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April 4, 2011

David W. Danner, Executive Director and Secretary
Washington Utilities and Transportation Commission
1300 S. Evergreen Park Dr. SW
P. O. Box 47250
Olympia, Washington 98504-7250

RE: *WUTC v. PacifiCorp (PacifiCorp 2010 General Rate Case)*
Docket UE-100749

Dear Mr. Danner:

Enclosed for filing in the above-referenced docket are the original and 17 copies of the Commission Staff Petition for Reconsideration and Certificate of Service.

Sincerely,

DONALD T. TROTTER
Assistant Attorney General

DTT:klg
Enclosures
cc: Parties

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,

Complainant,

v.

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

Respondent.

DOCKET UE-100749

COMMISSION STAFF PETITION
FOR RECONSIDERATION

I. Introduction

I Pursuant to WAC 480-07-850, Commission Staff (Staff) seeks reconsideration of the Commission's decision on capital structure in Order 06¹ (Order) issued March 25, 2011. Specifically, Staff seeks reconsideration of the Commission's decision to use a 49.1 percent equity ratio in the ratemaking capital structure and to exclude short-term debt. The Commission should reconsider that decision and adopt Staff's recommended capital structure of 46.5 percent equity, 3.0 percent short-term debt, 0.30 percent preferred and 50.20 percent long-term debt.

¹ Order 06, *Final Order Rejecting Tariff Sheets; Authorizing Increased Rates; and Requiring Compliance Filing* (March 25, 2011).

II. Discussion²

A. A Ratemaking Capital Structure Containing an Equity Ratio of 46.5 Percent Is Safe and Economical, and Consistent With How Most Electric Utilities in This Country Are Capitalized

2 At the outset, Staff recognizes the bulk of the Commission’s discussion of the capital structure issue is fundamentally correct and well-supported, beginning with how the Commission placed the issue in the correct context by noting that capital structure and rate of return “have the greatest impact on revenue requirements in this case.”³

3 The Commission adopted the correct standard for evaluating capital structure for ratemaking: “...a capital structure should be balanced in a way that achieves financial safety while minimizing financial risk so the company may finance its operations at least cost”.⁴ The Commission correctly recognized the Company should be capitalized with “sufficient equity to provide financial security” but nor more than necessary to keep costs reasonable.⁵

4 The Commission was also astute and accurate to note that MEHC (PacifiCorp’s owner) has the financial incentive to maximize its returns by means of higher and higher equity ratios: “we understand MEHC’s interest in expanding the equity ratio to reap greater

² WAC 480-09-850(2) requires argument in reconsideration petitions to be “brief”. Staff has complied, but would refer the Commission to Staff’s briefing and the testimony of Mr. Elgin in this case for a full presentation of Staff’s position on capital structure.

³ Order at 13, Paragraph 18.

⁴ Order at 14, Paragraph 21. Later in the Order, the Commission recognized the “general principle that ‘[t]he appropriate capital structure for ratemaking purposes is one that *balances economy with safety* in view of all of the sources of capital available to the company.’” (Emphasis in the original) Order at 17, Paragraph 27, citing *Utilities and Transp. Comm’n v. PacifiCorp*, Docket UE-050684, Order 04 at 79, ¶ 224 (April 17, 2006).

⁵ Order at 20, Paragraph 39. The Commission was also correct in not requiring a “compelling reason” for departing from PacifiCorp’s actual capital structure, as the Company argued.

equity returns”,⁶ and the Commission properly concluded that PacifiCorp’s actual equity ratio is excessive and favors shareholders.⁷

5 However, the Commission should have applied the foregoing statements and analysis in the Order to accept the capital structure proposed by Staff. First, Staff’s proposed capital structure contains a level of common equity (46.5 percent) that is consistent with the average level of equity ratio for electric utilities in this country:

That data show the following for 2009, on average: 1) AUS reports electric companies were capitalized with 46 percent equity and combination electric/gas companies with 45 percent equity; 2) SNL reports the average common equity ratio for electric companies of 43.7 percent. The SNL data includes short-term debt in the calculation of the capitalization ratios.⁸

6 There is no reason on this record why PacifiCorp cannot finance successfully based on a 46.5 percent equity ratio. In fact, according to Standard and Poor’s, a 46.5 percent common equity ratio is “firmly investment grade” and consistent with the capital structure parameters for the credit ratings enjoyed by the “predominance” of electric utilities in this country.⁹ The Order fails to recognize or appropriately consider these undisputed facts.

7 The specific reason the Commission gave for rejecting Staff’s 46.5 percent equity ratio was because “a substantial part of PacifiCorp’s increased equity financing is being used for capital expenditures ... that provide value for ratepayers.”¹⁰ However, this reason lacks record support because there is no evidence PacifiCorp could not successfully make the same capital expenditures were it more economically capitalized with 46.5 percent equity.

⁶ Order at 21, Paragraph 40.

⁷ Order at 20, Paragraph 39. Indeed, MEHC’s actions (infusing large amounts of equity, implementing a no-dividend policy, and paying off all short-term debt) call into question Merger Commitment 21, which prohibits MEHC and PacifiCorp from advocating for a cost of capital higher than it would have been absent the transaction. *In re Application of MEHC and PacifiCorp*, Docket UE-05090, Order 07 at Appendix A, page 5, Commitment 21 (February 22, 2006).

⁸ Elgin, Exhibit KLE-1T at 16:9-13.

⁹ Williams, Exhibit No. BNW-17 at 1 (per S&P): “predominance of ratings is in the ‘BBB’ category, firmly investment grade.”

¹⁰ Order at 21, Paragraph 41.

8 In fact, the evidence shows the electric industry as a whole has been undertaking large capital programs for several years and has successfully accomplished that with equity ratios averaging well below 49 percent.¹¹ There is no reason on this record why PacifiCorp cannot do the same.

9 The Commission accepted the equity structure recommendation of Mr. Gorman, which is based on his calculation of the amount of equity capital PacifiCorp actually devotes to supporting utility investments.¹² However, Mr. Gorman provided no evidence this level of equity appropriately balanced safety and economy, in compliance with the Commission's standard. Notably, Mr. Gorman did not challenge Staff's equity ratio recommendation.

10 Staff is also concerned about the Commission's comment in Paragraph 42, that a 49.1 percent equity ratio will likely "maintain the Company's current credit ratings", which is A-. As the Commission is well aware, A-rated utilities will have high equity ratios and thus higher equity costs. It is significant that no electric company in this state other than PacifiCorp is A-rated, and PacifiCorp has attained that rating by building up its equity ratio consistent with its owner's interest in "reaping the benefit of greater equity returns".¹³ A consequence is an A- rating, and the Order suggests or implies an equity ratio consistent with such a consequence is consistent with the Commission's capital structure policy.

11 Staff's concern is that if the "safety and economy" test can be met with an equity ratio supporting an A- rating, other utilities in this state will increase their equity ratios to achieve it. We therefore encourage the Commission to reconsider what may well be

¹¹ Elgin, Exhibit No. KLE-1T at 51:3-10.

¹² Order at 21-22, Paragraph 42.

¹³ See Order at 21, Paragraph 40.

interpreted as an explicit or implicit policy objective to move toward A-rated utilities in this state.¹⁴

B. The Commission's Order in Docket UE-050684 Provides No Impediment to Including A Layer of Short-Term Debt in the Ratemaking Capital Structure

12 The Commission gave two reasons for excluding short-term debt from PacifiCorp's capital structure, but neither is sufficient. First, the Commission applied language from the second sentence of Paragraph 224 of the Commission's order in PacifiCorp Docket UE-050684, emphasizing that "[t]he Commission has traditionally included a component for short-term debt *based on a company's actual capital structure.*"¹⁵

13 However, the Commission should have read that language in the context of the first sentence of Paragraph 224 from that prior order, where the Commission stated that an appropriate capital structure examines "...all the sources of capital available to a company."¹⁶ Short-term debt is a source of readily available capital, so it is consistent with Paragraph 224 overall for the Commission to consider short-term debt in the capital structure in this case.

14 In other words, the Commission should not interpret the reference to short-term debt in the second sentence of Paragraph 224 as a policy to *exclude* short-term debt from a hypothetical capital structure when the utility has no short-term debt, but rather as a general

¹⁴ If moving to A ratings is not a general Commission policy objective for utilities in this state, the Order is still a problem from Staff's perspective, because the Commission has effectively condoned PacifiCorp's movement to that rating, without proving that is more economical than its prior rating. We suggest PacifiCorp did not prove this because it cannot prove this. For example, assume an A rating (and the higher equity ratio that goes with it) is more economical than a BBB rating. Given that the predominance of electric utilities in this country are BBB-rated, this suggests either: (1) the preponderance of electric utilities in this country are being regulated under unsafe and/or uneconomical equity ratios, or (2) an equity ratio in the 46 percent range is safe and economical. Staff has seen no evidence to support (1) and all the evidence supports (2).

¹⁵ Order at 22, Paragraph 43, quoting *Utilities and Transp. Comm'n v. PacifiCorp*, Docket UE-050684, Order 04 at 79 (April 17, 2006).

¹⁶ *Utilities and Transp. Comm'n v. PacifiCorp*, Docket UE-050684, Order 04 (April 17, 2006) at 79, ¶ 224.

indication of the level of short-term debt the Commission might use when the utility has some short-term debt.

15 In any event, even if the Commission intended to articulate a policy in Docket UE-050684 that a source of capital must be excluded from a hypothetical capital structure when the utility has no capital from that source, the Commission should abandon that policy because it improperly deprives the Commission of an important regulatory tool (i.e., imputing a lower cost source of capital to achieve a balanced capital structure).

16 For example, if a utility moved to 100 percent equity, surely no one (except perhaps the utility) would argue against the imputation of debt for ratemaking purposes, despite the lack of such capital in the utility's actual capital structure.

17 There are ample other reasons why the Commission should not apply literally the second sentence of Paragraph 224. That sentence is unsupported by precedent or other justification,¹⁷ and it is dicta, because PacifiCorp actually had short-term debt in Docket UE-050684 (that docket predated MEHC's acquisition of PacifiCorp and the subsequent efforts by MEHC to maximize the equity ratio for its benefit).

18 But, even if the Commission still believes the second sentence of Paragraph 224 should be applied literally, the Commission should recognize an exception where, as here, the utility actually maintains short-term credit lines and exacts the cost of those credit lines from its ratepayers.¹⁸

¹⁷ In the prior order, the Commission did not cite any precedent to support the second sentence of Paragraph 224. Staff could not find any prior order in which the Commission excluded short-term debt from a hypothetical capital structure on the basis the utility did not use such financing. The Commission's practice has been to include a layer of such capital in ratemaking capital structures.

¹⁸ It is undisputed that PacifiCorp maintains short-term credit lines of around \$1.4 billion and includes the costs of maintaining these credit lines in its books of account for recovery in rates. Williams, Exhibit No. 14C at 2, and TR. 276:12 to 277:11, and at 1, part (b). No party recommended removing the costs of these credit facilities.

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The Commission also said excluding short-term debt from the capital structure “ameliorates the potential adverse effects of the Company’s proposed capital structure” that already has excessive equity,¹⁹ but this statement is insufficient absent a calculation of the impact of the Company’s excessive equity ratio and the amount and means necessary to ameliorate it. Yet, such an adjustment still would miss the point, because the Commission’s correctly-stated goal is to find a capital structure that properly balances safety and economy considering all available sources of capital, not simply adjusting the equity ratio to ameliorate certain adverse impacts of an actual, excessive equity ratio and the utility owner’s decision to abandon use of short-term debt.

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The bottom line is that Staff’s evidence showed the goal of safety and economy can be attained using a 46.5 percent equity ratio and 3.0 percent short-term debt, which, again, is consistent with how the large majority of electric utilities in this country are successfully capitalized. Under the Order, ratepayers will experience a very large rate increase. There is no reason to increase the rate of return via an excessive equity ratio and the elimination of short-term debt.

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¹⁹ Order at 22, Paragraph 43.

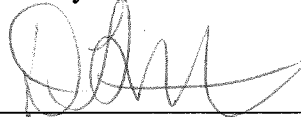
III. Conclusion

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For the foregoing reasons, the Commission should reconsider its decision on capital structure and adopt Staff's recommended capital structure of 46.5 percent equity, 3.0 percent short-term debt, 0.30 percent preferred and 50.20 percent long-term debt.

DATED this 4th day of April 2011.

ROBERT M. MCKENNA
Attorney General



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Assistant Attorney General
Counsel for Washington Utilities and
Transportation Commission Staff

Docket UE-100749
CERTIFICATE OF SERVICE

I hereby certify that I have this day served the Commission Staff Petition for Reconsideration upon the persons and entities listed on the Service List below by depositing a copy of said document in the United States mail, addressed as shown on said Service List, with first class postage prepaid.

DATED at Olympia, Washington this 4th day of April 2011.



KRISTA L. GROSS

All parties have signed confidentiality agreements

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