that the median value of salaries, bonuses, long-term incentives, and grants of stock and stock options for the CEOs of 200 major U.S. companies *declined* nine percent in 2009. The article goes on to state that the declines “reflected the recession, government controls and continued public outcry over big pay packages.”<sup>54</sup> Likewise, *USA Today* presented an analysis of 121 S&P 500 companies that showed base salaries for CEOs in 2009 were “essentially flat” and other types of compensation declined markedly from the preceding year.<sup>55</sup>

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<sup>52</sup> Wilson, TR. 421:8-17.

<sup>53</sup> Exh. No. GRM-1CT, p. 31:13-15 (Meyer Direct).

<sup>54</sup> Exh. No. EDW-19.

<sup>55</sup> Exh. No. EDW-20.

24. Utilities and commissions across the country have followed suit. In 2009, the Connecticut Department of Public Utility Control disallowed certain executive salary increases, stating:

The Department, however, is not inclined to allow large pay raises... in these difficult economic times where payroll concessions and job losses are prevalent throughout all industries. Accordingly, the Department sets a base annual escalation factor... with the *intent of limiting or eliminating pay raises for executives....* In this economic climate, ratepayers simply cannot afford to pay high payroll escalation rates.<sup>56</sup>

25. Again in 2010, Connecticut disallowed a portion of executive salary increases. In *Application of the Connecticut Water Company for Amended Rates*, the commission rejected a four percent increase to executive salaries over two years, stating: “[We] are concerned about the escalation of payroll and the Company’s unwillingness to adjust to the current economic climate in terms of wages.”<sup>57</sup>

26. Similarly, in approving a joint settlement that disallowed a portion of executive base salaries for 2010 through 2013, the New York Public Service Commission described its general principle regarding executive compensation:

We have... required all utilities in the state to comply with austerity guidelines that require belt-tightening beyond that imposed by our usual regulatory oversight. For example, we have limited the companies' rate allowances on the assumption that... they will *forgo discretionary salary increases for their executive employees.* The rates approved in this order incorporate these principles.<sup>58</sup>

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<sup>56</sup> *Application of the United Illuminating Co. to Increase its Rates and Charges*, Docket No. 08-07-04, Decision, p. 33 (issued Feb. 4, 2009 and setting rates for 2009 and 2010) (internal citation omitted).

<sup>57</sup> *Id.*

<sup>58</sup> *Re Central Hudson Gas & Electric Corp.*, 2010 WL 2546853, p. 4 (N.Y.P.S.C. 2010) (emphasis added).

27. In sum, the Commission should adopt Mr. Meyer's adjustment to Officer/Exempt wages to reflect a more appropriate test-year wage increase for PacifiCorp executives and other highly-compensated employees. The Officer/Exempt labor group is the best representative group for PacifiCorp executives and other highly-paid employees. PacifiCorp has not adequately justified its 3.5 percent wage increase for Officer/Exempt employees and improperly relies on a skewed and misrepresentative group of "competitor" utilities. Indeed, the trend in 2009 among utilities and non-utilities alike was to limit or lower executive compensation.<sup>59</sup> When the general trend in Washington has been for declining individual and household incomes, PacifiCorp should not be conducting "business as usual" for executive salary increases.<sup>60</sup>

**B. The Commission Should Reject PacifiCorp's Pro Forma Adjustment for 2010 Wage Increases.**

28. PacifiCorp proposes a pro forma adjustment to reflect wage increases that took effect in January, February, July, and October 2010.<sup>61</sup> However, instead of calculating the adjustment based on actual workforce levels in these months of 2010, PacifiCorp improperly relied on its higher average 2009 workforce levels. Thus, the Company's calculation artificially inflates the cost of wages beyond what it actually knew would occur in 2010. Mr. Meyer recommended that the Commission reject this adjustment, thereby lowering the Company's revenue requirement by \$373,895.

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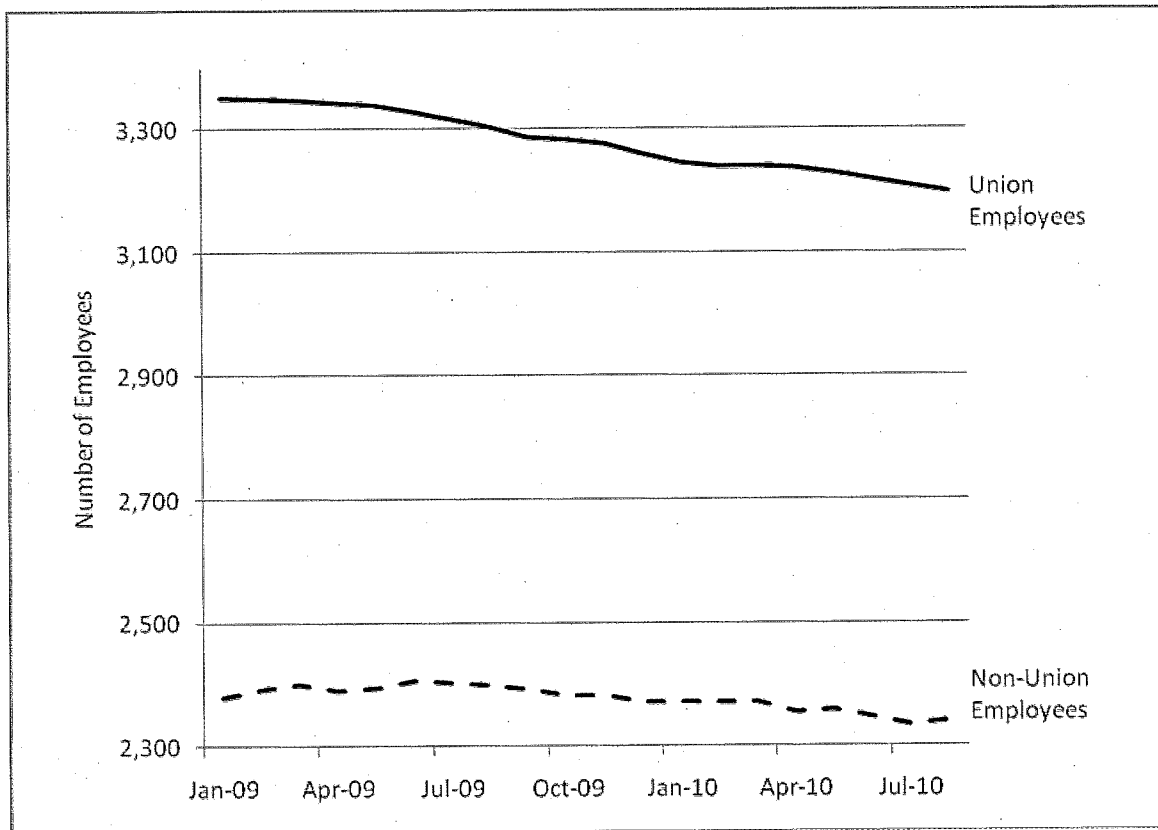
<sup>59</sup> See Exh. Nos. EDW-19 and EDW-20.

<sup>60</sup> See Exh. Nos. EDW-6, p. 2 and RPR-4, p. 1.

<sup>61</sup> Exh. No. GRM-1CT, p. 22:9-10 (Meyer Responsive).

29. Despite the Company's statement that it had no planned workforce reductions, the number of full-time equivalent (FTE) employees has steadily declined over the last two years as illustrated in Chart 1 below.<sup>62</sup>

**CHART 1: PACIFICORP 2009-2010 WORKFORCE LEVELS<sup>63</sup>**



In 2009, the total number of employees decreased by nearly 100.<sup>64</sup> This trend continued in the first half of 2010, during which the number of non-union employees decreased by 24.5 and the number of union employees decreased by 40.<sup>65</sup> In addition, testimony at the public hearing in

<sup>62</sup> Exh. No. RBD-12.

<sup>63</sup> *Id.*

<sup>64</sup> *Id.*

<sup>65</sup> *Id.*

Yakima indicates that PacifiCorp employees anticipate additional lay-offs in the future.<sup>66</sup>

30. In sum, PacifiCorp has improperly inflated its pro forma adjustment for 2010 wages. Therefore, the Commission should reject this adjustment and reduce the Company's requested revenue requirement by \$373,895.

**C. The Commission Should Remove Fifty Percent of Costs Associated with PacifiCorp's Incentive Compensation Plan.**

31. The Commission should disallow a portion of the costs of PacifiCorp's incentive compensation program. This disallowance is proper in light of the current economic conditions in PacifiCorp's service territory and the practices of other utilities and state commissions. This disallowance is also proper given that the Company has failed to demonstrate that the program is necessary for its provision of electric service or that it provides a benefit to customers.

32. PacifiCorp included in its proposed revenue requirement \$29.8 million on a total-company basis (\$1.4 million on a Washington basis) for incentive compensation.<sup>67</sup> Mr. Meyer recommended that 50 percent, or \$700,000, of the incentive compensation expense be disallowed.<sup>68</sup> Mr. Meyer testified that a disallowance was proper because program goals relate to normal job requirements and therefore do not incent "above-average" performance.<sup>69</sup> Mr. Meyer also testified that the goals are not "quantitative," and that the individual goals are applied

<sup>66</sup> TR. 072: 3-9. (Ms. Connie A. Gotzu, a PacifiCorp customer in Yakima, testified: "I talked to a gentleman that was going around reading the meters, and he told me that there's quite a few people that are going to be laid off, once the new system goes in.... And he said... he will be sad when that is completed because he will no longer have a job"); TR. 074:20-23 (Mr. Tom W. Davidson, also a PacifiCorp customer, testified, "in Yakima, I just happened to ask the guy who was reading the meters just a day or two ago, he said Yakima is going to lose 18 employees, Walla Walla will lose around 11").

<sup>67</sup> Exh. No. EDW-1T, p. 8:8-15 (Wilson Direct).

<sup>68</sup> Exh. No. GRM-1CT, p. 9:18-19 (Meyer Responsive).

<sup>69</sup> *Id.* at p. 9:21-15. *See also* Exh. No. EDW 1T, p. 6 (stating "[i]ndividual employee goals start wit the goals set for the Company as a whole," and "Company-wide goals... serve as the foundation for the goals set for each individual employee").

at the manager's discretion and thus subject to bias. In addition, the Company's assertions that its incentive program is necessary to attract and retain qualified employees is discounted by the fact that the Company has numerous other bonus programs in place designed to do specifically that.<sup>70</sup>

33. The costs of incentive programs are only recoverable where the programs themselves have demonstrable benefits to ratepayers. The Commission has clearly stated: "Plans which do not tie payments directly to goals that clearly and directly benefit ratepayers will face disallowance in future proceedings."<sup>71</sup> This is consistent with the general requirement that any cost that does not provide a benefit to ratepayers is not recoverable.<sup>72</sup>

34. In this case, PacifiCorp has provided no evidence of how its incentive program benefits customers. While the Company's witness, Mr. Wilson, testified that since the incentive plan was put in place, "PacifiCorp has seen improvements in safety, customer service standards, and operational output,"<sup>73</sup> he confirmed at hearing that the Company had not provided *any* data to support his claim.<sup>74</sup> Additionally, while Mr. Wilson testified that the incentive program has provided "demonstrable benefits to customers,"<sup>75</sup> there is no evidence in the record of any

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<sup>70</sup> Wilson, TR. 402:2-13.

<sup>71</sup> See e.g., *WUTC v. Washington Natural Gas Co.*, Docket No. UG-920840, Fourth Suppl. Order, p. 19. Public Counsel acknowledges that the Commission may allow recovery of incentive compensation program costs where there is a dual benefit to shareholders and ratepayers. However, Mr. Meyer's recommendation here is based not on the fact that the Company's incentive plan may benefit shareholders, but that it indeed provides *no* demonstrable benefits to ratepayers.

<sup>72</sup> *U.S. West v. WUTC*, 134 Wn. 2d 74, 126 (1997) (*stating*, "[a]n expense may be prudent but not recoverable from ratepayers if it provides no benefit").

<sup>73</sup> Exh. No. EDW-3T, p. 7:6-7 (Wilson Rebuttal).

<sup>74</sup> Wilson, TR. 401:8-11.

<sup>75</sup> Exh. No. EDW-3T, p. 11:17 (Wilson Rebuttal).

demonstrated benefits. The lack of demonstrable benefits or improvements is not surprising given that many of the program goals are impossible to measure or quantify.<sup>76</sup>

35. The Company's assertions that the program incents above average or superior performance are also unsupported.<sup>77</sup> As currently designed, the program awards an employee his or her total target incentive payment for performing at an "acceptable" level.<sup>78</sup> In 2009, 99.6 percent of eligible employees received incentive payments.<sup>79</sup> Moreover, many of the goals simply restate basic requirements of employment, such as "achiev[ing] a satisfactory level of skill and knowledge" and "meet[ing] deadlines."<sup>80</sup> The fact that program goals are actually basic job requirements is further highlighted by Mr. Wilson's testimony that any employee who did not receive incentive compensation in a given year would be subject to disciplinary action.<sup>81</sup>

36. PacifiCorp's incentive compensation program provides unreasonably high payments to the Company's top executives.<sup>82</sup> At hearing, Mr. Reiten, testified that the Company was managing expenses "very, very carefully"<sup>83</sup> and looking for efficiencies "everywhere we can."<sup>84</sup> All the while, Mr. Reiten is advocating for a rate increase that includes \$215,000 for a single year of his own incentive award.<sup>85</sup> Put in perspective, the Company is proposing to charge

<sup>76</sup> Exh. No. GRM-1CT, pp. 12-13 (discussing Exh. No. EDW-2, which lists among others, goals such as "keeps up with current developments and trends in area of expertise as part of personal development," "not afraid to make decisions," performs well under pressure and does not create undue pressure for others," "holds self and other accountable to quality results," "demonstrates passion," and "embraces change").

<sup>77</sup> See e.g., Exh. No. EDW-1T, p. 4:15-16 (Wilson Direct); Exh. No. EDW-3T, p. 2:8 (Wilson Rebuttal).

<sup>78</sup> Exh. No. EDW-1T, p. 5 (Wilson Direct).

<sup>79</sup> Exh. No. EDW-14, p. 2.

<sup>80</sup> Exh. No. EDW-2; Exh. No. GRM-1CT, pp. 13-14 (Meyer Responsive).

<sup>81</sup> Wilson, TR. 414:16 – 415:14.

<sup>82</sup> See e.g., Exh. No. EDW-15C (showing that PacifiCorp is seeking to recover through rates bonuses for its top twenty employees ranging from [Begin Confidential] ~~XXXXXXXXXXXXXXXXXX~~ [End Confidential]).

<sup>83</sup> Reiten, TR. 230:8.

<sup>84</sup> Reiten, TR. 231:15-18.

<sup>85</sup> Exh. No. EDW-22 (excerpt from PacifiCorp's 2009 10-K showing that, in 2009, Mr. Reiten, received \$215,000 annual incentive, in addition to a base salary of \$265,000 and \$444,664 in additional below-the-line compensation. Mr. Reiten's total compensation in 2009 was \$277,922 higher than in 2008).



customers *five times* the median household income of Yakima and Walla Walla Counties for Mr. Reiten's *individual bonus alone*.<sup>86</sup>

37. PacifiCorp's request to receive executive incentives is also out-of-line with the practices of Washington's two other electric IOUs which have *both* foregone recovery of incentives for highly-compensated individuals.<sup>87</sup> In its most recent electric general rate case, Puget Sound Energy did not seek recovery of executive incentive compensation, stating: "the Company is removing the cost of the officers' incentives in consideration of the difficult economic times customers are facing."<sup>88</sup> In its most recent rate case, Avista also agreed to remove the cost of incentives paid to highly-compensated employees.<sup>89</sup>

**D. Costs Associated with MEHC and MEC Bonuses Should be Disallowed.**

38. The Commission should reduce PacifiCorp's Washington revenue requirement by \$135,863, the amount attributable to MEHC bonuses<sup>90</sup> embedded in the management fee that PacifiCorp is charged by MEHC.<sup>91</sup> PacifiCorp's continued insistence that it be allowed to recover bonuses for MEHC and MEC executives in this case is nothing short of offensive.

39. In 2009, PacifiCorp was invoiced \$11.56 million for the management fee.<sup>92</sup> In its direct case, the Company removed from this amount: below-the-line costs associated with long-term

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<sup>86</sup> See e.g., Exh. No. RPR-5.

<sup>87</sup> See e.g., Exh. Nos. RBD-10, pp. 4-5 and RBD-11, p. 2.

<sup>88</sup> *WUTC v. Puget Sound Energy, Inc.*, Docket Nos. UE-090704 & UG-090705 (consolidated), Exh. No. TMH-1T, p. 27:13-19 (Direct Testimony of Thomas M. Hunt).

<sup>89</sup> *WUTC v. Avista Corporation, d/b/a Avista Utilities*, Docket Nos. UE-100467 & UG-100468 (consolidated), Appendix A, ¶ 5 (stating, "[t]he incentives for executives were removed from the revenue requirement"), and Final Order (Order 07), ¶ 12.

<sup>90</sup> The invoices provided for the management fee list MEHC and MEC bonuses separately. Given that the vast majority of the bonus amounts are for MEHC, both amounts will be collectively referred to as MEHC bonuses in this brief.

<sup>91</sup> The management-fee is allocated among PacifiCorp jurisdictions using the "SO" factor, which assigns Washington 7.408 percent. See Exh. No. RBD-3, pp. 4.5.

<sup>92</sup> *Id.*

incentives, aircraft costs in excess of commercial equivalents, and capitalized amounts.<sup>93</sup> ICNU and Public Counsel proposed that three additional types of costs be removed: supplemental retirement plans for MEHC executives (SERP), legislative costs, and MEHC bonuses.<sup>94</sup> As mentioned previously in this brief, the Company agreed on rebuttal to remove SERP and legislative costs, but did not agree to remove the portion of the management fee attributable to MEHC bonuses. The \$7.11 million (total company) still sought by the Company for the management fee includes \$1,831,579 in MEHC bonuses.<sup>95</sup>

40. The amount that PacifiCorp seeks to recover for MEHC bonuses is excessive and out of line with the services provided to PacifiCorp by MEHC executives. Well over half of this amount—\$1,105,460—went to a bonus for a single individual, PacifiCorp CEO, Mr. Gregory E. Abel.<sup>96</sup> However, serving as CEO of PacifiCorp is only one of numerous roles that Mr. Abel plays at MEHC and its various subsidiaries across the globe. At hearing, PacifiCorp witness, Douglas Stuver, confirmed that, besides acting as PacifiCorp’s CEO, Mr. Abel is CEO of two other MEHC companies, one of which is a British utility that serves well over twice as many customers as PacifiCorp.<sup>97</sup> Mr. Abel also spends his time as a director of three other MEHC companies, two natural gas utilities, and Minnesota-based HomeServices of America which is

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<sup>93</sup> In its initial filing, the Company adjusted the booked amount downward by an additional \$1.053 million to comply with acquisition accomplishment WA4 from Docket UE-051090. Exh. No. RBD-3, p. 4.5.

<sup>94</sup> Exh. No. GRM-1CT, p. 34:3-4 (Meyer Responsive).

<sup>95</sup> Stuver, TR. 430:4-8. *See also* Exh. No. RBD-22, p. 2.

<sup>96</sup> Stuver, TR. 431:4-6. This was in addition to the \$217,933 that PacifiCorp was charged for Mr. Abel’s base salary. Mr. Abel receives no direct compensation from PacifiCorp. Instead, he is paid by MEHC, which is then reimbursed by PacifiCorp through the management fee. *See* Exh. No. GRM-7, p. 4. It is unclear what type of employees the remaining \$726,119 in bonuses was paid to, although according to the agreement that governs the management fee, the types of services covered by the fee include services by “executive, management, professional, technical and clerical employees,” which suggests that the bulk of the remaining \$726,119 in bonuses went to high-level executives and management. *See* Exh. No. RBD-20, p. 4.

<sup>97</sup> Stuver, TR. 431:20-432:22.

the second-largest full-service independent residential real estate brokerage firm in the US.<sup>98</sup> On top of all of that, Mr. Abel also serves on at least five additional boards for other companies and institutions.<sup>99</sup> Despite the fraction of his time that Mr. Abel can possibly spend serving PacifiCorp, he received a \$5,000,000 bonus in 2009, \$1,105,460 of which was paid by PacifiCorp and which PacifiCorp seeks to recover here. This was in addition to a \$1,000,000 base salary, \$217,933 of which was paid by PacifiCorp and which it also seeks to recover in this case. In that same year, Mr. Abel also realized a value of \$26 million on stock options.<sup>100</sup>

41. As well as being unreasonably high, PacifiCorp has provided no evidence that MEHC's incentive program benefits PacifiCorp's customers and thus that its costs are properly recoverable. The MEHC "bonuses," as they are identified in the Company's own invoices<sup>101</sup> and SEC filings,<sup>102</sup> consist of annual incentive payments to MEHC employees.<sup>103</sup> The Company did not provide any information about the MEHC incentive program, such as a program description or sample program goals. Thus, the only source of available information regarding MEHC's

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<sup>98</sup> Exh. No. DKS-3.

<sup>99</sup> *Id.*

<sup>100</sup> Stuver, TR. 434:25-435:2. This amount is recorded below-the-line.

<sup>101</sup> See e.g., Exh. No. RBD-20, pp. 2-3.

<sup>102</sup> See e.g., Exh. No. DKS-4, p. 7.

<sup>103</sup> Exh. No. RBD-21, p. 2.

incentive compensation is MEHC's Form 10-K. This document describes the incentive plan as:

[A]n annual discretionary cash incentive award which is determined on a subjective basis and is not based on a specific formula or cap. Awards paid to a NEO under the [program] are based on a variety of measures linked to each NEO's performance, our overall performance and each NEO's contribution to that overall performance. An individual NEO's performance is measured against defined objectives that commonly include financial and non financial measures (e.g., customer service, operational excellence, financial strength, employee commitment and safety, environmental respect and regulatory integrity, as well as the NEO's response to issues and opportunities that arise during the year.<sup>104</sup>

MEHC's sole function is to serve as a holding company for various subsidiaries. It does not directly serve PacifiCorp's retail customers. Thus, while the 10-K lists customer service and safety among the incentive plan's objectives, PacifiCorp has not shown how actual service performance of PacifiCorp would affect the incentive compensation paid to an MEHC executive.

## VI. CASH WORKING CAPITAL

42. The Commission should reject PacifiCorp's proposal to include an allowance for cash working capital (CWC) of \$11,105,103 in rate base.<sup>105</sup> Leonard Saul Goodman provides the following explanation of working capital in his treatise, *The Process of Ratemaking*:

The working capital allowance in rate base [is] the average amount of capital provided by investors in the company, over and above the investments in plant and other specifically identified rate base items, to bridge the gap between the time that expenditures are required to provide service and the time collections are received for that service... If collection occurs prior to the rendering of service, no shortfall occurs and little need, perhaps no need, will arise for capitalized working capital. If working capital must be supplied by investors, it is included in rate base.<sup>106</sup>

<sup>104</sup> Exh. No. DKS-4, p. 4.

<sup>105</sup> Exh. No. RBD-6, p. 12.8.

<sup>106</sup> Leonard S. Goodman, *The Process of Ratemaking*, Public Utilities Reports, Inc. (1998), pp. 828-29.

Accuracy is the primary objective in determining what method should be used to develop a working capital proposal.<sup>107</sup> Any study relied upon must be “valid, current, accurate and appropriate.”<sup>108</sup>

43. These explanations make clear that no CWC allowance should be included in this case. PacifiCorp calculated its proposed allowance using the 1/8 of O&M, or 45-day, method.<sup>109</sup> This method, described previously by this Commission as a “short cut,” simply provides a working capital allowance equal to 12.5 percent of a company’s annual operating expenses regardless of the actual level, if any, of working capital the company has.<sup>110</sup>

44. ICNU and Public Counsel recommended that PacifiCorp’s proposed CWC allowance be rejected because the 1/8 of O&M method used by the Company does not reflect actual levels of investor-funded working capital.<sup>111</sup> Staff, likewise, recommended removing CWC from rate base<sup>112</sup> and found fault with the Company’s 1/8 of O&M method.<sup>113</sup> ICNU, Public Counsel, and Staff agree that the Company’s 1/8 of O&M method does not capture the “average amount of capital provided by investors,” nor does it reflect the Company’s actual capital needs during the time between collections and expenditures.

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<sup>107</sup> *WUTC v. PacifiCorp, d/b/a Pacific Power & Light*, Docket No. UE-050684, Final Order (Order 04), ¶¶ 185 and 189 (rejecting Staff and Company CWC proposals because both “failed to capture an accurate or balanced presentation of this issue” and stating that the method used must “quantify the amount of working capital and current assets supported by capital on which investors are entitled to a return”). See also *WUTC v. Puget Sound Power & Light Co*, Docket No. U-85-53, Second Suppl. Order, p. 29 (stating, “[t]he Commission remains open to... other suggestions to accurately calculate the working capital need of the Company”).

<sup>108</sup> *WUTC v. PacifiCorp, d/b/a Pacific Power & Light*, Docket No. UE-050684, Final Order (Order 04), ¶ 189.

<sup>109</sup> Exh. No. RBD-1T, pp. 20-21 (Dalley Direct).

<sup>110</sup> *WUTC v. PacifiCorp, d/b/a Pacific Power & Light*, Docket No. UE-050684, Final Order (Order 04), ¶ 186.

<sup>111</sup> Exh. No. GRM-1CT, p. 8:5-8 (Meyer Responsive).

<sup>112</sup> Exh. No. TES-1T, p. 5:14-15 (Schooley Responsive) (Mr. Schooley used the investor-supplied working capital method to show that PacifiCorp investors do not contribute any funds to create working capital).

<sup>113</sup> Schooley, TR. 794:23-495:1 (testifying that the lead lag method was more accurate than the 1/8 of O&M method). See also Exh. No. TES-1T, p. 22:1-5 (Schooley Responsive).

45. Mr. Meyer demonstrated the inappropriateness of the 1/8 of O&M by comparing it to another commonly used method, the lead-lag study.<sup>114</sup> Indeed, the Company testified that the lead-lag method is its preferred approach and that it performs a lead-lag study to calculate CWC in all of its other jurisdictions.<sup>115</sup> The flaws in the 1/8 of O&M method are also highlighted by the fact that the method can *never* result in zero or a negative CWC, even though it may in fact be the case that a company has negative working capital if collections precede expenditures.<sup>116</sup> Moreover, since it looks only at operating expenses, the 1/8 of O&M method, by definition, does not reflect how much working capital a company's *investors* supply, which is critical to a proper calculation of CWC.

46. PacifiCorp argues in favor of the 1/8 of O&M method in part by citing to the fact that its working capital adjustment based on a lead-lag study was rejected in its 2006 general rate case.<sup>117</sup> However, in that case, the Commission's basis for rejecting the Company's adjustment was not that the lead-lag study was improper in principle, but that it was performed inconsistently with the Commission-approved WCA allocation methodology and was therefore inaccurate.<sup>118</sup> The Commission went on to note that a review of thirty years' of Commission decisions showed that it has "generally accepted [Investor Supplied Working Capital] ISWC

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<sup>114</sup> Exh. No. GRM-1CT, pp. 3-7 (Meyer Responsive).

<sup>115</sup> Exh. No. RBD-4T, p. 14:9-11 (Dalley Rebuttal).

<sup>116</sup> A company "will have negative working capital, if revenue collections precede normal payment of expenses. If after proper computation of a working capital allowance the result indicates the company has negative working capital, the result implies that the rate base, without adjustment, will include ratepayer-supplied funds." Leonard S. Goodman, *The Process of Ratemaking*, Public Utilities Reports, Inc. (1998), p. 830. At hearing, Mr. Schooley, implied that PacifiCorp may very well have negative cash working capital. See TR. 796:10-12.

<sup>117</sup> RBD-4T, p. 14:14-18 (Duvall Rebuttal).

<sup>118</sup> *WUTC v. PacifiCorp, d/b/a Pacific Power & Light*, Docket No. UE-061546, Final Order (Order 08), ¶¶ 42-43.

analyses... [and] also accepted lead-lag studies,” while indicating an openness to, but not accepting, other methods.<sup>119</sup> At the time, the Commission had never accepted a working capital adjustment calculated with the 1/8 of O&M method. In this case, nothing precluded PacifiCorp from developing a lead-lag study that was consistent with the WCA allocation methodology or from performing an ISWC analysis.

47. In sum, PacifiCorp’s CWC allowance should be disallowed because the Company’s method for calculating the allowance—the 1/8 of O&M method—does not accurately reflect the actual level of capital provided by investors necessary to bridge the gap between PacifiCorp’s expenditures and collections.

## VII. OUTSIDE LEGAL EXPENSES

48. PacifiCorp has allocated outside legal expenses to Washington using the System Allocation (SO) factor even though these expenses can be traced and assigned to specific states.<sup>120</sup> As recommended by ICNU and Public Counsel, non-Washington legal expenses should be removed from PacifiCorp’s Washington operating expenses because they do not, by their very definition, provide any benefit to Washington customers. Removing non-Washington legal expenses reduces PacifiCorp’s revenue requirement by \$48,931.

49. PacifiCorp’s WCA Allocation Handbook makes clear that costs “that can be identified with a specific state” should be assigned to that state.<sup>121</sup> PacifiCorp witness, Mr. R. Bryce

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<sup>119</sup> *WUTC v. PacifiCorp, d/b/a Pacific Power & Light*, Docket No. UE-050684, Final Order (Order 04), ¶ 185.

<sup>120</sup> Public Counsel supports the review of PacifiCorp’s cost allocation recommended by Staff witness, Mr. Foisy. See Exh. No. MDF-1CT, p. 19:17-18 (Foisy Responsive). However, the Commission should still remove improper costs in *this* case regardless of whether it orders a review of PacifiCorp’s allocation practices.

<sup>121</sup> PacifiCorp’s WCA Allocation Handbook, Part II, p. 2.3.

Dalley, testified that this is, indeed, the Company's policy: "[W]here possible and cost effective, the Company's policy is to assign costs directly to the state in which the cost is incurred. When costs cannot be directly attributable to a state a system allocation [SO] factor is used."<sup>122</sup> In discovery, Public Counsel asked PacifiCorp to provide a comparison between SO and state-specific "Situs" allocation of outside legal expenses.<sup>123</sup> The Company provided a timely response with no objection.<sup>124</sup> The response shows that, by using the SO factor, PacifiCorp has included \$48,931 of non-Washington expenses in its Washington operating costs.<sup>125</sup>

50. PacifiCorp argues that non-Washington legal expenses should not be removed because Mr. Meyer, in recommending the adjustment, did not "present[] an exhaustive analysis of all cost and revenue categories."<sup>126</sup> By making this argument, PacifiCorp seems to suggest that two wrongs, both on *its* part, can make a right. PacifiCorp should not be allowed to recover improper costs simply because it contends, but does not state with certainty, that it may have also misallocated other costs.

51. Moreover, it is the Company's duty to analyze its rate case filing and cost allocation to ensure that it has not assigned to Washington costs that are not necessary for service in this state. As Staff witness, Mr. Michael Foisy, pointed out in his testimony, the Commission has previously stressed that PacifiCorp's inter-jurisdictional allocation methodology must "only assign to Washington costs that provide a tangible and quantifiable benefit to customers."<sup>127</sup> The Commission made this very point with regard to the Avista's inclusion of inappropriate costs in

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<sup>122</sup> Exh. No. RBD-4T, p. 21:18-21 (Dalley Rebuttal).

<sup>123</sup> Exh. No. RBD-18C, p. 1.

<sup>124</sup> See Dalley, TR. 363:14-24.

<sup>125</sup> Exh. No. GRM-1CT, p. 26:21-22 (Meyer Responsive).

<sup>126</sup> Exh. No. RBD-4T, p. 22:10-14 (Dalley Rebuttal).

<sup>127</sup> Exh. No. MDF-1CT, p. 17:7-9.



That company's most recent general rate case:

The testimony supporting the Settlement explained that the Company's original filing contained costs that were either incorrectly booked to utility accounts or booked to improper accounts. These errors were discovered through Public Counsel's targeted audit. Although Public Counsel's audit was limited to a small subset of accounting entries, it revealed several instances where ratepayers would have been inappropriately and unlawfully saddled with costs that must be borne by shareholders alone.... It is not Public Counsel's function to provide accounting oversight for the Company. Nor should Staff and the other parties be responsible for ensuring that Avista is complying with the law.<sup>128</sup>

Here, too, it is not Public Counsel's function to provide oversight of PacifiCorp's accounting practices, specifically its cost-allocation. The Company should have corrected any allocation errors before filing this case. Thus, removing the \$48,931 of non-Washington legal expenses is proper.

### VIII. RESIDENTIAL REVENUE NORMALIZATION

52. The purpose of normalizing adjustments is to remove any abnormalities from the test year and thereby provide the most accurate possible prediction of what can be expected during the rate-effective period.<sup>129</sup> Here, PacifiCorp has a proposed a weather normalization adjustment for residential usage. The Company then based its level of residential revenue for the rate-effective period on this normalized level of usage.<sup>130</sup>

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<sup>128</sup> *WUTC v. Avista Corporation, d/b/a Avista Utilities*, Docket No. UE-100467 and UG-100468 (consolidated), Final Order (Order 07), ¶¶ 30-31.

<sup>129</sup> *See WUTC v. Puget Sound Energy, Inc.*, Docket Nos. UE-090704 and UG-090705, Final Order (Order 11), ¶ 24 (stating that the fundamental question regarding normalizing adjustments is whether the expense in question "should be adjusted to levels that are more indicative of ordinary levels for the expenses in question") and ¶¶ 96-99 (accepting Public Counsel's recommendation to normalize injuries and damages costs, stating "[a]bsent any evidence from PSE showing the test year level is representative (*i.e.*, normal), we accept Public Counsel's recommendation to normalize this expense using a three year average"). At hearing, Staff witness, Mr. Schooley, confirmed that the purpose of temperature normalization is to adjust test-year results to a level that "will be normal." TR. 801:1.

<sup>130</sup> RBD-1T, p. 8:8-20 (Dalley Direct).

53. PacifiCorp has not adequately supported this adjustment. A comparison between the Company's proposed normalized residential usage and recent actual usage exposes that the Company's normalization adjustment yields a level of usage that appears to be anything but normal.<sup>131</sup> Accordingly, the Commission should, in this case, adopt the five-year average normalization proposed by Mr. Meyer as a more accurate reflection of what can be expected to occur during the rate-effective period.<sup>132</sup>

54. PacifiCorp's weather normalization methodology has been an area of concern for parties and the Commission for many years. In the Company's 2005 general rate case, the Commission approved a methodology that was agreed upon by the Company and Staff (no other party addressed the issue), but stated that the methodology was only an "interim solution for the next rate case."<sup>133</sup> In the following case, there was little discussion of temperature normalization because the Company implemented the interim methodology to which Staff had previously agreed.<sup>134</sup> In 2008, PacifiCorp filed another general rate case in which it again reduced residential revenues through temperature-normalization adjustment.<sup>135</sup> The Company offered no explanation of the methodology used and, since the case was resolved through a black-box settlement prior to the filing of response testimony, the methodology was not discussed on the record by any party or specifically considered by the Commission.<sup>136</sup> In PacifiCorp's 2009

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<sup>131</sup> Exh. No. RPR-10, ¶ 19 (reserving right to challenge methodology if new information "comes to light").

<sup>132</sup> See Exh. No. GRM-1CT, pp. 16-18 (Meyer Responsive).

<sup>133</sup> Docket No. UE-050684, Final Order (Order 04), ¶ 117 (stating that the methodology was approved as an "interim solution for the next rate case and noting that the parties "agree to work towards a longer term solution for a temperature normalization methodology").

<sup>134</sup> Docket Nos. UE-061546, Final Order (Order 08), ¶ 13.

<sup>135</sup> *WUTC v. PacifiCorp, d/b/a Pacific Power & Light*, Docket No. UE-080220, Exh. No. RBD-2, p. 3.1.1. The temperature normalization adjustment in the 2008 rate case reduced residential revenues by \$4,167,000.

<sup>136</sup> *WUTC v. PacifiCorp, d/b/a Pacific Power & Light*, Docket No. UE-080220, Final Order (Order 09), ¶ 11.

general rate case, the Company and Staff agreed to changes to the temperature normalization methodology.<sup>137</sup> In approving the settlement, the Commission stated:

*All parties agree to the temperature normalization methodology advocated by the Company in this filing.... The parties agree to its use here, but reserve the right to contest its use in future proceedings. We accept the parties' resolution of this issue recognizing that it represents a change in the method by which we determine overall and peak demand. While this gives us pause, we also recognize that the Company's methodology faces further scrutiny by the parties, which we encourage and support.*<sup>138</sup>

55. The comparison to recent actual usage performed by Mr. Meyer demonstrates that residential usage has, with the exception of one year, been consistently below the weather-normalized average used by PacifiCorp in this case.<sup>139</sup>

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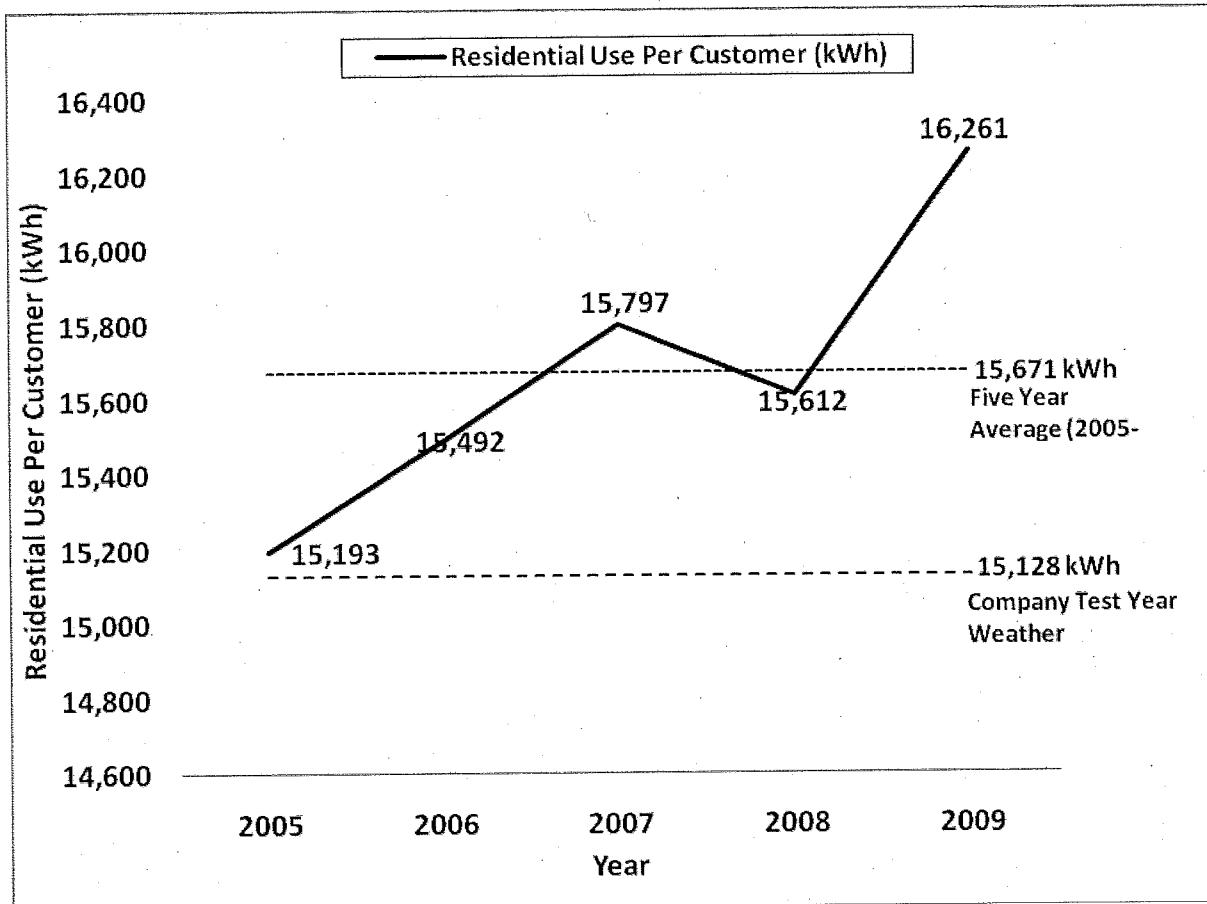
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<sup>137</sup> See *WUTC v. PacifiCorp, d/b/a Pacific Power & Light*, Docket No. UE-090205, Exh. No. TES-1T (Testimony of Thomas E. Schooley In Support of the Settlement), pp. 14-19.

<sup>138</sup> *WUTC v. PacifiCorp, d/b/a Pacific Power & Light*, Docket No. UE-090205, Final Order (Order 09), ¶ 61 (hereinafter *2009 GRC*).

<sup>139</sup> Neither PacifiCorp nor Commission Staff contest the usage data presented by Mr. Meyer. See Duvall, TR. 329:13-17; Schooley, TR. 799:3-9 (Schooley).

**CHART 2: HISTORICAL ANALYSIS OF RESIDENTIAL USE-PER-CUSTOMER<sup>140</sup>**



56. As the chart above shows, and as was confirmed at hearing, PacifiCorp’s “normalized” customer usage is abnormally low: 360 KWh less than actual usage in 2006, 639 KWh less than 2007, 484 KWh less than 2008, and 1,133 KWh less than 2009.<sup>141</sup> Accordingly, the Commission should adopt Mr. Meyer’s proposed five-year average as it is a more accurate reflection of likely residential usage during the rate-effective period.<sup>142</sup>

<sup>140</sup> Exh. No. GRM-1CT, p. 17 Table 3 (Meyer Responsive).

<sup>141</sup> *Id.* See also Griffith, TR. 330:9-331:25.

<sup>142</sup> See Exh. No. GRM-1CT, pp. 16-18 (Meyer Responsive).

## IX. RENEWABLE ENERGY CREDIT REVENUE

57. PacifiCorp's Washington retail customers are entitled to a full return of all Washington-allocated REC revenues. To ensure this, the Commission should adopt Staff's alternative recommendation to credit customers actual CY 2009 revenues over one year and establish a regulatory liability account to track actual revenues with interest from January 2010 going forward.<sup>143</sup> This approach also ensures that there is no "double counting" of revenues or the possibility of a liability account balance that is less than what is reflected in rates.

### A. PacifiCorp Customers are Entitled to One-Hundred Percent of All REC Revenues.

58. Staff's alternative recommendation properly credits REC revenues to customers. As Mr. Foisy pointed out, customers are entitled to these revenues because they derived solely from customer-funded assets.<sup>144</sup>

59. The Commission has repeatedly concluded that "the right to gain follows risk of loss and that the benefit of [a] sale should follow those who bore the burdens...."<sup>145</sup> Several courts and numerous commissions have adopted this analysis.<sup>146</sup> Moreover, in *U.S. West v. WUTC*, the Washington Supreme Court held that a regulated utility *cannot fail to return to ratepayers the*

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<sup>143</sup> Exh. No. MDF-1CT, p. 11:3-6 (Foisy Responsive). Public Counsel acknowledges that the alternative treatment proposed by Staff and supported here by Public Counsel *may* overlap with the relief requested in the Joint Complaint filed by Public Counsel and ICNU (dated January 6, 2011) in Docket No. UE-110070. However, Public Counsel is addressing the issue here because it has been raised by other parties in this case.

<sup>144</sup> Exh. No. MDF-1CT, pp. 9:20-10:3 (Foisy Responsive) (stating "ratepayers are paying rates based on the costs of [the assets that give rise to the REC revenues] which includes a return on PacifiCorp's investment, plus all related operating expenses, and taxes. It is entirely proper for those ratepayers to receive the benefits generated by these assets on the same basis that their rates are set. Said another way, PacifiCorp may not keep this revenue").

<sup>145</sup> *In re the Matter of the Application of Avista Corp. for Authority to Sell its Interest in the Coal-Fired Centralia Power Plant*, Docket Nos. UE-991255, UE-991262, and UE-991409 (consolidated), Second Suppl. Order, ¶ 47.

<sup>146</sup> *Id.* (citing *Democratic Central Comm. of the Dist. of Columbia v. Washington Metro. Area Transit Comm'n.*, 458 F.2d 786 (D.C. Cir. 1973), and numerous state commission decisions).

full value of “a lucrative ratepayer-funded asset.”<sup>147</sup> In its decision, the Court reiterated that, since the lucrative operations at issue had been generated from ratepayer funds, ratepayers were entitled to a return of their full value.<sup>148</sup>

60. In early 2010, the Commission applied this principle and declared that the gains on the sale of RECs should be credited to ratepayers absent unusual or extraordinary circumstances.<sup>149</sup> Moreover, the Commission has consistently required that PacifiCorp and all other utilities fully credit to customers revenues from sales of SO<sub>2</sub> emissions credits, which are similar to RECs in many respects.<sup>150</sup>

**B. A Regulatory Liability Account is Necessary to Credit Customers 2010 REC Revenues and to Ensure That All Future REC Revenues are Fully Accounted For.**

61. PacifiCorp has been selling RECs since at least 2005. Throughout that time, PacifiCorp has included in its rate case filings REC revenues far below those which it actually received. Table 1 shows PacifiCorp’s actual REC revenue as compared to the amount reflected in rates.<sup>151</sup> Absent a regulatory liability account or some other form of tracking mechanism, it is likely that PacifiCorp will continue to under-reflect REC revenues, allowing the Company to improperly retain revenues that should be returned to ratepayers.

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<sup>147</sup> *US West, Inc. v. WUTC*, 134 Wn.2d 74, 96 (1997) (emphasis added).

<sup>148</sup> *Id.* at 94-95.

<sup>149</sup> *In re Petition of Puget Sound Energy*, Docket No. UE-070725, Order 03, ¶¶ 41-47.

<sup>150</sup> See e.g., *Petition of Puget Sound Energy, Inc. for an Order Regarding the Authorization to Sell Sulfur Dioxide Emission Allowances and an Associated Accounting Order*, Docket No. UE-001157, Final Order, p. 2; *In the Matter of the Petition of PacifiCorp Seeking Blanket Authorization for the Sale of Surplus Sulfur Dioxide Emission Allowances*, Docket No. UE-940466, Commission Decision and Order Granting Authorization; and *In the Matter of the Petition of the Washington Water Power Company Seeking Blanket Authorization to Sell and Lease Sulfur Dioxide Emission Allowances and Seeking an Associated Accounting Order*, Docket No. UE-961156, Commission Decision and Order Granting Authorization.

<sup>151</sup> In each previous rate case, the Company’s own adjustment was used to determine the amount of REC revenue reflected in rates.

**TABLE 1: HISTORIC WASHINGTON REC REVENUE**

Year	Reflected in Rates <sup>152</sup>	Actual Revenue <sup>153</sup>	Revenue Not Reflected in Rates <sup>154</sup>
2010	\$657,755	\$21,670,000 <sup>155</sup>	\$21,012,245
2009	\$576,254	\$4,784,095	\$4,207,841
2008	\$43,404	\$424,892	\$381,488
2007	\$43,404	\$290,930	\$247,526
2006	\$5,054	\$60,010	\$54,956
2005	\$5,054	\$46,132	\$41,078

62. Again in this case, PacifiCorp under-reflected REC revenues in its proposed rates. In its initial filing, PacifiCorp removed *all* REC revenues from the test year. While the Company justified removing REC revenues on the basis that it would not be selling Washington-allocable RECs in 2011,<sup>156</sup> the evidence suggests that this was never the case. First, months in advance of filing this case, PacifiCorp possessed firm, non-contingent contracts to sell large volumes of RECs from WCA generating facilities during 2011 and 2012. Moreover, PacifiCorp has been generating, and will continue to generate, RECs **[Begin Confidential]** ~~XXXXXX~~ **[End Confidential]** of what is needed to meet Washington’s renewable portfolio standard (RPS). Moreover, the Company’s statement that it “anticipated legislative changes to Washington’s RPS which would allow longer-term REC banking” and therefore would not sell these excess RECs in 2011 does not square with the facts.<sup>157</sup> Washington’s Regular Legislative Session ended March 11, 2010, and the Special Session ended April 12, 2010. PacifiCorp did not file this case until

<sup>152</sup> Exh. No. GND-26, p. 2.

<sup>153</sup> Exh. No. GND-27, p. 2.

<sup>154</sup> Calculated by subtracting the revenue reflected in rates from the actual revenue for each year.

<sup>155</sup> Mr. Duvall testified that the Company has received approximately \$98 million in REC revenues on a total Company basis from the twelve-month period ending June of 2010. TR. 297:4-13. The Company applies the CAGW (22%) factor to REC revenues. *See* Exh. No. RBD-4T, p. 10 (Dalley Rebuttal).

<sup>156</sup> Exh. No. RBD-1T, pp. 9:16-10:3 (Dalley Direct).

<sup>157</sup> Duvall, TR. 298:4-14.

May 4, 2010, nearly a month *after* the end of the Special Session, meaning that the Company was fully aware there was no possibility of the Legislature making any changes to REC banking rules before 2011.

**C. PacifiCorp's Arguments Against a Regulatory Liability Account are Without Merit.**

63. PacifiCorp witness, Mr. Duvall, presents three arguments against establishing a regulatory liability account for 2010 and future REC revenues.<sup>158</sup> None of these arguments are persuasive.

**1. Crediting revenues to customers through an immediate bill credit avoids potential "double counting" of revenues.**

64. Mr. Duvall first argues that a regulatory liability account is improper because it would result in double counting of REC revenues.<sup>159</sup> However, as mentioned previously, crediting 2009 revenues to customers instead of reflecting these revenues in base rates would avoid any potential double counting. At hearing, Mr. Duvall stated that his opposition to a regulatory liability account would be lessened if revenues were not reflected in base rates:

Q: ...If there were not a possibility of double counting, i.e., putting the REC revenues in base rates and [in a] REC liability account would that lessen your concern?

A: It would lessen it, yes.

Accordingly, adopting Staff's alternate approach described above negates this point of opposition.

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<sup>158</sup> The Company's opposition to deferred accounting for actual Washington REC revenues appears contrary to Mr. Reiten's statement that "the Company certainly wants to be forthcoming" about these revenues. See TR. 223:9-11.

<sup>159</sup> Exh. No. GND-5T, p. 6:4-9 (Duvall Rebuttal).



**2. Deferring REC revenues through a regulatory liability account is not prohibited by the matching principle.**

65. Mr. Duvall argues secondly that tracking REC revenues through a regulatory liability account without tracking net power costs in the same manner violates the matching principle.<sup>160</sup> However, Mr. Duvall does not mention that the Company currently uses deferred accounting for numerous other power-cost related items, including SO<sub>2</sub> emission credit sales revenues<sup>161</sup> and hydro deferral costs related to 2005 low hydro conditions<sup>162</sup>.

66. Mr. Duvall also argued that the fact that the Company uses different allocation methodologies in varying states and for actual RECs versus REC revenues, thereby creating “pseudo RECs” for allocation purposes, makes deferred accounting of REC revenues improper. This argument is a red herring. The fact that actual RECs may be allocated in a different manner does not impact PacifiCorp’s ability to allocate the revenues, whether to establish a test year amount of revenues to embed in base rates as the Company did in its direct case, or to credit a regulatory liability account on an ongoing basis.<sup>163</sup> In fact, the Company has been making REC sales and allocating the revenues between states for over five years.<sup>164</sup> Moreover, the Company routinely allocates generation costs despite the fact that actual power cannot be allocated (i.e., used) twice, even where differing allocation methodologies result in the Company ultimately

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<sup>160</sup> *Id.* at pp. 6:10-7:6.

<sup>161</sup> See Exh. No. RBD-3, pp. 3.4 and 3.4.4 (showing the amortization of SO<sub>2</sub> emission credit sales revenues).

<sup>162</sup> *WUTC v. PacifiCorp, d/b/a Pacific Power & Light*, Docket No. UE-050684, Final Order (Order 04), ¶ 306.

<sup>163</sup> Exh. No GND-26, p. 2.

<sup>164</sup> *Id.*

recovering over 100 percent of its costs. As Mr. Duvall testified:

- Q: Okay. Now, under revised protocol the Company allocates the Chehalis plant to *all* states, doesn't it?
- A: That's correct.
- Q: But under western control area that plant is allocated 100 percent to Washington; isn't that correct?
- A: That's correct. Well, 100 percent to west control area.
- Q: ... And so Washington would be allocated more of the Chehalis plant under western control area then it would under revised protocol; is that fair to say?
- A: That is fair to say.
- Q: And I don't know how that works out, if the Company is regulated in the western control area in Washington and the revised protocol elsewhere. If you looked at the Company as a whole it would either have more than 100 percent of Chehalis in its rate base or less than 100 percent just depending on how the allocation system worked, right?
- A: That's exactly right.
- Q: Conceptually that's the same kind of allocation issue that you're trying to explore with us on Exhibit 6C [showing REC and REC revenue allocations]; correct?
- A: It is with the distinction I mentioned before. If you're just allocating the cost of Chehalis it doesn't have to add up to 100 percent. If you're allocating RECs they absolutely have to add up to 100 percent because you can't use them twice.<sup>165</sup>

Indeed, the costs of the plants from which RECs are derived *are* allocated using various allocation methodologies. Thus, as confirmed by Mr. Duvall at hearing, the concept of "pseudo" RECs is only an issue for compliance and not an issue for ratemaking.<sup>166</sup>

**3. The rule against retroactive ratemaking does not prohibit crediting REC revenues to customers.**

67. The third argument presented by Mr. Duvall is that returning REC revenues to customers

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<sup>165</sup> Duvall, TR. 320:8-321:11. Mr. Duvall later confirmed that the Company does over-allocate all costs of Chehalis while at the same time deferring the Washington allocated portion of these costs. See Duvall, TR. 322:3-21.

<sup>166</sup> Duvall, TR. 321:12:15.

in the manner recommended by Staff would constitute retroactive ratemaking. However, this ignores the fact that the REC revenues at issue, namely those earned by the Company from 2009 to date, arose during the test year proposed by the Company (2009), the year in which the Company filed this case (2010), and the time directly preceding the proposed rate-effective period, and therefore may be considered by the Commission.<sup>167</sup>

68. Even if this were not the case, the rule against retroactive ratemaking does not prohibit crediting customers these revenues because exceptions exist for treatment of funds that ratepayers are fully entitled to and that they could not have anticipated. Moreover, applying the rule in such a manner would misconstrue the rule and go against its very purpose.

69. Numerous courts have held that the rule against retroactive ratemaking does not bar the return of funds to customers that they are fully entitled to.<sup>168</sup> Furthermore, this Commission has acknowledged that policy-based exceptions to the rule exist for extraordinary costs or revenues that could not have been anticipated.<sup>169</sup> Here, the parties were unaware that PacifiCorp was receiving REC revenues

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<sup>167</sup> See e.g., *WUTC v. Avista Corp.*, Docket Nos. UE-991606 & UG-991607 (consolidated), Third Suppl. Order, ¶ 22.

<sup>168</sup> *Southern Union Gas Co. v. Railroad Comm'n*, 701 S.W.2d 277 (Tex.Ct.App. 1985). See also *Chesapeake & Potomac Telephone Co.*, 514 A.2d 1159 (D.C. 1989) (holding that the rule against retroactive ratemaking did not bar return of funds where the funds were “intended to restore to the ratepayers what they themselves had invested in a project that was no longer of any benefit to them.”); *Turpen v. Oklahoma Corp. Comm'n*, 769 P.2d 1309, 1331-34 (Okla. 1988) (allowing ratepayers to receive reimbursements and stating in part, “the reimbursements represent an unexpected windfall and the relevant question posed here is who should receive the benefit of this windfall—shareholders or ratepayers”); *Pike County Power Co. v. Penn. Public Utilities Comm'n*, 487 A.2d 118, 120-21 (Pa.Coomw, 1985); *Washington Gas Light Co. v. Public Serv. Comm'n*, 450 A.2d 1187 (D.C. 1982); *Citizens of the State v. Florida Pub. Serv. Comm'n*, 415 So.2d 1268 (Fla. 1982); *Richter v. Florida Power Corp.*, 366 So.2d 798 (Fla.Dist.Ct.App. 1979).

<sup>169</sup> *In the Matter of the Application of Puget Sound Energy for Authorization Regarding the Deferral of the Net Impact of the Conservation Incentive Credit Program*, Docket No. UE-010410, Order Denying Petition to Amend Accounting Order, ¶¶ 7 and 9.

[Begin Confidential] [REDACTED]

[REDACTED]<sup>170</sup> [End Confidential]

PacifiCorp was fully aware that parties intended to rely solely on the REC reports to monitor its REC sales revenues.<sup>171</sup> [Begin Confidential] [REDACTED]<sup>172</sup>

[REDACTED]

[REDACTED]

[REDACTED] [End

Confidential]

70. Moreover, PacifiCorp's attempt at hearing to imply that parties were provided information about REC revenues through the Company's April 2010 results of operations report is misleading.<sup>173</sup> The purpose of the additional REC reports was to provide information not presented in any other filing, and not to duplicate anything already included in other reports. And unlike the REC reports, the Company's results of operations reports do not clearly identify REC revenues.<sup>174</sup>

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<sup>170</sup> See Duvall, TR. 628:20 – 629:6. Accordingly, Mr. Duvall's arguments regarding the fact that no party has filed an accounting petition is beside the point because no party previously had reason or basis to file a petition.

<sup>171</sup> In testimony supporting the REC reporting provision of the settlement of PacifiCorp's last general rate case, Public Counsel witness, Ms. Donna Ramas, stated that the projected revenues from the sale of RECs incorporated in the filing was of "concern" to the parties and that the reports would be "very helpful to the parties in monitoring the RECs." 2009 GRC, Exh. No. DR-1T, pp. 5:22-6:11. Similarly, ICNU witness, Mr. Robert M. Meek, testified that the REC report provision was "important" and would "provide[] the parties the practical ability to file for deferred accounting or request that the Commission take another action regarding PacifiCorp's Washington-allocated RECs." 2009 GRC, Exh. No. RMM-1T, p. 3:12-14.

<sup>172</sup> See Duvall, TR 628:20-629:2.

<sup>173</sup> Duvall, TR. 351:10-16.

<sup>174</sup> See Quarterly Report for the Quarter Ending December 31, 2009, Docket No. UE-100498 (filed March 31, 2010).

71. The rule against retroactive ratemaking exists to protect ratepayers from being improperly charged for costs that were recoverable only in a past period or periods.<sup>175</sup> The rule should not be “blindly applied” as to prohibit customers from receiving funds that they are fully entitled to and that PacifiCorp knew about, but that other parties had no knowledge of or ability to predict.<sup>176</sup> Applying the rule in such a manner would incent companies such as PacifiCorp to hide or under-report revenues.

## X. RATE SPREAD

72. The results of PacifiCorp’s cost of service study in this case show the following parity ratios for the Company’s customer classes:

**TABLE 2: RESULTS OF PACIFICORP’S COST OF SERVICE STUDY<sup>177</sup>**

Schedule	Class	Distance from parity
48T (Dedicated Facilities)	Industrial	-.041
48T	Industrial	-.030
<b>16</b>	<b>Residential</b>	<b>-.026</b>
36	Large Commercial	+.024
40	Agricultural Pumping	+.030
24	Small Commercial	+.073
15, 52, 54, 57	Street Lighting	+.195

Based on this study, the Company proposed in its initial filing to spread the requested rate increase on an equal percentage basis among all major customer classes.<sup>178</sup>

<sup>175</sup> *In the Matter of the Application of Puget Sound Energy for Authorization Regarding the Deferral of the Net Impact of the Conservation Incentive Credit Program*, Docket No. UE-010410, Order Denying Petition to Amend Accounting Order, ¶ 7. See also Leonard S. Goodman, *The Process of Ratemaking*, Public Utility Reports, Inc., 1998, pp. 165-66.

<sup>176</sup> *Narragansett Electric Co. v. Burke*, 505 A.2d 1147, 1148 (R.I. 1986). See also *In the Matter of the Application of Puget Sound Energy for Authorization Regarding the Deferral of the Net Impact of the Conservation Incentive Credit Program*, Docket No. UE-010410, Order Denying Petition to Amend Accounting Order, ¶¶ 7 and 9.

<sup>177</sup> Exh. No. TES-1T, p. 33, Table 2 (Schooley Responsive) (information presented above calculated based on figures presented in the “Ratio” column).

<sup>178</sup> Exh. No. WRG-1T, pp. 2-3 (Griffith Direct).

73. Without performing its own cost of service study, Staff proposed in its responsive testimony to increase residential and industrial rates by 114 percent of the average, while increasing commercial rates by only 83 percent of the average.<sup>179</sup> On rebuttal, PacifiCorp accepted Staff's proposal, which when paired with the Company's position on revenue requirement, would result in a 20.20 percent increase to residential rates, but only a 14.7 percent increase for large commercial customers.<sup>180</sup>

**A. Residential Customers Should Be Assigned No More than the Average Overall Increase in this Case.**

74. The Commission has stated that cost of service studies may not accurately reflect the actual costs to serve various customer classes because of the high number of underlying judgment calls they involve. In an earlier Pacific Power & Light rate case, the company, as well as two other parties, each performed their own cost of service studies.<sup>181</sup> Based on a single study, Pacific Power initially proposed an equal percentage rate spread, but on rebuttal revised its proposal to impose varying rate increases that the company stated were aimed at bringing classes closer to parity.<sup>182</sup> The Commission rejected Pacific Power's revised proposal, instead ordering an equal percentage increase to all customer classes, noting that cost of service studies are susceptible to many "underlying judgment calls so incapable of precise determination" that therefore the company's single study could not be relied upon as representing "unity" or warranting any change in rate spread.<sup>183</sup> The Commission further stated: "The Commission

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<sup>179</sup> Exh. No. TES-1T, p. 34:14-23 (Schooley Responsive).

<sup>180</sup> Exh. No. WRG-7T, p. 2:14-23 (Griffith Rebuttal). The Company testified that its acceptance of Staff's proposal it was also responsive to the recommendation of Walmart, which is discussed separately below.

<sup>181</sup> *WUTC v. Pacific Power & Light Co.*, Docket No. U-84-65, Final Order, pp. 40-41.

<sup>182</sup> *Id.* at p. 40.

<sup>183</sup> *Id.* at p. 43.

does agree [that] there is such *relatively little difference* among the [parties' cost of service studies], and the variation among the underlying judgment calls [are] so incapable of precise determination, that the *proposed restructure would be relatively pointless.*"<sup>184</sup>

75. Moreover, the Commission does not rely solely on cost of service studies in determining rate spread, frequently citing such other factors as: "perceptions of equity and fairness, and rate stability over time, as well as overall economic circumstances within the region."<sup>185</sup> In addition, the Commission has found that a ten percent confidence range in the relative revenue-to-cost ratios for each customer class "seems sensible."<sup>186</sup>

76. Given the unreliability of cost of service studies and how close historically PacifiCorp's residential class has remained to parity, attempting to adjust the residential parity ratio in this case is inappropriate. Placing a higher-than-average increase on residential customers is also improper given residential customers' relative inability to bear the increase as compared to other customer classes. Staff witness, Mr. Schooley, testified that a 20 percent increase would be "shocking" to residential customers.<sup>187</sup> Such an increase would be especially shocking for the high number of PacifiCorp customers living at or below the poverty line and the senior citizens in its service territories already struggling to make ends meet.<sup>188</sup> It will also come at a time where government assistance for these very customers, namely low-income families and seniors, are being drastically reduced and cut.<sup>189</sup>

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<sup>184</sup> *Id.*

<sup>185</sup> *WUTC v. Pacific Power & Light Co.*, Docket No. U-84-65, Final Order, p. 42. *See also, e.g.*, Docket Nos. U-78-05, U-86-100, U-89-2688-T, and UG-940034.

<sup>186</sup> *WUTC v. Pacific Power & Light Co.*, Docket No. U-84-65, Third Suppl. Order, p. 46.

<sup>187</sup> Exh. No. TES-1T, p. 35:19 (Schooley Responsive).

<sup>188</sup> *See* discussion at I.A above.

<sup>189</sup> *See id.*

**B. Staff Provides Insufficient Support for its Proposed Rate Spread.**

77. Staff has not adequately supported its recommendation to place a higher-than-average increase on residential customers while giving other customer classes, including large commercial, a lower-than-average increase.

78. Staff witness, Mr. Schooley, testifies that it is necessary to apply higher- or lower-than-average increases to various customer classes in order to avoid having one or more classes persistently remain below parity (thereby allowing that customer class to persistently benefit from unfairly low rates). Mr. Schooley then presents the parity ratios from PacifiCorp’s last five rate cases, as shown below in Table 3.

**TABLE 3: PACIFICORP HISTORICAL PARITY RATIOS<sup>190</sup>**

		050684	061546	080220	090205	100749
<b>16</b>	<b>Residential</b>	<b>.98</b>	<b>.99</b>	<b>1.00</b>	<b>1.01</b>	<b>.97</b>
24	General Service	1.10	1.11	1.11	1.10	1.07
36	Large General Service	1.05	1.04	1.02	1.01	1.02
48T	Large Power Service	.94	.93	.90	.92	.97
48T	Dedicated Facilities				.85	.96
40	Irrigation	.99	.96	.93	.99	1.03
15 & 50s	Street Lighting	.91	1.00	1.33	1.43	1.20

79. While Mr. Schooley notes that industrial customers—Schedule 48T—have been below parity in every case, he does not mention that, unlike industrial customers, the residential class

<sup>190</sup> Rounded to the second decimal point. See Table 4 below for current parity ratios rounded to the third decimal point.



has been within three percent of parity in *every* case, and was *at or above* parity in the two most recent cases. While it may be true that industrial class rates have been persistently below parity, the residential class has not had this same rate benefit. Mr. Schooley also fails to point out that residential customers are currently within the range that Staff’s proposal seeks to achieve—Mr. Schooley states that his proposal will achieve parity levels between .97 and 1.05 while residential customers are currently at .974. Regardless of this, Mr. Schooley then asserts that industrial customers *and* residential customers should be assigned an increase 14 percent above average.

**TABLE 4: STAFF’S PROPOSED PERCENTAGE INCREASE**

Schedule	Class	Distance from parity <sup>191</sup>	% of Average Increase Proposed <sup>192</sup>
48T (ded. fac.)	Industrial	-.041	113
48T	Industrial	-.030	113
16	Residential	-.026	113
36	Large Commercial	+.024	83
40	Agricultural Pumping	+.030	83
24	Small Commercial	+.073	83
15, 52, 54, 57	Street Lighting	+.195	1

80. Table 4 above shows how mismatched Staff’s proposed rate spread actually is. The proposal places the *same* percentage increase on small and large commercial classes, even though the small commercial class is 4.9 percent *further* from parity than the large commercial class. Also, Staff’s proposal places a disproportionately high increase on residential customers

<sup>191</sup> Exh. No. TES-1T, p. 33, Table 2 (Schooley Responsive) (Information presented above calculated on figures presented in the “ratio” column).

<sup>192</sup> Exh. No. WRG-7T, p. 2:14-23 (Griffith Rebuttal).

even though residential and large commercial customers are nearly equidistant from parity.

81. In sum, Staff's position ignores the fact that residential customers have been very close to, at, *or above* parity in all five of PacifiCorp's most recent cases. Staff also fails to consider the various other factors to be considered when spreading rates, including the potentially more dramatic impact that a rate increase of that proportion would have on residential customers.

**C. PacifiCorp Provides Insufficient Support for its Adoption of Staff's Proposal.**

82. PacifiCorp provides little to no support for adopting Staff's proposed rate spread. First, the Company did *not* perform a new cost of service study, simply amending its original recommendation without any new evidence to warrant the change.<sup>193</sup> Thus, Mr. Griffith offers contradictory testimony, stating first that the Company's original proposal is supported by its cost of service study, and then testifying in rebuttal that, in fact, the cost of service study better supports the Staff rate spread.<sup>194</sup>

83. Moreover, Mr. Griffith glosses over the central fact that Staff made its rate spread proposal based on Staff's proposed overall rate increase, which is *significantly lower* than PacifiCorp's requested level of revenue. Because of this considerable difference, under Staff's proposal, residential customers would not see a 20.2 percent increase, but a much lower 12.06 percent increase.<sup>195</sup> Finally, like Staff, PacifiCorp fails to recognize any other factor relevant to determining the proper spread of rates, including the relatively more detrimental impact the proposed increase may have on residential customers.

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<sup>193</sup> Exh. No. WRG-12. *See also* Griffith, TR. 540:8-20.

<sup>194</sup> *Compare* Exh. No. WRG-1T, p. 2:19-21 (Griffith Direct) *and* Exh. No. WRG-7T, p. 2:14-17 (Griffith Rebuttal).

<sup>195</sup> *See* Exh. No. TES-1T, p. 34:15 (Schooley Responsive).

**D. Walmart's Rate Spread Recommendation is Without Merit and Should be Disregarded.**

84. Walmart focuses its entire advocacy on shifting the cost of any rate increase from its customer classes onto residential customers while offering no analysis of the actual cost drivers in this case.<sup>196</sup> Moreover, Walmart witness, Mr. Steve Chriss, offers insufficient support for his proposal. Mr. Chriss did not consider *any* of the numerous other factors that bear on the appropriate distribution of rates among customer classes, which is contrary to the Commission's declared approach of "avoid[ing] the mechanical application of results of a given study."<sup>197</sup> Moreover, like Staff, Walmart did not perform his own cost of service study, instead accepting *carte blanche* the results of the Company's study.

**XI. FIXED CUSTOMER CHARGE**

85. In its rebuttal case, PacifiCorp proposes increasing the residential fixed charge from \$6.00 to \$8.50, or 41 percent.<sup>198</sup> Without separately analyzing PacifiCorp's designation and valuation of "fixed" costs, Staff supported increasing the fixed charge (to a lower \$7.50 based on Staff's lower overall revenue recommendation).<sup>199</sup>

86. The Commission previously made clear that much more than a company's cost of service study must be considered when determining the appropriate level for fixed charges, stating: "Embedded cost studies should only be *one consideration* in determining rate spread and rate design."<sup>200</sup> However, both PacifiCorp and Staff fail to recognize *any other* factor relevant to

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<sup>196</sup> Chriss, TR. 684:24 -685:10.

<sup>197</sup> *WUTC v. Pacific Power & Light Co.*, Docket No. U-84-65, Final Order, p. 42.

<sup>198</sup> Exh. No. WRG-7T, p. 3:10 (Griffith Rebuttal). PacifiCorp originally requested to increase the fixed charge by 30 percent to \$9.00. See Exh. No. WRG-1T, p. 4:7-8 (Griffith Direct).

<sup>199</sup> Exh. No. TES-1T, p. 37:6-8 (Schooley Responsive).

<sup>200</sup> *WUTC v. Washington Water Power*, Docket No. UG-901459, Third Suppl. Order, p. 4 (emphasis added).

setting fixed charges, such as customer impact and whether a rate design with a higher fixed charge sends proper price signals. Both PacifiCorp and Staff also fail to acknowledge that the determination of what costs are considered “fixed” or “variable” is subjective and can change dramatically depending on the context. Moreover, PacifiCorp’s comparisons of its proposed fixed charge to other utilities are inaccurate and misleading. Therefore, as discussed below in further detail, the Commission should reject Staff’s and PacifiCorp’s recommendations and retain the current residential fixed charge of \$6.00.

**A. Increasing the Fixed Charge Will Unfairly Burden Low-Income Customers.**

87. It is not in dispute that increasing the fixed charge will disproportionately increase rates for low-use customers.<sup>201</sup> Commission staff testified to this point, stating: “Increasing the basic charge commensurately reduces the energy charge,” and thus “[t]he low use customer’s bill will increase by a higher percentage than the bill of a high use customer.”<sup>202</sup>

88. Since, as The Energy Project witness, Mr. Charles Eberdt testified, usage generally increases with income, low-use customers are likely lower-income and would be unfairly burdened by an increased fixed customer charge: “Generally speaking, usage increases with income, with house size, or with the number of bedrooms. As you go up those scales, you are moving away from low-income customers.”<sup>203</sup>

89. Mr. Schooley’s testimony that “maintaining a low basic charge and higher energy charges harms low-income customers”<sup>204</sup> is inaccurate and unsupported.<sup>205</sup> Mr. Schooley did

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<sup>201</sup> Exh. No. WRG-10, p. 1.

<sup>202</sup> Exh. No. TES-1T, p. 38:5-6 (Schooley Responsive).

<sup>203</sup> Exh. No. CME-5T, pp. 3:23-4:2 (Eberdt Cross Answering).

<sup>204</sup> Exh. No. TES-1T, p. 39:11-12 (Schooley Responsive).

<sup>205</sup> Schooley, TR. 782:7-12:

not provide any data to support his contention, and generally, there is no comprehensive data on actual usage among PacifiCorp's low-income customers.<sup>206</sup> Mr. Schooley also testified to the fact that the Company's own comparison of usage between low-income to non-low-income residential customers, which showed low-income customers as high-usage, is "biased."<sup>207</sup>

**B. Increasing the Fixed Charge Will Discourage Conservation.**

90. Price signals are one of the most effective and efficient tools available to regulators to promote conservation. Rate structures with high fixed charges promote consumption because a consumer's price of incremental consumption is less than what it would otherwise be under an efficient price structure. The lower the price of incremental consumption, the lower a customer's incentive to conserve.<sup>208</sup> Accordingly, increasing PacifiCorp's fixed charge could undermine any gains made from the Company's efforts to incent conservation among its residential customer class<sup>209</sup> and would directly conflict with state policies promoting increased conservation.<sup>210</sup>

91. This Commission previously recognized the negative impact that increasing fixed customer charges has on conservation. In *WUTC v. Washington Water Power*, the Commission

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Q: Now, you rebut Mr. Eberdt's testimony in your contention that low income customers tend to be relatively higher residential users; is that right?

A: I simply said there were, perhaps, many low income customers with high use and that those customers are harmed by having low basic charges.

Q: The word "many," is that based on some type of empirical evidence that you provided in this case?

A: No, I was just creating a circumstance.

<sup>206</sup> Schooley, TR 782:4-2.

<sup>207</sup> Schooley, TR. 784:1-4.

<sup>208</sup> See Exh. No. CME-1T, p. 13:16-14:6 (Eberdt Responsive) (stating in part, "the more the consumption-based cost is diminished and transferred to an unavoidable fixed monthly charge, the more one removes a customer's incentive to use energy efficiently. Particularly at a time when our national focus is on reducing consumption as much as possible, such a price signal is contrary to sound policy objectives").

<sup>209</sup> PacifiCorp currently has five ratepayer-funded residential demand-side management programs and has a multi-million dollar budget for residential programs alone. See Demand-Side Business Plan Washington, November 2010 Update, Docket No. UE-100170 (filed November 1, 2010), Table 1.

rejected the Company's request to increase its fixed monthly charge, stating: "The Commission agrees that disproportionate increases to customer charges *discourage conservation*."<sup>211</sup> In an earlier case, the Commission denied an increase to Puget Sound Power & Light's fixed charge for the same reason, stating: "The Commission finds the arguments against increasing the charge persuasive. An increase in the cost of the initial block of energy through the addition of higher service charges sends no signal to the customer that higher energy rates result from increase use."<sup>212</sup> The impact of increased fixed charges on usage was also discussed by FERC in its Order 636, adopting "straight fixed variable" pricing to *promote the additional usage of domestic natural gas*.<sup>213</sup> As these decisions make clear, the price signal that results from a rate structure with higher fixed monthly charges sends price signals to customers to use *more*, rather than less, electricity.

**C. The Calculation of Fixed Costs Is Necessarily Subjective.**

92. The selection of which costs to include in a calculation of a fixed charge is necessarily subjective. In actuality, nearly every cost of a utility could be considered "fixed" or "variable"

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<sup>210</sup> See RCW 19.285.020 and .040(1).

<sup>211</sup> Docket No. UG-901459, Third Suppl. Order, p. 17 (emphasis added). As recently as 2009, the Commission has acknowledged the conservation disincentive resulting from lowering energy charges in its Final Order regarding Avista's gas decoupling mechanism. See *WUTC v. Avista Corp., d/b/a Avista Utilities*, Final Order (Order 10), Docket Nos. UE-090134, UG-090135 & UG-060518 (consolidated), ¶ 292 (stating "[w]e also note that with such rate designs, the variable charge for gas purchased would be smaller, thereby decreasing the incentive for each customer to conserve on his or her usage").

<sup>212</sup> *WUTC v. Puget Sound Power & Light*, Docket No. U-83-54, Final Order, p. 42.

<sup>213</sup> FERC, Docket Nos. RM91-11-011 and RM87-34-065, Order No. 636, pp. 7-8 and 128-29.

depending on the context. Staff witness, Mr. Schooley, testified to this point:

Q: To cut right to the point, isn't it true that one, in theory, could argue that almost all costs [a] utility incurs are necessary to serve customers and that [a] company's customers, of course, vary from month to month, year to year? Every single cost incurred by the utility is necessary to serve its customers[?]

A: Yes, that's true. There's certain costs, many of which are not recovered on fixed charges that are, basically, fixed. The cost of a generation plant is highly fixed with small relative amounts of variable costs in it, but those costs are not recovered as a direct flat charge to the customers. So [the] question is one of, I mean, in the long run, yes, all costs are variable and will be charged to the customers.

...

Q: My question is: Isn't that somewhat subjective? Couldn't one argue there could be any number of other costs that could be included in a basic charge?

A: It is subjective....

93. Confirming this, PacifiCorp's rate design witness, Mr. Griffith, testified that the "mix" of fixed costs used in the Company's different jurisdictions varies substantially. Moreover, Mr. Griffith could not say with certainty whether costs such as central office overhead and legal costs were included in the Company's calculation of "fixed" costs.<sup>214</sup>

94. Thus, PacifiCorp's unilateral selection of costs to identify as "fixed" for the purpose of calculating a fixed charge should not be wholly relied upon as a determination of the Company's truly fixed costs.

**D. PacifiCorp's Comparison of Fixed Charges Is Misleading and Should be Disregarded.**

95. PacifiCorp's statement that, even if increased, its fixed charge will "continue to be one of the lowest among Washington utilities"<sup>215</sup> is inaccurate and misleading. While Public Counsel

<sup>214</sup> Griffith, TR. 568:23-569:11.

<sup>215</sup> Exh. No. WRG-1T, pp. 4:21-5:1 (Griffith Direct).

does not believe that comparing rates between utilities is useful in determining the appropriate rate design for PacifiCorp, if any sort of comparison is to be made, it should take into account the relative size and different overall rate structures of the utilities being compared. PacifiCorp did not do this. In Washington, the vast majority of utilities that impose a higher electric monthly charge are smaller, publicly-owned utilities whose rate structures and rate designs are very likely a reflection of their small size and relative costs to serve customers, as well as any number of other factors. In fact, the largest Washington electric utilities—Puget Sound Energy, Avista, and Seattle City Light—all have fixed customer charges well below PacifiCorp’s proposed charge.<sup>216</sup> Additionally, PacifiCorp included in its comparison two utilities that do not even have fixed charges, instead presenting those utilities’ minimum monthly billing requirements as if they were fixed customer charges.

## XII. CONCLUSION

26. For the foregoing reasons, Public Counsel recommends that the Commission reject the electric revenue increase proposed by PacifiCorp. Public Counsel respectfully requests that the Commission adopt Public Counsel’s recommendations herein and establish fair, just, and

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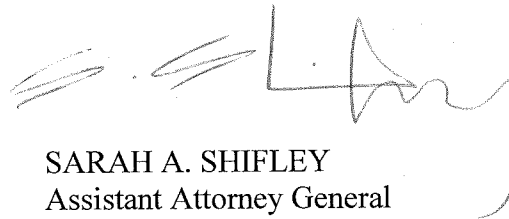
<sup>216</sup> Avista, has a \$6.00 fixed charge for electric service, which was not increased in its last general rate case. See *WUTC v. Avista Corp. d/b/a Avista Utilities*, Docket No. UE-100467, Final Order (Order 07), ¶ 14. Puget Sound Energy and Seattle City Light have fixed customer charges of \$7.25 and \$3.37 respectively. See Griffith Workpaper 2, “Survey of Washington Electric Utilities Basic Charges as of January 2010.”



reasonable rates for PacifiCorp's residential and small business customers, consistent with its authority to regulate in the public interest.

97. DATED this 11<sup>th</sup> day of February, 2011.

ROBERT M. McKENNA  
Attorney General

A handwritten signature in black ink, appearing to read 'S. Shifley', is written over the typed name and title of Sarah A. Shifley.

SARAH A. SHIFLEY  
Assistant Attorney General  
Public Counsel