

**BEFORE THE  
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

WASHINGTON UTILITIES AND  
TRANSPORTATION COMMISSION

Complainant,

vs.

PACIFICORP d.b.a. PACIFIC POWER,

Respondent.

**DOCKET UE-100749**

**PACIFICORP'S  
POST-HEARING REPLY BRIEF**

**February 18, 2011**

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1. The initial briefs filed by Commission Staff, Public Counsel, and the Industrial Customers of Northwest Utilities (ICNU) in this proceeding criticize the Company's requested rate increase as too large. These complaints do not match their actual proposals and the relatively small number of contested adjustments in this case.
2. The need for a significant rate increase is evident based on Staff's own proposal for a 9.5% rate increase, and Public Counsel's proposed adjustments amount to just \$4.9 million out of the proposed \$47.7 million revenue requirement increase. While both Public Counsel and ICNU claim that the Company presented no evidence that it has deferred any capital projects,<sup>1</sup> rates from this proceeding will not include any capital additions that already occurred in 2010 and 2011,<sup>2</sup> and no party has challenged the prudence of capital investments included in the filing. Similarly, Public Counsel complains that PacifiCorp has not put any travel restrictions in place,<sup>3</sup> but did not propose any disallowances of travel costs.
3. ICNU recommends that the Commission "utilize its discretion and further reduce [the Company's] proposed increase."<sup>4</sup> The Commission's ratemaking authority and policies preclude this kind of subjective, non-cost based adjustment to the Company's filing.
4. The Company has cut costs and limited its requested increase in this case in response to challenging economic conditions. But the undisputed fact remains that PacifiCorp is now under-recovering its costs and under-earning its allowed return. The \$47.7 million increase PacifiCorp is seeking is necessary for the Company to meet its service obligations and maintain its current financial integrity.

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<sup>1</sup> Post-Hearing Brief of Public Counsel ¶ 2; Post-Hearing Brief on Behalf of ICNU ¶ 10.

<sup>2</sup> PacifiCorp's Initial Post-Hearing Brief ¶ 4.

<sup>3</sup> Post-Hearing Brief of Public Counsel ¶ 2.

<sup>4</sup> Post-Hearing Brief on Behalf of ICNU ¶ 11.



## I. COST OF EQUITY AND CAPITAL STRUCTURE

### A. Return on Equity

#### 1. ICNU Urges Consideration of a Broad Range of Factors in Setting PacifiCorp's ROE, But Fails to Reconcile Its Low Proposed ROE with These Factors.

5. ICNU contends that “the broad array of analytical and non-analytical evidence strongly supports lowering ROE.”<sup>5</sup> Specifically, ICNU argues “that capital costs have declined and that utilities are viewed as favorable investment opportunities in the current economy.”<sup>6</sup> This position is directly contradicted by Mr. Gorman’s testimony at hearing that, through the second quarter of 2010, the utility stock index reflected a negative return of approximately 8%.<sup>7</sup> And Mr. Gorman admitted that utility stocks “did not outperform the market in 2009 and 2010.”<sup>8</sup> Dr. Hadaway’s testimony likewise shows that while the S&P 500 has recovered over 55% from its March 2009 lows, utility stock prices have increased by only 23%.<sup>9</sup> This evidence demonstrates the reality that utilities are not currently viewed as “favorable investment opportunities,” especially when compared to the time of the decision in PacifiCorp’s 2005 GRC, when an investment in utility stocks outperformed the market and provided 20% returns.<sup>10</sup>

6. Arguing that decisions of other utility commissions are another relevant factor, ICNU cites a single case in support of its 9.5% ROE—PacifiCorp’s Idaho Commission interlocutory order setting an ROE of 9.9%.<sup>11</sup> ICNU omits to mention that this decision also set PacifiCorp’s

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<sup>5</sup> Post-Hearing Brief on Behalf of ICNU ¶ 17.

<sup>6</sup> *Id.* ¶ 14. Similarly ¶ 17, ICNU claims that “the current economic conditions make utilities like PacifiCorp more attractive investment opportunities because they appeal to investors looking for stable investments during poor economic times.”

<sup>7</sup> Gorman, TR. 441:22-442:1.

<sup>8</sup> Gorman, TR. 442:2-13; *See also* Gorman, Exh. No. MPG-1T 7: Fig. 1; Gorman, Exh. No. MPG-1T 7:1 (“[d]uring 2009 and the first half of 2010 [utility stocks] *underperformed the market*”) (emphasis added).

<sup>9</sup> Hadaway, Exh. No. SCH-8T 9:1-2.

<sup>10</sup> Gorman, Exh. No. MPG-1T Fig. 1.

<sup>11</sup> Post-Hearing Brief on Behalf of ICNU ¶ 17.

common equity ratio at 52.1%,<sup>12</sup> and came at the very bottom of the interest rate trough in 2010.<sup>13</sup> ICNU ignores all other 2010 ROE outcomes for PacifiCorp (which ranged from 10.1% to 10.6%),<sup>14</sup> other 2010 ROE outcomes in Washington (which included a litigated result of 10.1% and a settlement of 10.2%),<sup>15</sup> and the 2010 ROE national average of 10.36%.<sup>16</sup>

7. Lastly, ICNU argues for a reduction in PacifiCorp's ROE on the basis that PacifiCorp has been able to attract capital at its current rates.<sup>17</sup> Mr. Williams's unrefuted testimony is that PacifiCorp's credit metrics are now borderline for a single "A" utility, and that rating agencies are becoming ever more stringent in their ratings expectations.<sup>18</sup> This evidence shows that PacifiCorp has no headroom to absorb ICNU's and Staff's proposed ROE reduction of 70 basis points and maintain its current debt rating and access to capital markets.

## **2. Staff's Proxy Group is Not Superior to PacifiCorp's.**

8. Staff advocates for its proposed ROE claiming that it is the result of a more focused proxy group of comparable utilities than the group utilized by Dr. Hadaway and Mr. Gorman. Dr. Hadaway's selection criteria are designed to create a proxy group that includes a broad group of utilities with comparable risks. A key criteria used by Dr. Hadaway requires all utilities in the proxy group to have a comparable credit rating because this is strong evidence that financial markets and investors will view the risk faced by these utilities as relatively comparable.

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<sup>12</sup> *Re Rocky Mountain Power*, Case No. PAC-E-10-07, Interlocutory Order No. 32151 at 2 (I.P.U.C. Dec. 27, 2010).

<sup>13</sup> Hadaway, TR. 259:8-18.

<sup>14</sup> *PacifiCorp*, Docket UE 210, Order No. 10-022 (O.P.U.C. Jan. 26, 2010) (10.125%); *Rocky Mountain Power*, Docket No. 09-035-023, Report and Order (U.P.S.C. Feb. 18, 2010) (10.6%); *Re PacifiCorp*, Application 09-11-015, Decision 10-09-010 (C.P.U.C. Sept. 3, 2010) (10.6%).

<sup>15</sup> *Wash. Utils. & Transp. Comm'n v. Avista Corp.*, Docket UE-100467, Order 07 ¶ 8 (Nov. 19, 2010) (10.2%); *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy, Inc.*, Docket UE-090704, Order 11 ¶ 301 (Apr. 2, 2010) (10.1%).

<sup>16</sup> Hadaway, Exh. No. SCH-8T 10:Table 3.

<sup>17</sup> Post-Hearing Brief on Behalf of ICNU ¶ 17.

<sup>18</sup> Williams, Exh. No. BNW-1T 11:7-14; Williams, Exh. No. BNW-1T 12:9-18.

9. Mr. Elgin, on the other hand, judgmentally removed 16 of the selected companies within Dr. Hadaway's proxy group on the basis that they reflected dissimilar business risks as PacifiCorp, and inserted Avista Corporation (Avista). Mr. Elgin's methods completely ignore the financial risk of a company which, along with business risk, are the two core elements used by rating agencies in determining a company's credit rating and by the financial markets and investors to evaluate investment risk. Ultimately, Dr. Hadaway's selection criteria are very similar to the selection criteria used by Staff witness David C. Parcell in the Puget Sound Energy, Inc. (Puget) 2009 general rate case (Puget GRC).<sup>19</sup> In contrast, Mr. Elgin's selection criteria are completely different from Mr. Parcell's.

**3. Staff's DCF Analysis Is Not Transparent, Nor Does it Capture Investor Expectations.**

10. Staff claims that it approached its DCF analysis like a prudent investor, evaluating and applying the data in a careful and transparent manner.<sup>20</sup> The record demonstrates that Mr. Elgin made ad hoc adjustments to every growth rate he considered, many of which were not transparent or in any way tied to verifiable investor expectations. For example, Mr. Elgin gave significant weight to growth in retained earnings, which he measured using "b times r" data.<sup>21</sup> Mr. Elgin's testimony explains that, in this analysis, he adjusted the earned returns of IdaCorp and DPL, and excluded Avista.<sup>22</sup> His handwritten work papers, however, suggest additional adjustments to other companies not referenced in the testimony.<sup>23</sup> Confirming this, Dr. Hadaway's restatement of Mr. Elgin's analysis from unadjusted Value Line data for

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<sup>19</sup> *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy, Inc.*, Docket UE-090704, Order 11 (April 2, 2010).

<sup>20</sup> Initial Brief on Behalf of Commission Staff ¶180.

<sup>21</sup> *Id.* ¶184.

<sup>22</sup> Elgin, Exh. No. KLE-1T 32:17-33:14.

<sup>23</sup> Hadaway, Exh. No. SCH-10 1.

Mr. Elgin's proxy group shows a different "b times r" result for every single company—producing a growth rate of 5.61% instead of Mr. Elgin's 5.0% result.<sup>24</sup>

11. One of the adjustments Mr. Elgin makes to his "b times r" results is to increase any earned return on book equity up or down to 10% as a reasonable approximation of a utility's expected earnings.<sup>25</sup> Tellingly, Mr. Elgin's proposed "floor" is not his 9.5% ROE recommendation in this case, a tacit acknowledgement that an ROE at this level does not comport with his own reasonable approximation of a utility's expected earnings or utility investor expectations.

12. Staff's brief contrasts Mr. Elgin's approach with Dr. Hadaway's, which it claims was to take "highly dispersed data and 'just average everything.'"<sup>26</sup> Correctly characterized, Dr. Hadaway's approach was to analyze a reasonable amount of data (tested to assure comparability with unbiased and verifiable third party opinions (*i.e.* credit ratings)), compile and report the data without ad hoc adjustments, and then apply professional judgment as to the weight to be accorded to the range of results. This is the same approach applied by most cost of capital witnesses, including Staff witness Mr. Parcell in the Puget GRC.

#### 4. Dr. Hadaway's Reliance on Long-term GDP Growth is Appropriate.

13. Staff criticizes Dr. Hadaway's use of a long-term GDP growth rate forecast, developed with historic GDP data.<sup>27</sup> Staff claims that Dr. Hadaway should have used one of the available "long-term" forecasts similar to those cited by Staff and ICNU. Staff is incorrect to refer to Staff's and ICNU's GDP forecasts as "long-term."<sup>28</sup> The longest range forecast used by Staff or

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<sup>24</sup> Hadaway, Exh. No. SCH-8T 17:14-18:13.

<sup>25</sup> Elgin, Exh. No. KLE-1T 32:6-15.

<sup>26</sup> Initial Brief on Behalf of Commission Staff ¶186.

<sup>27</sup> *Id.* ¶ 198.

<sup>28</sup> Initial Brief on Behalf of Commission Staff ¶ 199.

ICNU is ten years (Mr. Gorman's 10-year Blue Chip forecast).<sup>29</sup> While Mr. Elgin points to the "long run" Federal Reserve forecast,<sup>30</sup> the term "long run" projects to a point of economic stability, not a specific long-term time horizon.<sup>31</sup> Unlike the GDP forecasts cited by Staff and ICNU, Dr. Hadaway's GDP forecast is developed specifically to project long-term GDP growth to meet the requirements of the DCF model.

**5. ICNU Fails to Reconcile its Reliance on Forecast GDP Growth Rates With Its Rejection of Forecast Analysts' Growth Rates.**

14. ICNU offers no criticism of Dr. Hadaway's DCF analysis, instead extolling the virtues of Mr. Gorman's DCF analysis because he used "forecasted growth rates," not historical averages. But ICNU fails to reconcile or even acknowledge Mr. Gorman's inconsistent embrace of short-term GDP growth forecasts and his rejection of short-term security analysts' growth rate forecasts.<sup>32</sup>

15. With respect to forecast GDP growth rates, at hearing Mr. Gorman testified that, "analysts' projections in general are a good basis to assess what investors' outlooks are," and a "consensus of all analysts' projections is" reliable.<sup>33</sup> Mr. Gorman argued that because these analysts are in the business of providing forecasts, they must be reliable because otherwise investors would not look to them for information.<sup>34</sup> While Mr. Gorman discounts the security analysts' forecasts used in his constant growth DCF method as "abnormally high,"<sup>35</sup> the same arguments Mr. Gorman makes in support of his reliance on analysts' forecasts of GDP growth

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<sup>29</sup> Gorman, Exh. No. MPG-1T 45:Table 6.

<sup>30</sup> Elgin, Exh. No. KLE-1T 55: 21-56: 3.

<sup>31</sup> See Federal Reserve Open Market Committee minutes at [www.federalreserve.gov](http://www.federalreserve.gov); which project GDP only through 2013 and do not specify a time horizon time-line for "long-run" GDP estimates. See also *Money Growth and Inflation: How Long is the Long Run?* Federal Reserve Bank of Cleveland (1999) (measuring "long-run" over 2, 4 and 8-year periods); [www.clevelandfed.org/research/commentary/1999/0801.htm](http://www.clevelandfed.org/research/commentary/1999/0801.htm).

<sup>32</sup> Post-Hearing Brief on Behalf of ICNU ¶¶ 23-24.

<sup>33</sup> Gorman, TR. 472:9-14.

<sup>34</sup> Gorman, TR. 472:15-23.

<sup>35</sup> Post-Hearing Brief on Behalf of ICNU ¶ 24.

rates apply equally to analysts' growth rate forecasts. Mr. Gorman's constant growth method using analysts' growth rates resulted in an ROE of 10.5%;<sup>36</sup> this result and Mr. Gorman's testimony endorsing security analysts' forecasts "as the most likely growth estimates that are built into stock prices,"<sup>37</sup> demonstrate that his 9.5% ROE is out of step with investor expectations.

**6. ICNU's Criticism of Dr. Hadaway's Risk Premium Analysis is Flawed.**

16. ICNU criticizes Dr. Hadaway's risk premium analysis because it claims that the Commission rejected the use of forecasted interest rates in the Company's 2005 GRC.<sup>38</sup> ICNU overlooks the fact that Dr. Hadaway used current interest rates, as well as forecasted rates in his risk premium analysis.<sup>39</sup> Dr. Hadaway's risk premium with interest rates that approximate current rates (based upon a 5.83% interest rate), indicate an ROE of 10.38%.<sup>40</sup>

17. ICNU also claims that Dr. Hadaway relies upon a "simplistic inverse relationship between equity risk premiums and interest rates . . . that is not supported by academic research." ICNU ignores the fact that Dr. Hadaway's analysis of the inverse relationship between equity risk premiums and interest rates is demonstrated empirically by his own testimony.<sup>41</sup> ICNU does not challenge Dr. Hadaway's empirical analysis but rather cites two academic articles from 1985 and 2001 to argue that *although this inverse relationship exists*, it should be ignored because it "is not expected to exist in the current marketplace."<sup>42</sup> ICNU thus acknowledges the existence of the relationship, and Dr. Hadaway's unchallenged empirical evidence demonstrates that the relationship does indeed persist in the current marketplace. As noted in PacifiCorp's Initial Post-

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<sup>36</sup> *Id.* ¶ 24.

<sup>37</sup> Gorman, Exh. No. MPG-24 6:18-19.

<sup>38</sup> Post-Hearing Brief on Behalf of ICNU ¶ 21.

<sup>39</sup> Hadaway, Exh. No. SCH-1T 39:19-20.

<sup>40</sup> Hadaway, Exh. No. SCH-1T 41:Table 5.

<sup>41</sup> Hadaway, Exh. No. SCH-1T 40:1-13; Hadaway, Exh. No. SCH-7

<sup>42</sup> Post-Hearing Brief on Behalf of ICNU ¶ 21; Gorman, Exh. No. MPG-1T n 29, 30.

Hearing Brief, when Mr. Gorman's risk premium analysis is corrected to include the inverse relationship between equity risk premiums and interest rates, his results produce a midpoint ROE of 10.23%.<sup>43</sup>

**7. Dr. Hadaway's Decision to Not Rely Upon CAPM is Not Arbitrary.**

18. ICNU argues that Dr. Hadaway acted arbitrarily when he decided not to perform a CAPM analysis in this case, and failed to provide an explanation for departing from the Commission precedent set in the Puget GRC.<sup>44</sup> ICNU argues that the Commission relied on CAPM in that case and therefore Dr. Hadaway should have included it here. In that case, the Commission also relied upon the MEPR, MTB, and Comparable Earnings methods—none of which were used by any witness in this docket.<sup>45</sup> If Dr. Hadaway's analysis was deficient in this manner, then likewise Mr. Gorman's testimony was deficient for his failure to explain why he did not rely upon the MEPR, MTB, or Comparable Earnings methods. Additionally, ICNU fails to acknowledge the Commission's statement in the Puget GRC that given market conditions, it would accord CAPM diminished weight.<sup>46</sup>

**B. Capital Structure**

**1. Under Any Legal Standard, Staff's Capital Structure is Unsafe and Uneconomic.**

19. Staff argues that the Company's analysis is flawed because it used the standard announced in the Commission's most recently litigated capital structure case, which Staff claims is different from the standard used in PacifiCorp's 2005 GRC.<sup>47</sup> Staff argues that orders in recent cases involving Puget do not apply to PacifiCorp. This is wrong for two reasons. First,

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<sup>43</sup> Hadaway, Exh. No. SCH-8T 26:23.

<sup>44</sup> Post-Hearing Brief on Behalf of ICNU ¶ 29.

<sup>45</sup> *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy, Inc.*, Docket UE-090704, Order 11 at 103 Table 10 (April 2, 2010).

<sup>46</sup> *Id.* at n. 369.

<sup>47</sup> See Initial Brief on Behalf of Commission Staff ¶¶ 158, 159-162.

nothing in these orders suggest that the analysis is limited to Puget—the order in the Puget GRC states clearly: “The Commission has approved hypothetical capital structures when there was a clear and compelling reason to do so.”<sup>48</sup>

20. Second, Mr. Elgin recommends his 46.5% equity ratio because that “is consistent with the capital structure used by the Commission in recent contested proceedings for energy companies.”<sup>49</sup> Staff cannot argue that the equity ratio adopted in the Puget GRC supports its proposed ratio while also arguing that the analysis and standards used by the Commission to arrive at its result do not apply here.

21. In any event, under any legal standard, Mr. Elgin failed to demonstrate that his proposed capital structure is safe. Staff admits that its capital structure results in financial metrics for PacifiCorp that align with a “BBB” credit rating.<sup>50</sup> A credit downgrade, which is already a risk because of the Company’s stand-alone credit metrics, will harm customers in the form of increased borrowing costs and potentially limited access to debt markets. For example, Puget is rated “BBB,” and its long-term debt costs are nearly 100 basis points higher than PacifiCorp’s.<sup>51</sup>

22. Staff downplays this issue, arguing that Puget and Avista issued debt later in 2009 at lower costs than PacifiCorp.<sup>52</sup> This is an inapt comparison because market conditions changed dramatically throughout 2009. A more informative comparison is the Puget debt issuance on January 20, 2009, 15 days after PacifiCorp’s January 2009 issuance. Puget paid 6.75% for seven year debt, a spread of 480.3 basis points over the corresponding 7-year Treasury rate at the time

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<sup>48</sup> *Wash. Utils. & Transp. Comm’n v. Puget Sound Energy, Inc.*, Docket UE-060266, Order 08 ¶ 76 (Jan. 5, 2007) (The Commission will use hypothetical capital structures “when there [is] a clear and compelling reason to do so”) The Commission subsequently confirmed this standard in Puget Sound Energy’s next general rate case. See *Wash. Utils. & Transp. Comm’n v. Puget Sound Energy, Inc.*, Docket UE-090704, Order 11 ¶ 278 (April 2, 2010).

<sup>49</sup> Elgin, Exh. No. KLE-1T 16:14-15. The equity ratio in Docket UE-090704 was 46% and the equity ratio in Docket UE-060266 was 44%.

<sup>50</sup> Elgin, Exh. No. KLE-1T 15:19-20; Elgin, Exh. No. KLE-1T 16:17-19.

<sup>51</sup> Williams, Exh. No. BNW-7T 11:20-23.

<sup>52</sup> Initial Brief on Behalf of Commission Staff ¶ 206.



of their issuance.<sup>53</sup> By comparison, PacifiCorp obtained 10 year debt at 5.50% and 30 year at 6.00%, a 310 basis point spread over the corresponding Treasury rate when issued.<sup>54</sup>

PacifiCorp's single "A" rating allowed it to achieve a longer maturity at less cost to customers than Puget obtained.

23. Staff also implies that a downgrade is unlikely because PacifiCorp's equity ratio temporarily decreased to 46.5% after the January 2009 debt issuance without a downgrade.<sup>55</sup> The credit agencies did not react because this capital structure was for a single, short-lived point in time and it was clear that PacifiCorp was not permanently "re-setting" its capital structure with a 46.5% common equity level—in contrast to Staff's recommendation in this case.

**2. There is No Evidence that the Company's Actual Capital Structure is Driven by MEHC's Financial Motives.**

24. Both Staff and ICNU urge the Commission to reject the Company's actual equity ratio because of their unfounded allegation that PacifiCorp's parent company, MEHC, unnecessarily drove up the equity ratio in pursuit of profits.<sup>56</sup> This argument ignores the testimony of both Mr. Williams and Mr. Gorman explaining why the Company's equity ratio has increased.

25. Mr. Williams testified that the current equity ratio is vital to the Company because of its increasing capital expenditures<sup>57</sup> and credit rating agencies' more stringent requirements for maintenance of the Company's single "A" credit rating.<sup>58</sup> Mr. Gorman acknowledged the value to customers in the Company's current single "A" credit rating in this case,<sup>59</sup> testified before the Wyoming Commission in the fall of 2010 that an equity ratio greater than 50% would balance

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<sup>53</sup> *Re Puget Sound Energy, Inc.*, Docket UE-090004, Securities Issuance Filing (Jan. 26, 2009). The Company requests that the Commission take official notice of this document pursuant to WAC 480-07-495

<sup>54</sup> Williams, Exh. No. BNW-19.

<sup>55</sup> Initial Brief on Behalf of Commission Staff ¶ 203.

<sup>56</sup> Post-Hearing Brief on Behalf of ICNU ¶ 30; Initial Brief on Behalf of Commission Staff ¶ 164.

<sup>57</sup> Williams, Exh. No. BNW-1T 4:19-22; 5:12-17.

<sup>58</sup> Williams, Exh. No. BWN-1T 4:19-22.

<sup>59</sup> Gorman, Exh. No. MPG-25 9:8-16.

total investment risk because PacifiCorp has no power cost recovery mechanism,<sup>60</sup> and testified before the Iowa Utilities Board (also in the fall of 2010) that a single “A” rating for a utility is optimal, helps minimize the overall cost of capital and an equity ratio exceeding 50% is important to support that rating.<sup>61</sup>

26. The Company’s actual ROE during the test period was 3.15%.<sup>62</sup> Notwithstanding such returns, MEHC has infused over \$900 million of equity into PacifiCorp.<sup>63</sup> During the worst economic downturn since the 1930’s, the Company worked hard to maintain a strong credit rating which, as expressly recognized by the Commission in approving the recent Avista settlement, will result in lower long-term costs to customers.<sup>64</sup> These facts do not describe a parent company unnecessarily driving up capital costs to line its own pockets.

### 3. The Commission Should Not Impute Short-Term Debt.

27. Staff argues that the Commission should impute 3% of short-term debt because, in Mr. Elgin’s opinion, that is the level a prudent utility would have in its capital structure for a low-cost and flexible source of funds.<sup>65</sup> These arguments are unpersuasive, as none address PacifiCorp specifically or the impact that the current financial crisis has had on short-term debt markets.<sup>66</sup> Mr. Williams testified that the turmoil in the short-term debt markets has been substantial and supports the Company’s decision to maintain a capital structure with short-term debt not in excess of CWIP.

28. Staff argues that the Commission’s order in PacifiCorp’s 2005 GRC stands for the proposition that all available sources of capital should be included in the capital structure. But

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<sup>60</sup> Gorman, Exh. No. MPG-26 4:18-25.

<sup>61</sup> Gorman, Exh. No. MPG-25 9:8-16.

<sup>62</sup> Dalley, Exh. No. RBD-6T 1.0.

<sup>63</sup> Initial Brief on Behalf of Commission Staff ¶ 165.

<sup>64</sup> *Wash. Utils. & Transp. Comm'n v. Avista Corp.* Docket UE-100467, Order 07 at n.37 (Nov. 19, 2010).

<sup>65</sup> Initial Brief on Behalf of Commission Staff ¶ 168.

<sup>66</sup> Williams, TR. 279:12-25.

that order held that the Company's *actual* capitalization, which included short-term debt, should be used.<sup>67</sup> Here the actual capitalization does not include short-term debt.

29. Staff also argues that because capital is fungible, even if short-term debt is used exclusively to fund CWIP, it should nonetheless be included in the capital structure.<sup>68</sup> However, this argument fails if CWIP consistently exceeds the balance of short-term debt. Otherwise, it is unreasonable to assume that the Company is using short-term debt to finance long-term assets. Construction projects are not included in rate base and therefore to the extent that short-term debt funds these projects (and is funding CWIP), it should not be included in the capital structure used to finance rate base (because it is not financing rate base).<sup>69</sup>

### **C. Credit Metrics Under Staff's and ICNU's Cost of Capital Proposals.**

#### **1. ICNU Fails to Support its Contention that Its Recommendations Are Safe.**

30. ICNU argues that adoption of its cost of capital proposals will not result in a downgrade because Mr. Gorman performed an analysis based upon "S&P's own credit rating metrics" to determine that his proposal is adequate to maintain the current credit rating.<sup>70</sup> But ICNU omits key facts: (1) Mr. Gorman's analysis did not account for S&P's PacifiCorp-specific metrics<sup>71</sup> and he admitted at hearing that his analysis did not "duplicate Standard & Poor's methodology;"<sup>72</sup> (2) Mr. Gorman's analysis removed approximately one-half, or \$500 million, of off-balance sheet

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<sup>67</sup> *Wash. Utils. & Transp. Comm'n v. PacifiCorp*, Docket UE-050684, Order 04 ¶ 224 (Apr. 17, 2006) ("Public Counsel's recommended 3 percent share for short-term debt is consistent with the Company's recent capitalization.").

<sup>68</sup> Initial Brief on Behalf of Commission Staff ¶ 172.

<sup>69</sup> Williams, Exh. No. BNW-7T 7:19-8:5.

<sup>70</sup> Post-Hearing Brief on Behalf of ICNU ¶ 33.

<sup>71</sup> Williams, Exh. No. BNW-7T 22:2-13.

<sup>72</sup> Gorman, TR. 462:15-21.

debt that S&P imputes when determining the Company's credit metrics;<sup>73</sup> and (3) Mr. Gorman acknowledges that his proposed debt ratio "might deteriorate [PacifiCorp's] credit rating."<sup>74</sup>

## **2. Staff's Safety Analysis is Flawed.**

31. Staff argues that it was the only party to provide a "measurable test of its proposed 46.5 percent equity ratio for safety and economy."<sup>75</sup> That "measurable test" is Mr. Elgin's pretax interest coverage ratio, a metric that has not been used by ratings agencies for over 10 years.<sup>76</sup> This analysis demonstrated that Mr. Elgin's capital structure would not be safe if the Company's earnings in the future fall even a few percentage points below its authorized ROE.<sup>77</sup>

## **II. REVENUE ADJUSTMENTS**

### **A. Public Counsel/ICNU Provide No Basis for Rejecting Temperature Normalization for the Residential Class.**

32. Public Counsel/ICNU claim that Mr. Meyer's proposed five-year average "is a more accurate reflection of likely residential usage during the rate effective period."<sup>78</sup> Without explanation, Public Counsel/ICNU reject the concept of temperature normalization entirely—a position directly at odds with their position in PacifiCorp's last general rate case (2009 GRC) that normalizing loads based on temperature is appropriate<sup>79</sup> and one that neither Public Counsel nor ICNU has advocated in the past. Unlike Public Counsel/ICNU, Staff evaluated the Company's methodology and found it "to be appropriate for purposes of Residential class temperature normalization."<sup>80</sup> Additionally, under Public Counsel/ICNU's five-year average in

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<sup>73</sup> Gorman, TR. 463:3-7.

<sup>74</sup> Gorman Exh. No. MPG-1T 40:20-41:2.

<sup>75</sup> Initial Brief on Behalf of Commission Staff ¶ 157.

<sup>76</sup> Williams, Exh. No. BNW-7T 13:9-21; Elgin, Exh. No. KLE-5: 17.

<sup>77</sup> Elgin, Exh. No. KLE-1T 17:21-18:4; Elgin, KLE-4 12-13; Elgin, TR. 715:12-20.

<sup>78</sup> Post-Hearing Brief of Public Counsel ¶ 56.

<sup>79</sup> See *Wash. Utils. & Transp. Comm'n v. PacifiCorp*, Docket UE-090205 Order 09, Stipulation ¶ 19 (Dec. 16, 2009).

<sup>80</sup> Initial Brief on Behalf of Commission Staff ¶ 20.

usage, aberrant weather conditions in one year would wield significant influence on the revenues included in rates.

**B. Staff's Proposal to Remove Temperature Normalization of Commercial Class Reduces the Accuracy of the Forecast.**

33. The Company objected to Staff's adjustment to remove temperature normalization of the commercial class on the basis that it would reduce the accuracy of the load forecast. Staff incorrectly claims that this argument is circular.<sup>81</sup> Staff's entire argument rests on Staff's belief that the R-squared is too low. If removing the adjustment entirely would not explain the variation in loads at all, but applying the Company's adjustment would explain 64.4% of the variation, it is clear that the Company's methodology would produce a more accurate forecast than Staff's. While the parties may be able to develop modifications to the methodology in the future to further increase accuracy, the Company's proposal is a reasonable interim approach and is superior to the elimination of temperature normalization for the commercial class.

**C. The Parties' REC Revenue Proposals Should Be Rejected Because the Company has Already Reflected a Reasonable Level of REC Revenue in its Revenue Requirement.**

34. Staff agrees with the Company's proposed adjustment of \$4.8 million for 2009 REC revenues, but proposes to also establish a regulatory liability account in which REC revenues accruals from January 1, 2010 forward will be booked.<sup>82</sup> Public Counsel did not sponsor a witness on REC revenues, but now states that it supports Staff's alternative recommendation of crediting customers for actual 2009 REC revenues over one year and establishing a regulatory liability account to track actual revenues from January 2010 forward.<sup>83</sup>

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<sup>81</sup> *Id.* ¶ 12.

<sup>82</sup> Initial Brief on Behalf of Commission Staff ¶¶ 24-25.

<sup>83</sup> Post-Hearing Brief of Public Counsel ¶ 57.

35. In its brief, ICNU changes course and now proposes a \$10 million adjustment to account for REC revenues, as opposed to the \$4.9 million it proposed in its testimony.<sup>84</sup> ICNU had the opportunity to propose a \$10 million adjustment in both its responsive testimony and its cross-answering testimony and did not do so.<sup>85</sup> By proposing the \$10 million adjustment for the first time in brief, ICNU deprived the Company of the opportunity to respond in rebuttal or cross-examine Mr. Falkenberg on this proposal. ICNU's new adjustment should be rejected on this basis.

**1. The Parties' REC Revenue Proposals Should Be Rejected Because They Constitute Retroactive Ratemaking and No Exception to the Rule Against Retroactive Ratemaking Applies.**

36. Staff claims that its proposal to book revenues prior to the Commission's order in this proceeding is not retroactive ratemaking because "[t]his is not a case where a party seeks regulatory treatment of costs incurred prior to a test period."<sup>86</sup> But retroactive ratemaking more generally bars "the *current* collection, through rates, of *past* obligations."<sup>87</sup> Staff's regulatory liability account proposal would result in the Company reflecting in future rates actual revenues that occurred in the past. This is fundamentally different from using past revenues to predict or forecast future revenues.

37. Staff states that "no party to this case is required to file an accounting petition if it finds an extraordinary item on PacifiCorp's books."<sup>88</sup> In this case, however, an accounting petition was necessary to avoid implicating the rule against retroactive ratemaking. The fact that the parties to the 2009 GRC stipulation reserved the right to file for deferred accounting relating to REC revenues indicates that the parties understood that deferred accounting would be required to

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<sup>84</sup> Falkenberg, Exh. No. RJF-1CT 63:14-15; Post-Hearing Brief on Behalf of ICNU ¶ 34.

<sup>85</sup> Falkenberg, Exh. No. RJF-1CT 61:19-64:16; Exh. No. RJF-8CT 5:4-7:8.

<sup>86</sup> Initial Brief on Behalf of Commission Staff ¶ 32.

<sup>87</sup> *Wash. Utils. & Transp. Comm'n v. Avista Corp.*, Docket UE-080416, Order 08 ¶ 78 (Dec. 29, 2008) (emphasis in original).

<sup>88</sup> Initial Brief on Behalf of Commission Staff ¶ 33.

recover 2010 REC revenues in excess of the stipulated revenues included in base rates.<sup>89</sup> The Commission has previously found that it cannot retroactively create an accounting order to recognize “a deferral that was neither authorized nor recorded, and impose that deferral now to make up for [the utility] not collecting [the deferral] in the past.”<sup>90</sup> That is exactly what Staff, Public Counsel, and ICNU propose the Commission do in this case. The Company requests that the Commission similarly find that retroactively creating a deferral would be “improper and illegal.”<sup>91</sup>

38. Both Staff and Public Counsel contend that parties can request an after-the-fact deferral of expenses or revenues for the period between the end of the test year and the beginning of the rate year.<sup>92</sup> This position proposes a major change to Washington’s current ratemaking framework. Currently, parties propose known and measurable adjustments to the test year to reflect costs and revenues expected to occur during the rate effective period.<sup>93</sup> This is the basis for the \$4.8 million base rate REC revenue adjustment accepted by the Company. There is no authority or ratemaking policy that supports combining such a base rate adjustment with actual revenues or costs tracked in the interim period between the historic base period and the rate effective period, especially if the revenues or costs are being tracked retroactively without a deferral. The Company requests that if the Commission allows this approach, it define the new policy in a clear manner and specify that it may apply to both costs incurred and revenues received during the interim period.

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<sup>89</sup> *Wash. Utils. & Transp. Comm’n v. PacifiCorp*, Docket UE-090205 Order 09, Stipulation ¶ 22 (Dec. 16, 2009).

<sup>90</sup> *Wash. Utils. & Transp. Comm’n v. Olympic Pipe Line Co.*, Docket TO-011472, 20<sup>th</sup> Supp. Order ¶ 119 (Sept. 27, 2002).

<sup>91</sup> *Id.* ¶ 120.

<sup>92</sup> Initial Brief on Behalf of Commission Staff ¶ 32.

<sup>93</sup> WAC 480-07-510(3)(e).

39. Staff and Public Counsel rely upon a 1999 Avista rate case order as support for their position on retroactive ratemaking. That case does not reference or involve retroactive ratemaking at all.<sup>94</sup> The relevant issue in that case, the assignment of a contract, took place in the test year. The Commission found that “a pro forma adjustment to Avista’s 1998 results of operations should be made to reflect the new PGE contract terms.”<sup>95</sup> What occurred in the Avista case was a known and measurable adjustment to test year results to calculate a base rate adjustment. That case did not involve what Staff and Public Counsel are proposing here: a retroactive tracking of actual costs without a deferral, on top of a base rate adjustment.

40. Staff claims the fact that the parties agreed to shorten the amortization period for SO2 allowances in this case without the necessity of an accounting petition indicates that Staff’s REC revenue proposal is proper without a deferral.<sup>96</sup> As Staff notes, the Commission entered an accounting order that required the Company to record gains of SO2 sales to be amortized in rates.<sup>97</sup> That case has no bearing on this one, where no party filed for an accounting order relating to REC revenues.

41. Public Counsel cites a number of court cases in other jurisdictions that purportedly support Public Counsel’s argument that it is not retroactive ratemaking to include in future rates past revenues to account for higher-than-forecast revenues.<sup>98</sup> None of those cases support Public Counsel’s argument. The cases find that retroactive ratemaking did not occur because the ratemaking action in question was due to a legislative mandate that required the utility share a tax credit with customers,<sup>99</sup> a refund of a capital investment,<sup>100</sup> related to an unexpected windfall

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<sup>94</sup> *Wash. Utils. & Transp. Comm’n v. Avista Corp*, Docket No. UE-991606, 3<sup>rd</sup> Supp. Order at 19-28 (Sept. 29, 2009).

<sup>95</sup> *Id.*

<sup>96</sup> Initial Brief on Behalf of Commission Staff ¶ 34.

<sup>97</sup> *Re Petition of PacifiCorp Seeking an Accounting Order*, Docket UE-940947, Order (Sept. 14, 1994).

<sup>98</sup> Post-Hearing Brief of Public Counsel ¶ 69.

<sup>99</sup> *S. Union Gas Co. v. RR Comm’n*, 701 S.W.2d 277, 280 (Tex. Ct. App. 1985).



and not an inaccuracy in past ratemaking,<sup>101</sup> related to the proper accounting of gains on the reacquisition of long-term debt,<sup>102</sup> a change in depreciation rates,<sup>103</sup> or returned excessive fuel costs that were due to an illegal scheme.<sup>104</sup> None of these cases held that it is not retroactive ratemaking to credit customers for revenues that were higher than forecast. Moreover, Public Counsel cites no precedent—in Washington or otherwise—supporting its argument that the rule against retroactive ratemaking is a one-way street that only bars a utility from recovering excess costs.<sup>105</sup> In fact, the Commission has noted that retroactive ratemaking may be implicated both when excess costs incurred or costs avoided are applied in rates prospectively.<sup>106</sup>

42. Public Counsel's argument that it could not have taken action because it had no knowledge of REC revenues is wrong. In its brief, Public Counsel claims that the Company's results of operations reports do not clearly identify REC revenues.<sup>107</sup> Public Counsel's footnote 174 incorrectly refers to the quarterly reports filed with the Commission, not the annual Commission Basis Report to which Mr. Duvall referred at hearing.<sup>108</sup> The Company filed its 2009 Commission Basis Report on April 30, 2009. Page 3.5 of the report clearly identifies total-Company, east and west control area, and Washington-allocated REC revenues.<sup>109</sup> Given that even by its own determination Public Counsel has been aware of recent levels of REC revenues for many months and never filed for a deferral, its arguments regarding the timing of its knowledge of REC revenues are irrelevant.

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<sup>100</sup> *Chesapeake & Potomac Tel. Co. v. Pub. Serv. Comm'n of D.C.*, 514 A.2d 1159, 1170 (DC 1989).

<sup>101</sup> *Turpen v. Okla. Corp. Comm'n*, 769 P.2d 1309, 1332 (Okla. 1988); *Pike Ct. Power Co. v. Penn. Pub. Utils. Comm'n*, 487 A.2d 118, 456 (Penn. 1985)

<sup>102</sup> *Wash. Gas Light Co. v. Pub. Serv. Comm'n*, 450 A.2d 1187, 1215 (DC 1982).

<sup>103</sup> *Citizens of the State of Fla. v. Fla. Pub. Serv. Comm'n*, 415 So.2d 1268, 1270 (Fla. 1982).

<sup>104</sup> *Richter v. Fla. Power Corp.*, 366 So.2d 798, 800 (Fla. App. 1979).

<sup>105</sup> Post-Hearing Brief of Public Counsel ¶ 71.

<sup>106</sup> *Re Petition of PacifiCorp for an Accounting Order Authorizing Deferral of Excess Net Power Costs*, Docket No. UE-020417, 3<sup>rd</sup> Supp. Order ¶ 23 (Sept. 27, 2002).

<sup>107</sup> Post-Hearing Brief of Public Counsel ¶ 70.

<sup>108</sup> Duvall, TR. 351:10-16.

<sup>109</sup> *Re. PacifiCorp*, Docket No. UE-100712, Commission Basis Report at Page 3.5 (Apr. 30, 2010).

43. Finally, ICNU's proposal to include in rates a level of REC revenues equal to those that occurred in 2010 is a backdoor attempt at retroactive ratemaking. The test period in this case is 2009 and the rate effective period begins on April 3, 2011. ICNU's proposal claims to represent REC revenues for 2010, which are neither relevant to the test period nor the rate effective period. The only basis for including the level of 2010 REC revenues in rates would be to reach back to 2010 and capture those actual revenues—a clear violation of the doctrine against retroactive ratemaking.

44. Indeed, Mr. Falkenberg's cross-answering testimony indicates that ICNU understands that under the Commission's ratemaking policies, 2010 REC revenues cannot be included in rates as ICNU now proposes. Mr. Falkenberg testified that Staff's approach of reflecting the 2009 actual REC revenues in the test year "does not account for [2010 REC revenues] *that may not be passed back to ratepayers, especially if PacifiCorp does not file a new general rate case using a 2010 test period.*"<sup>110</sup> Mr. Falkenberg similarly observed that an advantage of Staff's approach is that it would allow customers to obtain the benefits of 2010 REC revenues through the use of a 2010 base period in a future rate case.<sup>111</sup> ICNU's new proposal to include actual 2010 REC revenues in rates is directly at odds with this testimony.

**2. The Parties Present No Basis for Treating REC Revenues Different from NPC in Violation of the Matching Principle.**

45. The parties' arguments in favor of accounting for actual REC revenues in rates all suffer from the flaw of failing to match the treatment of REC revenues to the treatment of net power costs (NPC). No party to this proceeding disputes that the Commission adheres to the matching principle, under which "revenues and costs are balanced at a common point in time, i.e., a rate

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<sup>110</sup> Falkenberg, Exh. No. RJF-8CT 5:16-19 (emphasis added).

<sup>111</sup> Falkenberg, Exh. No. RJF-8CT 5:11-14.

case, to determine fair, just, reasonable and sufficient rates.”<sup>112</sup> Public Counsel itself has argued that “REC revenues are directly related to the proper analysis of power costs . . . . Joint Movants do not explain why it is appropriate to update PSE power costs as was done in the most recent supplemental filing, without updating related revenues.”<sup>113</sup> Similarly, the parties in this case have not explained why it is appropriate to retroactively account for REC revenues but not do so for the NPC associated with generating those revenues. The Commission should disregard Public Counsel’s assertions that its proposed treatment of REC revenues does not implicate concerns regarding the matching of NPC, as Public Counsel’s current position is directly at odds with its prior statements on the issue.

46. Staff attempts to draw a comparison between the costs of Chehalis and RECs,<sup>114</sup> but the comparison ignores the fact that there are no legal prohibitions on the Company related to the over-allocation of Chehalis costs. There are, however, legal prohibitions that preclude the Company from over-allocating RECs. RECs can only be used once, for a single state.<sup>115</sup> Due to the inconsistent inter-jurisdictional allocation methods, the Company does not have actual RECs to sell on Washington customers’ behalf. This raises the same issues that were raised in opposition to the Company’s power cost adjustment proposal—if there are no actual sales that are recorded in the Company’s FERC accounts, what amount should be booked to a regulatory liability account? A regulatory liability account cannot reflect actual REC sales for Washington customers, just like a power cost adjustment mechanism cannot reflect actual west control area NPC as allocated to Washington. Some type of “pseudo” actual accounting is required.

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<sup>112</sup> *Re. Petition of Avista Corp. for an Order Authorizing Implementation of a Natural Gas Decoupling Mechanism and to Record Accounting Entries Associated With the Mechanism*, Docket UG-060518, Order 4 ¶ 19 (Feb. 1, 2007).

<sup>113</sup> *Wash. Utils. & Transp. Comm’n v. Puget Sound Energy, Inc.*, Docket UE-090704, Order 10 ¶ 7 (Jan. 8, 2010) (quoting Public Counsel’s Motion to Strike).

<sup>114</sup> Initial Brief on Behalf of Commission Staff ¶ 28.

<sup>115</sup> Duvall, TR. 299:14-20.

**3. Public Counsel's and ICNU's Adjustments are Based on Incorrect Calculations.**

47. Public Counsel and ICNU propose REC revenue adjustments based on incorrect calculations. Public Counsel claims that the Company received \$21.7 million in Washington-allocated REC revenues in 2010.<sup>116</sup> Public Counsel appears to have erroneously calculated this figure by applying Washington's west control area factor percentage to total Company REC revenues, which include REC revenues from the Company's generating facilities located outside of the west control area—revenues to which Washington customers are not entitled.<sup>117</sup> Mr. Duvall testified that for the first five months of 2010, the Company received \$3.47 million in REC revenue on a Washington basis, which on an annual basis would equal approximately \$8.3 million.<sup>118</sup> Moreover, this amount does not reflect the retirement of RECs for purposes of meeting the Washington RPS, a requirement applicable to the 2011 rate effective period.<sup>119</sup>

48. ICNU claims that its adjustment of \$10 million is intended to reflect REC revenues “actually earn[ed]” by the Company in 2010.<sup>120</sup> ICNU's figure was calculated incorrectly based on December 2009 through May 2010 data and should be disregarded.<sup>121</sup> ICNU's calculation also does not reflect the need to retire RECs during the rate effective period under the Washington RPS.

**4. Staff's Approach Will Result in Double-Counting REC Revenues.**

49. Staff claims that PacifiCorp's concern about double-counting REC revenues is “premature.”<sup>122</sup> As presented, Staff's proposal will certainly result in a double count of REC revenues, because there is no offset for the amount of REC revenues that will be included in base

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<sup>116</sup> Post-Hearing Brief of Public Counsel ¶ 61, Table 1.

<sup>117</sup> *Id.* n.155.

<sup>118</sup> Duvall, TR. 302:7-17. Calculated by annualizing five months of revenue of \$3.47 million.

<sup>119</sup> *See* Duvall, TR. 299:5-10.

<sup>120</sup> Post-Hearing Brief on Behalf of ICNU ¶ 37.

<sup>121</sup> Duvall, TR. 303:3-10.

<sup>122</sup> Initial Brief on Behalf of Commission Staff ¶ 26.

rates. Moreover, such an offset would need to be calculated based on REC revenues reflected in base rates beginning in the rate effective period, or the \$4.8 million proposed by the Company. Calculating the offset based on the level of REC revenues included in past rates would violate the rule against retroactive ratemaking.

**5. Public Counsel's and ICNU's Claim that the Company Should Have Included REC Revenues in the Initial Filing is Unreasonable and Irrelevant.**

50. Public Counsel claims that the Company should have reflected REC revenues in its initial case because PacifiCorp knew that legislative changes to Washington's RPS that would allow longer-term banking would not occur prior to the filing.<sup>123</sup> As Mr. Duvall testified, the Company's actual practice has been to bank all Washington-allocated RECs.<sup>124</sup> Public Counsel correctly notes that the Company filed this case less than a month after the end of the April 12, 2010 Special Session.<sup>125</sup> Given that the Company's practice is to bank all Washington-allocated RECs, the rapidity of changes in the area of RECs, and the lead time required to prepare a general rate case, Public Counsel's and ICNU's position that the Company should have changed its policy on banking RECs in the initial filing is unreasonable and irrelevant.

**V. NET POWER COST ISSUES**

**A. Staff's and ICNU's Adjustments for Arbitrage Sales Margins are Unnecessary.**

51. ICNU relies heavily on the Oregon Commission's order adjusting NPC to include arbitrage margins for support of its adjustment.<sup>126</sup> ICNU's reliance is misplaced, because the Oregon adjustment also includes short-term trading revenues.<sup>127</sup> Staff and ICNU have provided no basis for distinguishing between arbitrage margins and short-term trading margins. Using the most recent annual data (instead of four years of historic data) and including short-term trading

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<sup>123</sup> Post-Hearing Brief of Public Counsel ¶ 62.

<sup>124</sup> Duvall, TR. 298:15-23.

<sup>125</sup> Post-Hearing Brief of Public Counsel ¶ 62.

<sup>126</sup> Post-Hearing Brief on Behalf of ICNU ¶ 61.

<sup>127</sup> PacifiCorp's Initial Brief ¶ 70.

margins effectively zeros out this adjustment, demonstrating that it is unwarranted. The Company requests that the Commission reject this adjustment as it did a similar adjustment for short-term margins in the Company's 2006 GRC.

**B. Staff's and ICNU's Changes to the WCA are Unsupported and Inappropriate.**

52. ICNU claims that the current WCA methodology is inequitable, and that ICNU has proposed changes to make it more equitable.<sup>128</sup> ICNU claims that the WCA methodology is inequitable because there is evidence of cost shifting from Utah to Washington, citing the average industrial rates in each state.<sup>129</sup> ICNU's claim ignores the differences in service characteristics of industrial customers in Washington and Utah that are important drivers of average price differences between the two groups. Exhibit WRG-19, referenced by ICNU in support of its claim, states that:

Industrial rate differences are influenced by the composition of customer differences in levels of service (distribution delivery and transmission delivery) across the states. Customers receiving service at transmission voltage are charged lower rates because they have purchased their own substations and therefore do not receive service from the Company's distribution system.<sup>130</sup>

53. Exhibit WRG-19 shows that none of Washington's industrial customers are served at transmission voltage. All Washington industrial customers receive service from the Company's distribution system and appropriately pay the costs of the distribution system in their rates. In Utah, 76.3% of Utah's industrial MWh sales are provided to transmission voltage customers.<sup>131</sup> This means that over three quarters of Utah's industrial load does not receive service from the distribution system, and those customers do not pay costs of the distribution system in their rates.

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<sup>128</sup> Post-Hearing Brief on Behalf of ICNU ¶ 38-39.

<sup>129</sup> Post-Hearing Brief on Behalf of ICNU ¶ 39.

<sup>130</sup> Griffith, Exh. No. WRG-19 1.

<sup>131</sup> *Id.*

Accordingly, Utah industrial rates are lower. ICNU has therefore provided no credible evidence that the WCA methodology is inequitable and requires modification.

54. ICNU claims that “this is the first fully litigated proceeding in which the Company’s actual implementation of the WCA is being reviewed.”<sup>132</sup> This is not correct. The parties and the Commission thoroughly evaluated the Company’s actual implementation of the WCA in the 2006 GRC, including the issues that ICNU is attempting to re-litigate in this case. ICNU claims that “[t]he manner in which PacifiCorp has implemented the WCA does not pass on to Washington customers the full benefits of system operations.”<sup>133</sup> The evidence shows that the Company has implemented the WCA in the same manner ordered by the Commission in the 2006 GRC. ICNU’s proposed adjustments are unsupported and inappropriate outside of a larger WCA evaluation.<sup>134</sup>

55. With respect to the Idaho Point-to-Point transmission contract, Staff claims that the Company has not offered quantification of the benefits the contract provides to the east control area, so the contract should be split evenly.<sup>135</sup> But the quantification of these benefits was litigated in 2006 and the Commission found them to be speculative.<sup>136</sup> Neither ICNU nor Staff has presented new evidence that would justify a change in position on this issue.

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<sup>132</sup> Post-Hearing Brief of PacifiCorp ¶ 40.

<sup>133</sup> Post-Hearing Brief on Behalf of ICNU ¶ 51.

<sup>134</sup> In paragraph 51, ICNU proposes that the Commission accept an alternative additional adjustment to assign 100% of the volume of eastern sales to the west. This was not included in Mr. Falkenberg’s table of adjustments and should be rejected as a new proposal unsupported by the record. In any event, the assignment of 100% of the volume is arbitrary. The percentages now used for the sale are those used in Staff’s 2006 GRC testimony adopted by the Commission as defining the WCA eastern sale implementation.

<sup>135</sup> Initial Brief on Behalf of Commission Staff ¶ 84.

<sup>136</sup> *Wash. Utils. & Transp. Comm’n v. PacifiCorp*, Docket UE-061546, Order 08 ¶ 54 (June 21, 2007)

**C. The DC Intertie Agreement Provides Value to Customers and Will be Used in the Test Year.**

56. Both Staff and ICNU question the value of the DC Intertie agreement on the apparent basis that it does not provide enough revenue to justify the cost.<sup>137</sup> Staff and ICNU appear to have lost sight of the fact that the central benefit of NPC is to serve load. The value of a transmission resource cannot be evaluated exclusively on the amount of revenue it generates through energy purchases.

57. Staff alleges that the Company “recently chose to extend 200MW of DC Intertie rights.”<sup>138</sup> Mr. Duvall did not testify that the Company made a decision to retain the rights to the DC Intertie agreement in 2002.<sup>139</sup> The Company had a right to, and did, terminate the Winter Power Sales Agreement with Southern California Edison in 2002, but the DC Intertie rights did not expire at that time.

58. Contrary to ICNU’s incorrect statement, the Company provided evidence that the contract *is* likely to be used in the test period, even if GRID does not model purchases using the contract.<sup>140</sup> The Company has demonstrated that this agreement provides benefits to customers and Staff and ICNU have provided no substantial evidence warranting disallowance of the contract.

**D. The Company’s OATT Wind Integration Costs are Reasonable and Required Under the Company’s OATT.**

59. Staff attempts to widen the scope of its wind integration adjustment by arguing that if the Commission does not accept Staff’s OATT adjustments, it should accept Staff’s proposed disallowance on the basis of the reliability of the Company’s wind integration data.<sup>141</sup> Staff,

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<sup>137</sup> Initial Brief on Behalf of Commission Staff ¶ 87; Post-Hearing Brief on Behalf of ICNU ¶ 94.

<sup>138</sup> Initial Brief of Commission Staff ¶ 89.

<sup>139</sup> Duvall, GND-5T 41:4-16.

<sup>140</sup> PacifiCorp’s Initial Post-Hearing Brief ¶ 79.

<sup>141</sup> Initial Brief of Commission Staff ¶ 97.



however, rejected such an adjustment in testimony. In his testimony, Mr. Buckley outlined three alternative adjustments to wind integration costs based on his concerns with the reliability of wind integration data.<sup>142</sup> When asked whether he recommended any of these alternatives, he stated “No.”<sup>143</sup> The only wind integration adjustment proposed by Staff that is now before the Commission is the adjustment related to intra-hour, non-owned wind projects. Staff’s proposal to expand the scope of its proposed adjustment at this stage of the proceeding is improper, as the Company was unable to respond to an adjustment on the basis asserted by Staff in rebuttal testimony or cross-examine Mr. Buckley on such an adjustment at hearing.

60. Staff asserts that if the Company is able to charge wholesale customers for wind integration costs in the future, it would be “double recovering,” because the Company will already be collecting these costs from retail customers.<sup>144</sup> Staff is incorrect—any charges collected from third party wholesale customers for wind integration costs would be credited back to retail jurisdictions as an offset to retail rates precisely to avoid any double recovery issues.

61. ICNU argues that PacifiCorp’s “only excuse” for not seeking a FERC-approved wind integration charge is that FERC has provided little regulatory guidance on the issue. ICNU ignores the impact of the recent NOPR on wind integration, which effectively imposes a moratorium on new OATT filings on this issue, pending additional FERC guidance. Combined with the rejection of other utilities’ requests to implement a wind integration charge and the interim nature of the one wind integration charge that FERC did approve, the NOPR indicates that the Company could not have reasonably been expected to have received approval to implement a wind integration charge.

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<sup>142</sup> Buckley, Exh. No. APB-1CT 23:4-18.

<sup>143</sup> Buckley, Exh. No. APB-1CT 23:20-21.

<sup>144</sup> Initial Brief of Commission Staff ¶ 95.

62. ICNU's footnote 208 states that the Company accepted ICNU's Adjustment 11 to model wind integration costs in GRID.<sup>145</sup> To clarify, the Company agreed to reflect the cost of modeling wind integration costs in GRID, as calculated by ICNU, but proposed to model intra-hour wind integration in GRID in future proceedings where all parties would have the opportunity to evaluate modeling proposals.<sup>146</sup>

**E. ICNU's Planned Outage Schedule is Unreasonable.**

63. ICNU claims that in its proposal, Hermiston will experience an outage in 2011, but would have the outage start before the beginning of the test period.<sup>147</sup> This proposal is inconsistent with ICNU's purported goal of scheduling planned outages during a more economic period of time, because the period before April 2011 would be less economic for Hermiston maintenance than what the Company has scheduled for in spring of 2011.<sup>148</sup> ICNU's proposal is unreasonable and fails to reflect an appropriate planned outage length in the test period.

**F. Deoptimizing SMUD Would Be Inconsistent with the Broader Optimization Methodology that Reduces NPC.**

64. Staff argues that the Company should deoptimize the SMUD contract because "[t]he Company should use all available information to carry out modeling," and because "[i]f a particular contract has a definable shape . . . that information should be used."<sup>149</sup> But Staff has not advocated deoptimizing other contracts. Overall, optimizing the Company's system operations decreases NPC.<sup>150</sup> The Company requests that the Commission reject ICNU's and Staff's proposal to single out for deoptimization one contract while accepting the overall reduction to NPC provided by optimization.

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<sup>145</sup> Post-Hearing Brief on Behalf of ICNU n.208.

<sup>146</sup> Duvall, Exh. No. GND-5T 28:11-23.

<sup>147</sup> Post-Hearing Brief on Behalf of ICNU ¶ 76.

<sup>148</sup> Duvall, Exh. No. GND-5t:8-11.

<sup>149</sup> Initial Brief of Commission Staff ¶ 75.

<sup>150</sup> Duvall, GND-5T 36:21-22..

65. ICNU also claims that if the modeling of the SMUD contract is based on actual historic deliveries the Commission should ignore energy under the provisional clause of the contract on the basis that the Company has never sought to recover this part of the contract or demonstrated its prudence.<sup>151</sup> ICNU's argument is beside the point. If actual historic information should be used to model the SMUD contract, *all* available actual information should be used, not just selective information that reduces NPC.<sup>152</sup>

**G. ICNU's Minimum Loading and Deration Methodology is Not the Industry Standard.**

66. ICNU falsely claims that its proposal for modeling thermal units' minimum capacities and heat rates is standard industry practice.<sup>153</sup> Mr. Falkenberg cites only one other regional utility that currently uses the approach.<sup>154</sup>

**H. Non-Firm Transmission Should be Modeled in the Same Manner as Short-Term Firm Transmission.**

67. ICNU disagrees with the Company's modeling of non-firm transmission using a four-year average to compute the non-firm transmission capacity and the most recent year to compute costs.<sup>155</sup> This is the method used by the Company to model short-term firm transmission,<sup>156</sup> ICNU does not object to the Company's modeling in that context. ICNU has not explained why non-firm and short-term firm transmission should be modeled differently.

68. ICNU claims that its proposal is consistent with how the Company models non-firm transmission in both Utah and Oregon.<sup>157</sup> In fact, the Company's current filing in Utah is proposing to change the modeling of non-firm transmission to match the Company's proposal in

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<sup>151</sup> Post-Hearing Brief on Behalf of ICNU ¶ 66.

<sup>152</sup> See Duvall, Exh. No. GND 39:5-40:3.

<sup>153</sup> Post-Hearing Brief on Behalf of ICNU ¶ 77.

<sup>154</sup> Falkenberg, Exh. No. RFJ-1CT 55:1-15.

<sup>155</sup> Post-Hearing Brief on Behalf of ICNU ¶ 69.

<sup>156</sup> Duvall, Exh. No. GND-5T 27:6-18.

<sup>157</sup> Post-Hearing Brief on Behalf of ICNU ¶ 69.

this case because the Company has determined that how it purchases and uses short-term firm and non-firm transmission is the same.<sup>158</sup>

69. ICNU inaccurately characterizes the Company's incentive for entering into non-firm transmission as economic.<sup>159</sup> In fact, the data response quoted by ICNU for support on this point stated "the primary reason [the Company] should enter into non-firm transmission purchases is to serve load. The Company does attempt to serve load on firm transmission when possible, but firm transmission is not always available."<sup>160</sup> Therefore, ICNU's claim that non-firm transmission should necessarily decrease NPC is not accurate.

70. Staff rejects both the Company's and ICNU's proposed adjustments on the basis that the issues require further investigation.<sup>161</sup> While the Company believes it has correctly modeled short-term firm and non-firm transmission, Staff's approach is superior to ICNU's inconsistent modeling of short-term and non-term firm transmission.

**I. ICNU's New O&M Start Up Cost Adjustment is Unsupported.**

71. Although ICNU admits that the Company did not include incremental O&M start up costs in its filing, ICNU now proposes to adjust the screening methodology to exclude start-up O&M costs.<sup>162</sup> ICNU states that "[n]onexistent start up O&M costs should not be considered in the screens."<sup>163</sup> As Mr. Duvall explained in his testimony, ICNU did not explain its adjustment in Mr. Falkenberg's testimony,<sup>164</sup> and ICNU's brief sheds no light on the nature of the adjustment or its proper quantification. ICNU's adjustment unreasonably implies the Company

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<sup>158</sup> *Re Application of Rocky Mountain Power for Authority to Increase its Retail Electric Utility Service Rates in Utah*, Docket No. 10-35-124, Direct Testimony of Gregory N. Duvall at 18 (Utah PSC Jan. 24, 2011). The Company requests that the Commission take official notice of this document pursuant to WAC 480-07-495.

<sup>159</sup> Post-Hearing Brief on Behalf of ICNU ¶ 69.

<sup>160</sup> Duvall, Exh. No. GND-44 1.

<sup>161</sup> Initial Brief on Behalf of Commission Staff ¶ 101.

<sup>162</sup> Post-Hearing Brief on Behalf of ICNU ¶ 96.

<sup>163</sup> *Id.* ¶ 96.

<sup>164</sup> Duvall, Exh. No. GND-5T 56:3-6.

should not take into consideration the effect of wear and tear that each start-up contributes to the unit when making the decision to start a unit up. Because ICNU has not articulated the basis for its adjustment or provided coherent support for it, the Company requests that the Commission reject the adjustment.

#### IV. TAX ISSUES

##### A. Customers Will Benefit From Full Normalization.

72. Staff objects to the Company's proposal for full normalization on the basis that the Company has not demonstrated how customers would benefit from the change.<sup>165</sup> But Staff has previously acknowledged multiple benefits associated with full normalization, including upholding the matching principle,<sup>166</sup> avoiding fluctuations in taxes reflected in cost of service for ratemaking purposes,<sup>167</sup> and avoiding the loss of tax benefits that are out of period.<sup>168</sup> The repairs deduction illustrates the benefits of normalization as compared to flow-through accounting. If PacifiCorp had not sought fully normalized accounting, the repairs deduction would have been subject to flow-through accounting, at a cost to customers of \$25.3 million in tax benefits.<sup>169</sup>

73. Throughout the course of this case, another major benefit of a change to full normalization has become clear: full normalization will eliminate the significant confusion and ambiguity that now exists with respect to the Commission's policy for the regulatory treatment of the Company's income taxes.<sup>170</sup> Ambiguity was first created in response to the Company's

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<sup>165</sup> Initial Brief on Behalf of Commission Staff ¶ 123.

<sup>166</sup> Breda, Exh. No. KHB-1T 4: 18-22.

<sup>167</sup> Breda, Exh. No. KHB-1T 24: 17

<sup>168</sup> Breda, Exh. No. KHB-1T 7: 3-6.

<sup>169</sup> Fuller, Exh. No. RF-8T 12: 5-13.

<sup>170</sup> See e.g., Breda, Exh. No. KHB-1T 8:8-14; Fuller, Exh. No. RF-9 ("it is difficult to discern what specific accounting treatment is implied without examining the underlying record in the docket"), Breda, TR. 752:18-20 ("it's difficult to find an order that speaks specifically to tax normalization"); Breda, TR. 756:1-3 ("it's difficult to come up with a list [or orders authorizing normalization] because it's not always discussed").

Data Request 1.27, when Staff acknowledged that it could not provide a comprehensive list of items for which the Commission had previously allowed full normalization.<sup>171</sup> It was further compounded when Staff took the position for the first time in its Revised and Supplemental Testimony that some temporary book-tax differences receive implicit authorization from the Commission to be normalized.<sup>172</sup> Staff's Brief then continues to confuse the issue by articulating a new Staff position that, depending on rate base treatment, certain types of items are more appropriately treated under flow-through accounting than normalized accounting.<sup>173</sup> In taking these positions, Staff cites no Commission precedent, policy, or independent accounting guidance.

74. Based on this record, it is unclear how any party to this proceeding can apply Staff's approach and accurately determine what constitutes an exception to the general rule applying flow-through accounting for income taxes.<sup>174</sup> This case presents an opportunity for the Commission to resolve these ambiguities and access the multiple benefits of full normalization at zero cost to customers.

**B. PacifiCorp Has Properly Reflected the Impact of the Change to Normalization.**

75. Staff argues that PacifiCorp has "masked" the impact of full normalization by claiming, ironically, that PacifiCorp has incorrectly accorded flow-through treatment to certain items for which Staff claims the Commission has implicitly authorized full normalization.<sup>175</sup> Staff argues that when taxes are authorized to be deferred, then this automatically results in normalization of

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<sup>171</sup> Fuller, Exh. No. RF-9 1.

<sup>172</sup> Breda, Exh. No. KBH-5T.

<sup>173</sup> Initial Brief on Behalf of Commission Staff ¶ 136.

<sup>174</sup> Breda, Exh. No. KHB-1T 7:10-21, Breda, Exh. No. KHB -5T 1:14-21, Initial Brief on Behalf of Commission Staff ¶¶ 127-128.

<sup>175</sup> Initial Brief on Behalf of Commission Staff ¶ 138.

the book-tax difference associated with the creation of the deferred account.<sup>176</sup> Staff cites no Commission precedent, policy, or independent accounting guidance in support of this approach, nor does it cite any order specifically authorizing normalization of the contested items. The position is at odds with Staff's overall position in the case, which is that the Company should use flow-through accounting unless the Commission has authorized an exception to this policy.<sup>177</sup>

**C. PacifiCorp Has Addressed the Transitional Regulatory Asset/Liability.**

76. Staff contends that PacifiCorp has failed to address the transitional regulatory asset/liability PacifiCorp has proposed for recovery of flow-through effects from past periods.<sup>178</sup> This is incorrect. Because PacifiCorp proposes to move to full normalization on a prospective basis, the Commission must establish a period for recovery of the effects of flow-through accounting from past periods.<sup>179</sup> PacifiCorp proposes to allow flow-through effects from past periods to reverse over the same timing as would have occurred under the continuation of flow-through accounting.<sup>180</sup> Because PacifiCorp does not have a system that tracks the natural reversal of the flow-through on temporary book-tax differences tracked outside of its fixed asset system, PacifiCorp requested that the Commission establish a reasonable proxy in the form of a fixed amortization period in the Company's next general rate case.<sup>181</sup>

77. Staff argues that this proposal shows that PacifiCorp has not fully demonstrated and quantified the impacts of moving to full normalization.<sup>182</sup> This argument fails to recognize that PacifiCorp is currently entitled to recover these past flow-through amounts and has merely designed a proposal that implements its intention of allowing current recovery to continue in the

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<sup>176</sup> Breda, TR. 755:6-12 (“If there’s deferred taxes present you’re authorizing a form of normalization.”); 756:17-18 (“And most of the time the associated tax gets the same treatment as the item that it’s related to.”).

<sup>177</sup> Breda, Exh. No. KHB-1T 7:12-13.

<sup>178</sup> Initial Brief on Behalf of Commission Staff ¶ 141.

<sup>179</sup> Fuller, Exh. No. RF-8T 3:18-4:5.

<sup>180</sup> Fuller, Exh. No. RF-8T 3:1-10.

<sup>181</sup> Fuller, Exh. No. RF-8T 3: 6-10

<sup>182</sup> Breda, Exh. No. KHB-1T 10:5-13.

same manner as would have occurred under the continuation of flow-through accounting, and therefore without any net effect on customers.<sup>183</sup>

**D. It is Unfair to Annualize the Tax Benefits of the Repairs Deduction.**

78. It is undisputed that PacifiCorp did not reflect the tax benefit of the repairs deduction in its accumulated deferred income taxes (ADIT) until September 2009, when the tax benefit occurred.<sup>184</sup> While PacifiCorp reflects the benefit of the repairs deduction on a partial year basis, Staff has proposed an adjustment to annualize the repairs deduction, so that it is reflected in rate base on a full year basis.<sup>185</sup> Staff claims this is appropriate because the repairs deduction is an ongoing, known and measurable change.<sup>186</sup> However, the same could be said for all other rate base changes in the case. While all are known and measurable and all are ongoing, Staff has not proposed to annualize any other rate base adjustment in this case.<sup>187</sup> Staff argues that PacifiCorp's "average of ADIT" approach gives it a windfall because PacifiCorp has already received the full tax benefit.<sup>188</sup> There is no windfall in reflecting the repairs deduction in the test period in the same manner as it actually occurred.

**V. OTHER REVENUE REQUIREMENT ADJUSTMENTS**

**A. Cash Working Capital**

**1. Staff's ISWC Method is Inconsistent with Commission Precedent.**

79. Staff argues that its Investor Supplied Working Capital (ISWC) method is consistent with the Commission's decision in PacifiCorp's 2006 GRC, because all that order required was the creation of "Washington-specific allocation factors based on the WCA allocation method."<sup>189</sup>

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<sup>183</sup> Fuller, Exh. No. RF-8T 4:8-14.

<sup>184</sup> Breda, Exh. No. KHB-1T 25:4-7; Breda, TR. 758:6-14; Fuller, Exh. No. RF-8T 12:17-22.

<sup>185</sup> Initial Brief on Behalf of Commission Staff ¶ 146.

<sup>186</sup> *Id.* ¶ 147.

<sup>187</sup> *See* Breda, TR. 758:15-18 (Ms. Breda did not propose to annualize any other rate base items).

<sup>188</sup> Initial Brief on Behalf of Commission Staff ¶ 147.

<sup>189</sup> *Id.* ¶ 114.



Based on the dialogue between Mr. Schooley and Commissioner Oshie at the hearing in the 2006 GRC<sup>190</sup> and the Commission's order,<sup>191</sup> it appears clear that the Commission's criticism of the use of allocation factors in Staff's method was not the only concern. The Commission also criticized the use of the total Company balance sheet to determine the amount of cash working capital (CWC) to be allocated.<sup>192</sup> Staff's analysis here does not remedy this deficiency.

**2. The Company's CWC Method is Consistent with the WCA Allocation Methodology.**

80. Staff argues that because the Company's working capital adjustment includes an allocation of total Company amounts, it used the same basic method as Staff.<sup>193</sup> Therefore, Staff reasons, if its method is inconsistent with the WCA method, so is the Company's. Staff's analysis is wrong, because it incorrectly conflates the use of a total Company balance sheet and the use of total Company O&M costs. Staff's method relied upon the total Company balance sheet to determine the amount, if any, of CWC. That is fundamentally different from the Company's use of total Company O&M costs to determine CWC, because these O&M costs can be properly allocated to Washington consistent with the WCA methodology.<sup>194</sup> Staff has not challenged this fact. Rather, Staff argues that allocating the total Company balance sheet to Washington is the same as allocating O&M costs. The Company's balance sheet cannot, however, be accurately allocated to Washington because it includes numerous items that are not included in rates. The WCA methodology only prescribes allocation treatment for utility items included in rates; therefore Staff's method is inconsistent with the WCA methodology.

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<sup>190</sup> Docket UE-061546, TR. 318:19-319:4.

<sup>191</sup> *Wash. Utils. & Transp. Comm'n v. PacifiCorp*, Docket UE-061546, Order 08 ¶ 162 (June 21, 2007).

<sup>192</sup> *Id.*

<sup>193</sup> Initial Brief on Behalf of Commission Staff ¶ 118.

<sup>194</sup> Dalley, TR. 359:21-25.

### **3. Fuel Stock and Materials and Supplies Should Be Included in Rate Base.**

81. Staff argues that these assets should be excluded from rate base because they are consumed in the course of a year and their inclusion in rate base constitutes a double recovery.<sup>195</sup> This is wrong for two reasons. First, as Mr. Dalley testified at hearing, although these assets are consumed within a year, the inventories are constantly replenished and the balances never reach zero.<sup>196</sup> Therefore, the Company has a steady and consistent amount of these assets even as the specific assets are consumed and replaced. Second, there is no double recovery because by including these balances in rate base, the Company only earns a carrying charge for these items while they remain in inventory.

#### **B. Wage and Salary Adjustments**

##### **1. PacifiCorp has Demonstrated the Reasonableness of its Incentive Compensation.**

82. Public Counsel/ICNU claim that the Company's incentive program provides "unreasonably high payments to the Company's top executives."<sup>197</sup> Public Counsel/ICNU's claim is baseless, as Public Counsel/ICNU have presented no evidence, and indeed have not claimed, that PacifiCorp's overall compensation is higher than market average.

83. Public Counsel/ICNU's statements regarding the incentive compensation of Pacific Power President Pat Reiten appear to be intended to make his compensation appear unreasonable, even when Public Counsel/ICNU present no factual basis for such a finding.<sup>198</sup> On a Washington-allocated basis, Mr. Reiten's incentive compensation is \$15,928.<sup>199</sup> Public

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<sup>195</sup> Initial Brief on Behalf of Commission Staff ¶ 121.

<sup>196</sup> Dalley, TR. 355:10-14

<sup>197</sup> Post-Hearing Brief of Public Counsel ¶ 36.

<sup>198</sup> *Id.* ¶¶ 36-37.

<sup>199</sup> Applying the SO factor of 7.4084% to the total Company incentive compensation of \$215,000 equals \$15,928. See Dalley, Exh. No. RBD-3 Page 10.2.

Counsel/ICNU's rhetoric does not provide a justification for removing from rates incentive compensation that provides a level of compensation that is reasonable overall.

**2. Public Counsel/ICNU's Objections to the 2009 Wage Adjustment Are Not Relevant to the Entire Officer/Exempt Group and Are Unfounded.**

84. Public Counsel/ICNU appear to argue that they would have proposed an adjustment to the 2009 wage increase only for the Company's "highest-paid" employees, if only the Company had provided "detailed information regarding employee salaries."<sup>200</sup> The Company did in fact provide such detailed information, including the salaries for the top twenty highest paid employees.<sup>201</sup> Public Counsel/ICNU's undefined complaints of the salaries of the Company's "highest-paid" employees cannot be used as a basis for reducing the actual 2009 wage increase for nearly 2,000 employees in the Officer/Exempt group.<sup>202</sup>

85. Public Counsel/ICNU complain that the Company's assessment of market compensation is flawed because it includes no Pacific Northwest utilities, public utility districts, municipal utilities, or the Bonneville Power Administration.<sup>203</sup> The Company has, however, used the same methodology for evaluating market compensation in prior cases in which the Commission found the Company's compensation to be reasonable. Moreover, Public Counsel/ICNU raised this issue for the first time in brief, depriving the Company of the opportunity to provide evidence related to this issue in rebuttal testimony. Thus, it would be unreasonable to adopt Public Counsel/ICNU's 2009 wage adjustment on this basis.

86. Public Counsel/ICNU also rely on newspaper articles to argue that PacifiCorp's 2009 wage increases were unreasonably high compared with executives nationally.<sup>204</sup> The articles

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<sup>200</sup> Post-Hearing Brief of Public Counsel ¶ 9.

<sup>201</sup> Wilson, Exh. No. EDW-15C.

<sup>202</sup> See Dalley, Exh. No. RBD-12.

<sup>203</sup> Post-Hearing Brief of Public Counsel ¶ 20.

<sup>204</sup> *Id.* ¶ 23.

cited by Public Counsel/ICNU should not be used as a basis for disallowance because they are irrelevant to determining market compensation in the utility industry. Moreover, the levels of executive compensation cited in the articles—a median \$5 million in one article<sup>205</sup> and a median \$6.6 million in the other article<sup>206</sup>—are significantly higher than the compensation for any PacifiCorp executive. It would be unreasonable to rely on these articles to disallow PacifiCorp’s 2009 wage increase, which is applicable to all Officer/Exempt employees, when the data in the articles are so clearly inapplicable to PacifiCorp’s compensation.

87. Finally, Public Counsel/ICNU cite to “[u]tilities and commissions across the country” that have disallowed executive salary increases.<sup>207</sup> Public Counsel/ICNU cite only two commissions—Connecticut and New York—that have done so and provide no basis upon which the Commission can find that the decisions in those cases were based on similar facts or that the policies of those commissions are comparable to those of this Commission.

### **3. Public Counsel/ICNU’s Claims Regarding Workforce Levels Do Not Justify Their 2010 Wage Adjustment**

88. Public Counsel/ICNU also propose to remove the wage increases that occurred in 2010 because workforce levels have declined.<sup>208</sup> As Mr. Wilson testified, the decline in positions referenced by Public Counsel/ICNU represents positions that the Company is attempting to fill and does not represent permanent reductions.<sup>209</sup> Public Counsel/ICNU’s statements in briefing regarding “additional lay-offs in the future”<sup>210</sup> should be disregarded as unsupported hearsay.

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<sup>205</sup> Wilson, Exh. No. EDW-19 1.

<sup>206</sup> Wilson, Exh. No. EDW-20 1.

<sup>207</sup> Post-Hearing Brief of Public Counsel ¶ 24.

<sup>208</sup> *Id.* ¶ 28.

<sup>209</sup> Wilson, TR 423:3-424:10.

<sup>210</sup> Post-Hearing Brief of Public Counsel ¶ 29.

**C. PacifiCorp Has Presented a Reasonable Level of MEHC Management Fee that is Consistent with its MEHC Acquisition Commitment.**

89. As in the case of PacifiCorp executive compensation, Public Counsel/ICNU have the facts wrong and provide no basis to disallow costs associated with MEHC incentives. Public Counsel/ICNU claim that the Company is attempting to recover a \$1.1 million incentive payment to PacifiCorp's CEO Greg Abel.<sup>211</sup> As Mr. Stuver testified, the total cost of Mr. Abel to Washington customers is \$102,000, not in excess of \$1.1 million as Public Counsel/ICNU imply.<sup>212</sup> Further, in support of their argument, Public Counsel/ICNU cite to expenses that are not included in rates, such as the long term incentive plan and stock options which Public Counsel/ICNU concede are not included in rates and MEHC has not issued since March 2000.<sup>213</sup> Public Counsel/ICNU provide no basis for finding that the incentive compensation portion of MEHC management fees is unreasonable. As Staff notes, the affiliate management fee of \$7.1 million included in this case is reasonable and consistent with the Stipulation in the MEHC acquisition docket.<sup>214</sup>

**D. Public Counsel/ICNU Present No Basis for Ad Hoc Changes to the Assignment of Expenses under the WCA Methodology.**

90. Public Counsel/ICNU allege that PacifiCorp has "misallocated" outside legal expenses by not allocating some expenses *situs*.<sup>215</sup> Public Counsel/ICNU are incorrect. PacifiCorp allocated legal expenses in the same manner as it has previously; it is Public Counsel/ICNU who are now proposing to change the allocation of only those cost categories that reduce revenue requirement. Staff's proposal to have parties work together to refine the allocation of accounts and determine

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<sup>211</sup> Post-Hearing Brief of Public Counsel ¶ 40.

<sup>212</sup> See Stuver, TR. 435:13-436:8; Stuver, Exh. No. DKS-3.

<sup>213</sup> Stuver, Exh. No. DKS-4 8.

<sup>214</sup> Initial Brief on Behalf of Commission Staff ¶ 63.

<sup>215</sup> Post-Hearing Brief of Public Counsel ¶¶ 50.

whether it is cost effective to situs-assign certain accounts is more reasonable than Public Counsel/ICNU's cherry-picking approach.

## VI. RATE SPREAD AND RATE DESIGN

### A. ICNU's and Public Counsel's Arguments Against Staff's and the Company's Rate Spread are Groundless.

91. ICNU argues against Staff's and the Company's proposed rate spread because it deviates from Commission policy of applying an equal percentage rate spread.<sup>216</sup> ICNU states that it would have done "a more thorough review" if it had known the parties would propose deviating from an equal percentage rate spread.<sup>217</sup> ICNU had the opportunity to investigate and thoroughly comment on Staff's proposal in its cross-answering testimony. ICNU's decision not to do so does not limit the Commission's ability to adopt Staff's and the Company's proposal.
92. Additionally, ICNU should have been aware that the Commission may consider applying a rate spread other than an equal percentage. In the Company's 2008 rate case, ICNU entered into a settlement with other parties agreeing to apply no increase to lighting schedules, 85% of the overall average percentage increase for small general service, and the balance of the increase equally among all other classes.<sup>218</sup> Given the Commission's recent adoption of, and ICNU's agreement with, a rate spread other than equal percentage, ICNU's arguments regarding its understanding of Commission policy should be discounted.
93. The Company agrees that cost of service studies should not be mechanically applied, and indeed the Company has not done so in this case. As explained in the Company's and Staff's testimony, the evidence shows that the rate spread supported by the Company and Staff is

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<sup>216</sup> Post-Hearing Brief on Behalf of ICNU ¶ 105.

<sup>217</sup> *Id.* ¶ 105.

<sup>218</sup> *Wash. Utils. & Transp. Comm'n v. PacifiCorp*, Docket No. UE-080220, Order 5 ¶ 14 (Oct. 8, 2008).

appropriate because it moves rate schedules closer to cost and gives effect to the peak credit method.

94. Public Counsel incorrectly claims that the Company did not perform a new cost study in response to Staff's rate spread recommendations.<sup>219</sup> The Company did in fact perform a new cost of service study for its rebuttal case supporting its revised rate spread proposal.<sup>220</sup> In contrast, Public Counsel prepared no such study.

**B. Public Counsel Claims No Reasonable Basis for Rejecting the Company's Proposed Customer Charge.**

95. Public Counsel proposes that the Company's current residential fixed charge should remain \$6.00, arguing that increasing the customer charge will unfairly burden low-income customers because they are more likely to be low-use customers.<sup>221</sup> As Mr. Schooley testified, the evidence in this case shows that low-income customers are not the same as low-use customers.<sup>222</sup>

96. Public Counsel also claims, without any support in the record, that increasing the fixed charge will discourage conservation.<sup>223</sup> Public Counsel cites to a Commission order that found "that disproportionate increases to customer charges discourage conservation."<sup>224</sup> The evidence in this case shows that the customer charge proposed by the Company is significantly lower than the fixed cost of providing service.<sup>225</sup> There is therefore no basis to find that the Company's proposed customer charge is "disproportionate," especially considering that the Company has proposed to increase the energy charge as well. Finally, while there may be more than one way to calculate fixed charges, Public Counsel has presented no evidence that the Company's

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<sup>219</sup> Post-Hearing Brief of Public Counsel ¶ 82.

<sup>220</sup> Griffith, TR 540:8-15; Paice, Exh. No. CCP-6T 1:12-19..

<sup>221</sup> Post-Hearing Brief of Public Counsel ¶ 88.

<sup>222</sup> Schooley, TR. 482:13-21; Griffith, Exh. No. WRG-7T 4:12-5:12; Griffith, Exh. No. WRG-11.

<sup>223</sup> Post-Hearing Brief of Public Counsel ¶ 90.

<sup>224</sup> *Id.* ¶ 91.

<sup>225</sup> Griffith, Exh. No. WRG-7T 3:18-20.

calculation of fixed charges is inaccurate.<sup>226</sup> The Company requests that the Commission reject Public Counsel's arguments as unsupported.

## VII. LOW INCOME FUNDING

### A. PacifiCorp Continues to Support Increasing the Level of Participation in the LIBA Program.

97. The Energy Project argues against using a portion of the increased LIBA funding to allow more customers to participate in the program, despite pointing out that not all income eligible customers receive the LIBA discount due to the participation cap.<sup>227</sup> Pursuant to its commitment made in its last rate case, the Company developed its proposal after consultation with the agencies responsible for implementing the LIBA program.<sup>228</sup>

98. The Energy Project disputes this testimony but provides no evidence to support its contention that the Company misinterpreted the agencies' desires. The Energy Project misrepresents Ms. Eberle's testimony. For example, Ms. Eberle did not testify that she spoke "privately" with each agency's representative at the Toppenish meeting,<sup>229</sup> or that PacifiCorp already decided to increase the number of customers served through LIBA before the meeting.<sup>230</sup> The Energy Project also includes in its brief a number of objectionable, rhetorical questions attacking Ms. Eberle's testimony.<sup>231</sup> The Company requests that the Commission disregard such tactics. The Energy Project should have raised its questions at the hearing, where PacifiCorp could have responded either with an objection or a direct answer from Ms. Eberle.

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<sup>226</sup> See Post-Hearing Brief of Public Counsel ¶¶ 92-94.

<sup>227</sup> The Energy Project's Initial Post-Hearing Brief at 6-7.

<sup>228</sup> *Wash. Utils. & Transp. Comm'n v. PacifiCorp*, Docket UE-090205, Order 09 ¶ 28 (Dec. 16, 2009); Eberle, Exh. No. RME-1T 5:15-6:2.

<sup>229</sup> The Energy Project's Initial Post-Hearing Brief at 8. See Eberle, TR. 524:5-7 ("Well, I don't know if you'd consider it formal, but everyone was in the room, and I asked each person representing an agency.")

<sup>230</sup> The Energy Project's Initial Post-Hearing Brief at 9.

<sup>231</sup> *Id.* at 9-10.



**B. PacifiCorp Does Not Support The Energy Project's Increased Certification Fee, and the Company's Biennial Certification is Reasonable.**

99. The Energy Project argues for an increase in the certification fee paid to the local agencies from the current \$48 to \$65.<sup>232</sup> While the Company does not support this increase, it has proposed the initiation of a collaborative process to work with these agencies with the goal of developing a more streamlined process that will both lower agency costs and increase the benefits available to customers.<sup>233</sup> Notably, in Washington the local agencies' administrative costs account for 21% of total program costs.<sup>234</sup> The administrative costs for the Company's bill discount program in Utah, by contrast, constitute a mere 0.5% of total program costs.<sup>235</sup> While these two programs are not identical, the substantial discrepancy in administrative costs is cause for further inquiry.

100. Moreover, the Company's biennial certification proposal will also likely go a long way towards reducing the overhead costs so as to provide more support for the Company's low-income customers.<sup>236</sup> The Company requests that the Commission reject The Energy Project's unsupported allegation that the "sole goal" of the biennial certification proposal is to shift funding from program implementation to program benefits with no regard to the agencies who implement the programs.<sup>237</sup> Ms. Eberle emphasized that the Company values the agencies' services, and the goal of the biennial certification proposal is to reduce administrative costs.<sup>238</sup>

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<sup>232</sup> The Energy Project's Initial Post-Hearing Brief at 12-13.

<sup>233</sup> Eberle, Exh. No. RME-1T 7:13-19.

<sup>234</sup> Eberle, Exh. No. RME-1T 6:19-21.

<sup>235</sup> Eberle, Exh. No. RME-1T 7:5-6.

<sup>236</sup> Eberle, Exh. No. RME-1T 6:12-7:8. The Energy Project incorrectly states that the Company's programs in Utah and California use every-other-year certification. The Energy Project's Initial Post-Hearing Brief at 17. The Company's Utah program certifies every year through LIHEAP. Eberle, TR. 530:11-14.

<sup>237</sup> The Energy Project's Initial Post-Hearing Brief at 22.

<sup>238</sup> Eberle, TR. 535:8-12.

**C. There is No Reasonable Policy Basis for The Energy Project's Proposed Increase to Low Income Weatherization.**

101. Staff explains the proposed legal basis for finding that the funding of the low-income weatherization program is not properly before the Commission in this proceeding.<sup>239</sup> While the Company does not disagree with Staff's analysis, it believes that the Commission does not need to reach this issue to reject The Energy Project's proposed increase. As explained in the Company's Initial Post-Hearing Brief, the current level of funding is not fully used, so there is no reasonable policy basis for increasing funding.

**VIII. CONCLUSION**

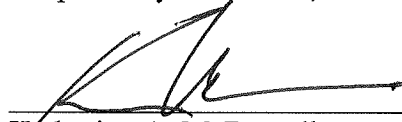
102. For the reasons discussed above, and in the Company's Initial Post-Hearing Brief, the Company respectfully requests that the Commission issue an order approving the Company's revenue requirement increase of \$47.7 million to be effective April 3, 2011, together with the Company's proposed rate spread and recommendations related to low income programs.

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<sup>239</sup> Initial Brief on Behalf of Commission Staff ¶¶ 238-241.

DATED: February 18, 2011.

Respectfully Submitted,



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