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-130043**

INITIAL BRIEF ON BEHALF OF COMMISSION STAFF

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I. INTRODUCTION

1 PacifiCorp d/b/a Pacific Power & Light Company ("PacifiCorp" or "Company") seeks to increase its revenues from electricity service in Washington by $36.9 million or 12.1 percent.[1] The Company also proposes a power cost adjustment mechanism ("PCAM").[2]

2 Commission Staff proposes an increase in electricity revenues of $13.6 million or 4.47 percent.[3] Staff opposes the PCAM as proposed by PacifiCorp.[4]

3 The difference between PacifiCorp and Staff presents several issues:

- Should the Commission increase the Company's return on equity and use a capital structure that increases the equity ratio and excludes short-term debt, all for the benefit of the Company's owners and despite falling capital costs?

- Should the Commission require Washington customers to be burdened with the cost of purchased power agreements ("PPAs") with Qualified Facilities ("QFs") in Oregon and California, despite Commission precedent that protects ratepayers from the potential harm of QF pricing policies in other states?

- Should the Commission allow recovery of major capital plant added after the Company's tariff filing despite the auditing burdens that would engender and despite an expedited rate filing ("ERF") proposal from Staff to recover those additions and protect PacifiCorp from the effects of regulatory lag?

- Should the Commission modify only select cost allocation factors without a comprehensive review of the approved West Control Area ("WCA") cost allocation methodology?

- Should the Commission use an end of period ("EOP") rate base despite the Company's failure to demonstrate the necessity for that exceptional treatment?

- Should the Commission adopt a PCAM without sharing bands or dead-bands, in violation of Commission precedent and policy?

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[1] McDougal, Exh. No. SRM-6T at 1:14-15.
[2] Duvall, Exh. No. GND-1CT at 26-49.
[3] This is a reduction from Staff's response case of $14.6 million. See Reynolds, Exh. No. DJR-1T at 3:5-6. The reduction results from Staff's agreement to various Company rebuttal adjustments as noted in the Final Issues List submitted August 23, 2013. Attachment A to this brief summarizes the revised Staff revenue requirement and lists all adjustments between uncontested and contested categories. Staff will submit a fully revised revenue requirement model (Exhibit JH-2) if directed by the Commission.
[4] Gomez, Exh. No. DCG-1T at 5:18-19.

4 The Company answers each of these questions affirmatively and provides three general reasons for its position. First, PacifiCorp argues that its proposals are designed to address attrition, represented allegedly and solely by a failure to earn its authorized return on equity. This assertion was not made until hearing and even then not until redirect by Company counsel.[5] Prior to that, the Company admitted that only its proposal for EOP rate base was designed to address its alleged attrition.[6]

5 PacifiCorp's argument also relies on a recent Commission Order stating that "attrition" means "any situation in which a company rate-regulated business fails to achieve its allowed earnings."[7] However, because that Order addressed a contested settlement the Commission warned that the Order "should not be taken as establishing hard and fast principles for general or future application."[8] Thus, by itself, any failure of the Company to earn its authorized return on equity does not prove attrition nor does it justify the Company's proposals in this case.

6 The Company's allegation of an inability to earn its authorized return on equity was also suspect because it was not supported by its annual Commission Basis Reports.[9] Even as presented, the PacifiCorp's earned returns on equity have improved steadily over time.[10]

7 The Company's second argument is to blame the regulatory environment in Washington as presenting a "unique set of challenges" including the use of an historical test period with an average of monthly average ("AMA") rate base, an interstate cost allocation methodology not

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[5] Griffith, Tr. 133:2-19.
[6] Griffith, Tr. 111:3-14.
[7] Griffith, Exh. No. WRG-1T at 4:1-3, citing, *WUTC v. Puget Sound Energy, Inc*., Dockets UE-121697/ UG-121705, Order 07 and Dockets UE-130137/UG-130138, Order 07 at ¶22, n.23 (June 25, 2013).
[8] *WUTC v. Puget Sound Energy, Inc*., Dockets UE-121697 /UG-121705, Order 07 and Dockets UE-130137/UG-130138, Order 07 at ¶23 (June 25, 2013).
[9] Reynolds, Tr. 418:10-419:2. The Company did state in direct testimony that its earned return on equity in Washington was 3.9 percent for the test period. Reiten, Exh. No. RPR-1T at 2:21-23. However, that single snapshot does not prove attrition even under PacifiCorp's definition. It also does not match the Company's rebuttal presentation, which shows a much higher return on equity for about the same period (7.14 percent). Griffith, Exh. No. WRG-1T at 3: Table 1.
[10] Griffith, Exh. No. WRG-1T at 3: Table 1.

used in other states, and the lack of a PCAM.[11] However, the Company did not present an attrition study or a decoupling mechanism,[12] did not file its case with a future test period alternative,[13] did not present a comprehensive evaluation of cost allocations,[14] did not propose a multi-year rate plan or expedited rate case process,[15] and did not propose a PCAM properly designed with dead-band and sharing-bands,[16] among other shortcomings. Clearly the Company confuses the "challenges" it alleges with its own burden of proof.[17]

8 Finally, the Company blames Staff for not supporting creative or progressive regulatory ideas, but instead rejecting any modifications to the status quo.[18] Even at face value, the Company's argument is a gross over-exaggeration. Including the dispute over capital plant additions and EOP versus AMA rate base, which are the only specific examples cited by PacifiCorp,[19] the Staff and Company fully adjusted, Washington-allocated rate bases are only $4 million (0.5 percent) apart on a rate base of over $820 million.[20] In fact, Staff's use of an AMA rate base actually increases the Company's revenue requirement by $300,000.[21]

9 The Company's final argument is also wrong. Staff supports the Company's revisions to the calculation of investor-supplied working capital, increasing rate base by $28.5 million.[22]

10 Staff is also the only party "thinking out of the box." The ERF offered by Staff will allow PacifiCorp to recover capital plant additions placed into service in 2013 and will reduce

[11] Griffith, Exh. No. WRG-1T at 2:13-3:15.
[12] Griffith, Tr. 111:3-7.
[13] Griffith, Tr. 117:17-118:5.
[14] See Section V.
[15] Griffith, Tr. 111:8-14.
[16] See Section IV.
[17] See RCW 80.04.130(4).
[18] Griffith, Exh. No. WRG-1T at 10:22-11:1.
[19] Griffith, Exh. No. WRG-1T at 11:2-12:6.
[20] Compare McDougal, Exh. No. SRM-7, page 1, line 57, column (e) versus Huang, Exh. No. JH-2, page 1, line 57, column (e).
[21] Griffith, Tr. 101: 4-10.
[22] Zawislak, Exh. No. TWZ-1T.

regulatory lag by using more recent data on power costs, load and other cost changes.[23] This is consistent with recommendations of a Governor's work-group asking the Commission to consider approaches to accelerate existing rate-setting practices and timelines.[24] PacifiCorp rejects the Staff proposal rather than embracing this advantageous and useful approach.

II. COST OF CAPITAL

11 The cost of capital for PacifiCorp is one of the most significant issues in this proceeding. It accounts for about $9.5 million of the difference between Staff and Company revenue requirement proposals.[25]

12 Staff witness Kenneth L. Elgin recommended an overall cost of capital for PacifiCorp of 7.03 percent. His proposal is based on a fair return on equity of 9.00 percent, and a safe and economical capital structure with 46 percent common equity and 4 percent short-term debt so that ratepayers realize the benefits of that low-cost and readily available source of funds.[26]

13 In contrast, Company witness Bruce N. Williams would place excessive costs on customers through an actual capital structure with no short-term debt and a common equity ratio of 52.22 percent. Likewise, Company witness Samuel C. Hadaway would increase the Company's cost of equity from 9.8 percent to 10.0 percent despite his own evidence of reduced capital costs since PacifiCorp's last litigated rate case (Docket UE-100749), including the pendency of this case itself.

14 Overall the Company proposes a cost of capital of 7.75 percent, which Mr. Williams states is similar to Puget Sound Energy, Inc. and Avista Corporation.[27] However, he admitted

[23] Reynolds, Exh. No. DJR-1T at 10:20-11:5.
[24] Reynolds, Exh. No. DJR-2 at 3 and Reynolds, Tr. 423:11-12.
[25] Attachment A, line 65.
[26] Elgin, Exh. No. KLE-1T at 2:17-3:5. Mr. Elgin does not dispute the Company's proposal for preferred stock: 0.28 percent at a cost of 5.48 percent. Elgin, Exh. No. KLE-1T at 2:9, updated per Williams, Exh. No. BNW-16.
[27] Williams, Exh. No. BNW-14T at 1:22-23 and Williams, Tr. 152:12-15.

that the Commission includes short-term debt in the capital structures of those two utilities.[28] His proposal to exclude short-term debt for PacifiCorp does not hold up under his own comparison and lays bare the excessive equity used to fund PacifiCorp's utility operations.

15 Moreover, the return on equity for PSE and Avista were the product of settlements which the Commission decided not to disturb. The Commission noted, however, that equity returns continue to trend downward and that if Avista had not been settled, the Commission may very well have found warranted a return on equity less than 9.8 percent.[29]

16 Likewise, the Commission noted that a reduction in PSE's authorized return on equity of 9.8 percent to reflect current financial conditions could not be undertaken because the record in that case was simply "too spare" and "lack[ed] the depth and breadth of data analysis, and the diversity of expert evaluation and opinion upon which the Commission customarily relies in setting return on equity."[30]

17 That is not the case here. Mr. Elgin has provided extensive and credible evidence that PacifiCorp's cost of capital should be reduced. His expert judgment and evaluation should be adopted by the Commission.[31]

A. Capital Structure

1. Fundamental Principles

18 The Commission's policy for determining an appropriate capital structure is to balance the amount of equity (safety) with its cost to ratepayers (economy) in order to ensure a

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[28] Williams, Tr. 152:16-22.
[29] *WUTC v. Avista Corp.*, Dockets UE-120436/120437, Order 09 at ¶74 (December 26, 2012).
[30] *WUTC v. Puget Sound Energy, Inc*., Dockets UE-121697 /UG-121705, Order 07 and Dockets UE-130137/UG-130138, Order 07 at ¶58 (June 25, 2013). Admittedly, the Commission noted that a 9.8 percent return on equity for PSE and Avista was within a zone of reasonableness, but it made clear that return was at the higher end of the zone.
[31] Boise White Paper witness Michael P. Gorman proposes an overall cost of capital of 7.38 percent. His proposed cost of equity of 9.20 percent is not unreasonable. However, for similar reasons stated below, his capital structure with 49.1 percent common equity and no short-term debt should be rejected because it favors inappropriately the interests of the Company's owners over the interests of ratepayers.

company's financial integrity and ability to meet its public service obligations.[32] This policy embodies a fundamental principle that a properly balanced capital structure ensures a utility efficiently finances its long-lived assets to achieve the lowest possible cost for ratepayers.[33] The Commission affirmed this policy in PacifiCorp's last two contested general rate cases.[34]

19 A critical factor in applying these principles here is that PacifiCorp is privately held by MidAmerican Energy Holdings Company ("MEHC"), which controls the Company's capital structure. Therefore, the Commission must ensure the Company's regulated operations are properly capitalized since MEHC's incentive is to enhance its returns by capitalizing PacifiCorp with too much equity rather than short-term debt.[35]

20 This incentive is not theoretical. Since it was acquired by MEHC, PacifiCorp's actual equity ratio has grown dramatically from 46.4 percent in 2005 to 52.4 percent in 2012.[36] The Commission cannot alter the policies of MEHC regarding equity financing of utility operations, but it can protect ratepayers from the higher cost of those policies.[37] The Commission, therefore, should not accept the Company's actual capital structure at face value or merely because other state commissions use an actual capital structure to set rates for PacifiCorp.[38]

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[32] *WUTC v. Puget Sound Energy, Inc.*, Dockets UE-040641/UG-040640, Order 06 at ¶27 (February 18, 2007).
[33] Elgin, Exh. No. KLE-1T at 11:12-15. See also, *Schneidewind v. ANR Pipeline Co.*, 485 U.S. 293, 302 (1988) (authority of commission to adjust ratemaking capital structure to limit burden on ratepayers of high equity costs).
[34] *WUTC v. PacifiCorp,* Docket UE-050684, Order 04 at ¶¶224 and 230 (April 17, 2006) and *WUTC v. PacifiCorp,* Docket UE-100749, Order 07 at ¶10 (May 12, 2011).
[35] Elgin, Exh. No. KLE-1T at 9:17-21. See also, *Schneidewind v. ANR Pipeline Co*., 485 U.S. 293, 302 (1988).
[36] Williams, Exh. No. BNW-18CX at 1 and 7.
[37] In doing so, the Commission would enforce the commitment that MEHC and PacifiCorp have failed to satisfy that ratepayers would not be harmed by paying a higher cost of capital as a result of the sale. *In re Application of MidAmerican Energy Holdings & PacifiCorp,* Docket UE-051090, Order 07 (February 22, 2006). (Appendix A, Commitment 21: "MEHC and PacifiCorp will not advocate for a higher cost of capital as compared to what PacifiCorp's cost of capital would have been, using Commission standards, absent MEHC ownership.")
[38] Williams, Tr. 261:5-10.

2. Staff's Capital Structure Containing 46 Percent Equity is Consistent with Commission Policy to Balance Safety and Economy

21 Mr. Elgin's recommendation for a capital structure with 46 percent equity is based upon several factors that implement Commission policy to balance safety and economy in order to maintain PacifiCorp's financial integrity, while also protecting ratepayers from excessive costs of the holding company structure:

- A 46 percent equity ratio is consistent with the consolidated equity ratios of utilities with limited unregulated operations.[39]
- A 46 percent equity ratio will support a BBB corporate credit rating and A- secured bond rating consistent with industry standards, and will allow PacifiCorp to raise capital on reasonable terms and conditions.[40]
- A 46 percent equity ratio is the same ratio the Commission found reasonable in PacifiCorp's 2005 general rate case. There, the Commission rejected a 49.5 percent equity ratio PacifiCorp advocated to account for cash infusions PacifiCorp received from its parent, at that time Scottish Power.[41]

22 Mr. Williams claims a capital structure with 52.22 percent equity is necessary to support PacifiCorp's capital budget[42] and any inability to access funds may cause problems with service reliability and other issues.[43] He also states that a capital structure with an equity ratio above 50 percent maintains a secured "A" rating, which is necessary to finance operations on reasonable terms and fulfill utility obligations during periods of financial turmoil.[44]

23 However, the Company failed to show that these benefits outweigh the costs. The Commission should reject PacifiCorp's proposed equity ratio for this reason alone.[45]

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[39] Elgin, Exh. No. KLE-1T at 12:15-19 and 14:1-5.
[40] Elgin, Exh. No. KLE-1T at 3:2-5 and 13:2-18.
[41] *WUTC v. PacifiCorp*, Docket UE-050684, Order 04 at ¶¶216 and 233 (April 17, 2006).
[42] Williams, Exh. No. BNW-1T at 13:9-10.
[43] Williams, Exh. No. BNW-1T at 3:4-6 and 6:9-11.
[44] Williams, Exh. No. BNW-1T at 3:10-16 and 6:17-19.
[45] *WUTC v. PacifiCorp,* Docket UE-050684, Order 04 at ¶232 (April 17, 2006).

24 Moreover, Mr. Elgin estimated the extra cost to ratepayers of PacifiCorp's proposed capital structure: $7 million annually, based on PacifiCorp's proposed $825 million rate base, PacifiCorp's recommended return on equity of 10.0 percent, and a 35 percent income tax rate, compared to the estimated marginal cost of debt for a utility with an A- secured rating.[46] He estimated an even higher annual cost of $8 million taking into account the difference between the cost of added equity and federal income taxes compared to the current cost of short-term debt. The Company did not rebut his calculations.

25 Nor did the Company support its claims with specific evidence. Indeed, the uncontroverted evidence disproves the Company's claims regarding the need to fund its capital budget. PacifiCorp has generated sufficient cash to fund its construction budget:

- In 2012, it generated $1.627 billion of cash with capital expenditures of $1.342 billion.
- In 2011, it generated $1.506 billion of cash with capital expenditures of $1.529 billion.
- In 2010, it generated $1.607 billion of cash with capital expenditures of $1.613 billion.[47]

The Company provided no evidence that it will be unable to continue this practice. Indeed, the Company's future capital budget shows lower expenditures than these prior years.[48] PacifiCorp also provided no evidence that its construction budget is unique or extraordinary as to require an "A" secured debt rating.

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[46] Elgin, Exh. No. KLE-1T at 45:24-46:5.
[47] Elgin, Exh. No. KLE-4.
[48] Exh. No. B-4, Attachment Bench Request No. 5-2.

26 In fact, the two utilities (PSE and Avista) Mr. Williams wishes to compare to PacifiCorp have secured debt ratings one notch below PacifiCorp. He was unable to identify any difficulties of those companies obtaining capital on reasonable terms and conditions.[49]

3. Staff's Capital Structure Containing 4 Percent Short-Term Debt Allows Ratepayers to Benefit Fairly from this Promptly Available, Low Cost Capital

27 The Commission has stated that a balanced capital structure should consider "all sources of capital available to a company."[50] Only Mr. Elgin applies this principle by including 4.0 percent short-term debt in his recommended capital structure.

28 His proposal recognizes this very low cost and readily available source of capital that provides PacifiCorp flexibility in managing its need for cash.[51] His proposal is also at the mid-point of the 3-5 percent range of short-term debt that any prudent utility should maintain.[52]

29 Finally, his proposal to include 4 percent short-term debt recognizes the Company does use this source of funds. In 2011 the Company had short-term debt of $688 million outstanding (5 percent of total capital).[53] Despite the Company's argument that it does not now use short-term debt, its current short-term debt credit facility is $1.2 billion.[54]

30 In the Company's last litigated rate case, the Commission excluded short-term debt, suggesting that the determining factor is whether a company's actual capital structure contains short-term debt.[55] However, the Commission also stated that it may impute short-term debt if it

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[49] Williams, Tr. 153:5-18.
[50] *WUTC v. PacifiCorp,* Docket UE-050684, Order 04 at ¶224 (April 17, 2006).
[51] Gorman, Tr. 227:9-15.
[52] Elgin, Exh. No. KLE-1T at 15:9-12.
[53] Williams, Exh. No. BNW-18CX at 7, column (c); Elgin, Exh. No. KLE-1T at 15:13-14.
[54] Elgin, Exh. No. KLE-1T at 15:17.
[55] *WUTC v. PacifiCorp,* Docket UE-100749, Order 06 at ¶43 (March 25, 2011) ("Here, we are not persuaded that the Company's 'actual' capital structure contains such short-term debt."). See also *WUTC v. PacifiCorp,* Docket UE-050684, Order 04 at ¶224 (April 17, 2006) ("The Commission has traditionally included a component for short-term debt, based on a company's actual capital structure.").

is appropriate.[56] PacifiCorp's proposal to exclude short-term debt fails to minimize its overall cost of capital and will harm ratepayers. It is, therefore, appropriate for the Commission to impute a reasonable amount of short-term debt in this case, as Mr. Elgin proposes.

31 Mr. Williams asserts that including short-term debt is inconsistent with FERC treatment and how construction work in progress is treated for purposes of recognizing an allowance for funds used during construction.[57] His argument has already been rejected by the Commission:

> We agree with Staff and Public Counsel that the appropriate capital structure should include a component of short-term debt. Using the cost for short-term debt in the FERC formula for CWIP neither "ear marks" all short-term debt for that sole purpose, nor precludes the use of short term debt in the Company's general capitalization. Contrary to what the Company alleges, including short-term debt in the capital structure does not amount to double-counting.[58]

32 Mr. Williams states that short-term debt balances fluctuate dramatically and are not a source of permanent financing.[59] The argument is self-serving. Fluctuating balances of short-term debt are the direct result of management decisions not to use these funds to manage operations and keep interest costs low. A prudent strategy would be to regularly use outstanding short-term borrowing capacity, turned over with more permanent financing from time to time.[60] The Commission should hold PacifiCorp to that standard and include 4 percent short-term debt in the capital structure, as recommended by Mr. Elgin.

4. Conclusion on Capital Structure

33 PacifiCorp has failed to show that its proposed capital structure is reasonable. Indeed, MEHC's financing policies preclude PacifiCorp's use of short-term debt and inflate the Company's equity ratio to levels above 52 percent, all for the benefit of PacifiCorp's owners.

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[56] *WUTC v. PacifiCorp,* Docket UE-100749, Order 06 at ¶43 (March 25, 2011).
[57] Williams, Exh. No. BNW-1T at 16:9-21.
[58] *WUTC v. PacifiCorp,* Docket UE-050684, Order 04 at ¶224 (April 17, 2006).
[59] Williams, Exh. No. BNW-1T at 16:22-17:4.
[60] Elgin, Exh. No. KLE-1T at 45:11-15.

34 Staff's proposal to impute 4 percent short-term debt will ensure ratepayers achieve the lowest overall cost of capital. When combined with 46 percent equity, Staff's proposed capital structure restores a balance of safety and economy that protects ratepayers from the policy decisions of MEHC, while still allowing PacifiCorp to obtain capital on reasonable terms and conditions in order to fulfill its public service obligations.

B. Cost of Equity

35 In PacifiCorp's most recent litigated rate case, the Commission determined that a fair return on equity was 9.8 percent. The Company seeks an increase to 10.00 percent based on Dr. Hadaway's analysis. Mr. Elgin recommends an equity return of 9.0 percent, the high end of his range of 8.5 percent to 9.0 percent.[61]

36 The 9.0 percent return on equity proposed by Mr. Elgin properly reflects the current cost of equity for PacifiCorp. His recommendation is supported by the comprehensive analytical methods he presented using published financial information considered by investors, and the necessary expert judgment he applied to fairly assess investor return requirements. His recommendation is also supported by the evidence Dr. Hadaway himself produced.

1. Staff's Proxy Group Contains Companies of Comparable Risk to PacifiCorp and Therefore Provides an Appropriate Basis for Analysis

37 Mr. Elgin places primary reliance on the Discounted Cash Flow ("DCF") model. This approach reflects Commission historical preference.[62]

38 Mr. Elgin employed the constant growth DCF model, which combines the current dividend yield for a group of proxy utilities with several indicators of expected dividend growth.

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[61] Elgin, Exh. No. KLE-1T at 9-12.
[62] *WUTC v. Puget Sound Energy, Inc*., Dockets UG-040641/UG-040640, Order 06 at ¶73 (February 18, 2005).

Selection of a proxy group is critical because PacifiCorp is not publicly traded. Therefore, there is no direct market evidence of its common stock.[63]

39 The goal when selecting a proxy group is to select companies of similar risk to the utility.[64] This principle of comparable risk is found in the bedrock principle of regulation that:

> A public utility is entitled to such rates as will permit it to earn a return on the value of the property it employs for the convenience of the public equal to that generally being made . . . on investments in other business undertakings which are attended by corresponding risks and uncertainties . . .[65]

40 Mr. Elgin's selection of proxy companies met this principle. He began with the 14 utilities selected by Dr. Hadaway, but then he removed companies that have a different risk profile than PacifiCorp because they have excessive amounts of revenue from unregulated operations, nuclear construction risk, and serve concentrated markets.[66] This resulted in a proxy group of eight companies that compare favorably to PacifiCorp and provides an appropriate basis to analyze investor return requirements.[67]

41 The Commission has previously expressed concern with the statistical reliability of a proxy group containing as few companies as seven.[68] Dr. Hadaway expressed a similar criticism regarding the size of Mr. Elgin's proxy group.[69]

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[63] Elgin, Exh. No. KLE-1T at 16:16-21.
[64] Elgin, Exh. No. KLE-1T at 20:1-9. See also, *WUTC v. PacifiCorp,* Docket UE-100749, Order 06 at ¶79 (March 26, 2011) ("We do not have to winnow down with precision a proxy group to a level of identical risk but instead use our best judgment to consider companies with similar characteristics and risks.").
[65] *Bluefield Water Works and Improvement Co. v. Public Service Comm'n of West Virginia*, 262 U.S. 679, 692 (1923).
[66] Elgin, Exh. No. KLE-1T at 17:7-16.
[67] Elgin, Exh. No. KLE-1T at 18:1-7. The companies are ALLETE, Alliant Energy Co., Avista Corp., IDACORP, Portland General, Westar Energy, Wisconsin Energy and Xcel Energy, Inc. Elgin, Exh. No. KLE-1T at 17:19-20.
[68] *WUTC v. PacifiCorp,* Docket UE-100749, Order 06 at ¶78 (March 26, 2011).
[69] Hadaway, Exh. No. SCH-10T at 9:6-8. Dr. Hadaway's criticism is perplexing. He did not provide statistical support to reduce his number of proxy companies from 22 in the last litigated case to 14 companies in this case. His only "analysis" was that his group is about twice the size of Mr. Elgin's. Hadaway, Tr. 145:17-21.

42 However, it is unnecessary to inquire into the statistical reliability of a proxy group as long as the selection criteria are objective, transparent and rationally related to the risk characteristics of the utility. That is precisely the case with the proxy group Mr. Elgin selected.[70]

2. Staff's Dividend Yield Rate of 4.25 Percent is Reasonable for Estimating PacifiCorp's Cost of Equity

43 For the dividend yield component of his DCF, Mr. Elgin evaluated the actual dividend paid by each proxy firm and used a range of "expected" prices to calculate a dividend yield for that group. This process accounted for the diversity of investor expectations for future dividends over time. Finally, he compared his dividend yield for PacifiCorp and his proxy group to dividend yield indications by *Value Line* (4.2 percent), *Morningstar* projections (3.95 percent) and Dr. Hadaway's estimate for Mr. Elgin's proxy group (4.22 percent).[71] He concluded that a reasonable dividend yield is in the range of 4.00 percent to 4.25 percent. He settled on 4.25 percent, which exceeds Dr. Hadaway's dividend yield of 4.01 percent for his proxy group.[72]

44 Thus, the dividend yield component of Mr. Elgin's DCF analysis provides an upward cushion in his overall return on equity recommendation. It also accounts for the possibility of changing interest rate policy on future share prices.

3. Staff's Dividend Growth Rate of 4.75 Percent is Reasonable for Estimating PacifiCorp's Cost of Equity

45 For the dividend growth rate of his DCF, Mr. Elgin provided a comprehensive analysis of four financial indices of investor expectations for each of his proxy companies, as projected by *Value Line* and other reporting services: 1) book value; 2) internal growth; 3) dividends per

[70] Mr. Elgin also described scholarly research supporting as few as three proxy companies in an analysis comparable to a DCF study. Elgin, Exh. No. KLE-1T at 21:17-22:22.
[71] Elgin, Exh. No. KLE-1T at 25:5-26:2.
[72] Hadaway, Exh. No. SCH-15 at 2, column 3.

share; and 4) earnings per share.[73] Each of these indices reflects published information investors consider and, when taken together, indicate what investors can expect reasonably as a proxy for long-term sustainable growth in dividends.[74] Thus, Mr. Elgin's analysis replicated the decision making of investors choosing an equity investment in an electric utility.

46 Mr. Elgin concluded from his analysis that investors can reasonably expect long-term dividend growth of 4.0 to 4.5 percent using all four indices.[75] Giving primary weight to earnings per share gave him a dividend growth of 4.75 percent.[76] Combined with his 4.25 percent dividend yield, gave him a cost of equity for PacifiCorp of 9.0 percent.[77] This was the high end of his range of 8.5 to 9.0 percent.[78]

47 Mr. Elgin's conclusion was corroborated by Dr. Hadaway's Capital Asset Pricing Model study. That study supported a return on equity of 7.55 percent to 8.25 percent, although Mr. Elgin cautioned this means only that the cost of capital has declined since the Commission last determined that 9.8 percent is a fair return on equity for PacifiCorp.[79] Mr. Elgin's equity risk premium of 450 basis points over PacifiCorp's long-term debt cost also shows that his DCF return on equity of 9.0 percent provides adequate compensation for PacifiCorp's owners.[80]

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[73] Elgin, Exh. No. KLE-1T at 26:20-27:1
[74] Elgin, Exh. No. KLE-1T at 27:1-5.
[75] Elgin, Exh. No. KLE-1T at 32:18-19.
[76] Elgin, Exh. No. KLE-1T at 33:5. Thus, Dr. Hadaway's mischaracterization that Mr. Elgin relied principally on internal growth rates and growth in book value should be rejected. Hadaway, Exh. No. SCH-10T at 9:8-10. In fact, had Mr. Elgin weighted equally each of the four factors, his dividend growth estimate would be only 4.40 percent and his resulting return on equity estimate would be correspondingly lower. Elgin, Exh. No. KLE-1T at 32:13-14.
[77] Elgin, Exh. No. KLE-1T at 33:4-6.
[78] Elgin, Exh. No. KLE-1T at 36:11-12. The low end of his range was calculated by combining the average dividend yield of his proxy group (4.00-4.25 percent) with a dividend growth estimate of 4.00 to 4.5 percent. Elgin, Exh. No. KLE-1T at 33:2-7.
[79] Elgin, Exh. No. KLE-1T at 34:1-14.
[80] Elgin, Exh. No. KLE-1T at 35:20-36:2.

48 The Commission needs look no further than Dr. Hadaway's rebuttal testimony for support for a 9.0 percent return on equity. That testimony includes a constant growth DCF result of 9.0 percent[81] even using analysts' estimates that Mr. Elgin explained tend to be inflated.[82]

49 The Company may refer to Dr. Hadaway's two alternate DCF results in the range of 9.4 to 9.6 percent.[83] However, both of those studies use a 5.6 percent historical growth calculation of Gross Domestic Product ("GDP") over the 60-year period from 1951 to 2011.[84] Mr. Elgin provided un-rebutted testimony that the 5.6 percent result was heavily weighted by early years of high inflation which skewed the result upward.[85] Using more recent data results in an historical GDP growth rate of 4.3 to 4.5 percent, producing a return on equity no more than 9.0 percent.[86]

50 Dr. Hadaway's reliance on historical GDP growth data is perplexing since the Commission has rejected his approach in the Company's last two contested cases:

- In the 2005 case, the Commission stated, "However, in this case we find persuasive Mr. Gorman's argument, that if growth in GDP is used for this critical input to the DCF formula, it should be forward-looking, not an historical average."[87]

- In the 2010 case, the Commission again rejected Dr. Hadaway's use of historical GDP data and specified that if GDP data is to be used at all it should be short-term estimates of GDP.[88]

51 Dr. Hadaway's failure to heed the Commission's warning must not have been an oversight. Early in this case, Dr. Hadaway provided estimates of future growth in long-term

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[81] Hadaway, Exh. No. SCH-15 at 2. This was a decline in the cost of equity from the 9.5 percent result he provided in his direct testimony. Hadaway, Exh. No. SCH-7 at 1.
[82] Elgin, Exh. No. KLE-1T at 29:16-30:2. Dr. Hadaway cites Mr. Gorman to criticize Mr. Elgin for rejecting the use of analysts' growth estimates. Hadaway, Exh. No. SCH-10T at 12: 16-20, citing, Gorman, Exh. No. MPG-1T at 20:13-14. Dr. Hadaway ignores Mr. Gorman's later admission that his constant growth DCF overstates results because it uses analysts' dividend growth projections. Gorman, Exh. No. MPG-1T at 21:21-23.
[83] Hadaway, Exh. No. SCH-15 at 1. Both of these results also showed a decline in the cost of equity from Dr. Hadaway's direct testimony: multi-stage DCF declined from 9.8 percent to 9.4 percent; GDP growth DCF declined from 10 percent to 9.6 percent. Hadaway, Exh. No. SCH-7 at 1.
[84] Hadaway, Exh. No. SCH-15 at 3, column 12 and 4, column 23 and Hadaway, Exh. No. SCH-6.
[85] Elgin, Exh. No. KLE-1T at 51:1-52:5.
[86] Elgin, Exh. No. KLE-1T at 52:10-17.
[87] *WUTC v. PacifiCorp*, Docket UE-050684, Order 04 at ¶261 (April 17, 2006).
[88] *WUTC v. PacifiCorp,* Docket UE-100749, Order 06 at ¶84 (March 25, 2011).

GDP in the range of 4.4 to 4.5 percent,[89] compared to the 5.6 percent he used in his DCF. He provided no reason to ignore these lower estimates of future GDP growth.

52 As a last resort, Dr. Hadaway disowns even his own DCF results based on his opinion that equity markets have not assimilated very recent increases in interest rates caused by changed policies of the Federal Reserve.[90] He relies instead on an updated risk premium study for his recommended 10 percent return on equity.[91]

53 Once again his argument is refuted by his own evidence. In March 2011, when the Commission set the Company's authorized return on equity at 9.8 percent, the Single A Utility Rate (5.56 percent) and the 30-Year Treasury Rate (4.51 percent) were both higher than the most recent report for July 2013(4.53 percent and 3.40 percent, respectively).[92] Thus, if the cost of equity is driven by interest rates, as Dr. Hadaway now opines, the Company's cost of equity should be reduced.

54 The contradiction of Dr. Hadaway's new argument is glaring. Apparently the Commission should not reduce the cost of equity when interest rates decline, but it should increase the cost of equity when interest rates rise. The Commission should reject such "logic".

55 Moreover, Dr. Hadaway asks the Commission to abandon the DCF approach because of extremely recent developments with consequences yet determined.[93] The Commission should reject any notion that equity markets are irrational and that equity prices do not measure accurately investor return requirements.[94] The price of common stock is set in highly

[89] Hadaway, Exh. No. 18CX at 1 and 3 (real growth domestic product of 2.5 percent plus GDP chain-type price index of 1.9 percent).
[90] Hadaway, Exh. No. SCH-10T at 23:1-7.
[91] Hadaway, Exh. No. SCH-10T at 23:8-14 and Hadaway, Exh. No. SCH-16.
[92] Gorman, Exh. No. MPG-31CX.
[93] Hadaway, Tr. 270:15-18.
[94] Elgin, Tr. 265:24-268:11 and Gorman, Tr. 236:11-239:16.

competitive capital markets that reflect investor expectations. The DCF model relies on the price of common stock and, therefore, is a reliable indicator of the cost of equity.[95]

C. Cost of Debt

56 Mr. Elgin considered the impact of his capital structure recommendation on the Company's cost of long-term debt. In doing so, he accepted Mr. William's theory that his proposal could lower the Company's investment grade credit rating one notch from "A" to "A-" and increase its cost of debt.[96] Therefore, Mr. Elgin calculated a hypothetical cost of debt using the debt cost of Avista, which is an investment grade utility with an equity ratio of 46 percent supporting a secured bond rating of A-. He arrived at a total cost of debt of 5.34 percent.[97]

57 Mr. Williams claims that the Company's debt costs would be 6.125 percent as a result of Mr. Elgin's capital structure recommendation.[98] His argument is flawed. First, despite his insistence on comparing PacifiCorp to other Washington utilities, none of the surrogate companies underlying his calculation provide service in Washington.[99]

58 Second, Mr. Williams assumed that PacifiCorp would have issued the exact same amount of debt at the exact same time as each of his surrogate companies.[100] His assumption that PacifiCorp would have no flexibility on the timing and amount of each issuance is unsupported. The Company's failure to use short-term debt contributes to this faulty assumption.

59 Finally, in December 2012, Avista's cost of long-term debt was 5.60 percent (only 31 basis points higher than PacifiCorp's) and would be 5.34 percent if short-term debt is considered

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[95] Elgin, Exh. No. KLE-1T at 5:21-6:3.
[96] Elgin, Exh. No. KLE-1T at 37:1-13, citing, Williams, Exh. No. BNW-1T at 15:19-16:4.
[97] Elgin, Exh. No. KLE-3.
[98] Williams, Exh. No. BNW-14T at 10:1-8.
[99] Williams, Exh. No. BNW-19CX and Tr. 162:5-12. Only one of the companies (Westar) is even in Dr. Hadaway's proxy group of comparable companies.
[100] Williams, Tr. 161:19-162:4.

(only 5 basis points higher than PacifiCorp's).[101] Likewise, contemporaneous long-term debt issuances by PacifiCorp, PSE and Avista all had similar coupon rates in the late 2011 to early 2012 time period.[102] Thus, the un-rebutted evidence is that PacifiCorp's cost of debt is not much different than the other Washington utilities Mr. Williams cites. There is no reason why PacifiCorp cannot finance its operations with debt at the same cost Avista has obtained.[103]

D. Staff's Overall Cost of Capital Will Maintain the Company's Financial Integrity at the Lowest Cost to Ratepayers

60 Mr. Elgin established that the Company's total cost of capital should be 7.03 percent. His recommendation is based on a balanced capital structure that uses all available sources of funds to ensure that PacifiCorp is financed at the lowest overall cost of capital that maintains its financial integrity and ability to attract capital on reasonable terms and conditions.

61 In support of this conclusion, Mr. Elgin provided an analysis of profitability showing that his recommendation produces earnings before interest and taxes ("EBIT") of 3.22 times interest expense. This interest coverage represents a significant level of profit margin that will support a solid investment grade rating of A- for secured debt.[104] The Commission should adopt Mr. Elgin's cost of capital recommendation.

III. POWER COSTS

62 The Company proposes a number of changes from current methods approved by the Commission for allocating power costs under the WCA methodology and running the Generation

[101] Elgin, Exh. No. KLE-3, column (j), lines 27 and 31.
[102] Elgin, Exh. No. KLE-1T at 42:20-43:2.
[103] Elgin, Exh. No. KLE-1T at 37:9-13.
[104] Elgin, Exh. No. KLE-1T at 38:3-8. EBIT is similar to cash flow metrics used by rating agencies to measure a company's ability to service debt. In fact, EBIT is preferable because it considers prospective profitability based upon the jurisdictional operations of the Company, while cash flow metrics rely only on historical total Company results. Finally, as we discussed above, PacifiCorp generates sufficient cash to finance utility operations. A cash flow analysis is unnecessary. Elgin, Exh. No. KLE-1T at 38:13-23.

& Regulation Initiative Decision ("GRID") model. Staff opposes four of these changes, which have a combined effect of increasing Washington revenue requirement by $11.3 million:[105]

- The Company proposes to change the calculation of the Control Area Generation West ("CAGW") allocation factor used to allocate total WCA generation and transmission costs to Washington. This proposal increases Washington revenue requirement $800,000. Section V explains why the Company's proposal should be rejected.

- PacifiCorp proposes to include in the calculation of net power costs the costs of the Company's purchased power agreements with QFs located in Oregon and California. The net power cost impact of this proposal is an increase of $10.7 million to the Commission's approved "situs" approach of allocating only Washington QF contracts.

- The Company proposes to exclude the imputed value of sales from the WCA to the East Control Area ("ECA") that it has modeled previously to calculate net power costs. The net power cost impact of this proposal is an increase of $300,000 compared to the Commission-approved method to impute these market sales.

- PacifiCorp proposes to include the costs of the Company's transmission rights for the Pacific Direct Current Intertie ("DC Intertie"). The effect of including this transmission right and associated modeled purchases at the Nevada-Oregon Border hub is to increase net power costs by $1.1 million. The Commission has previously disallowed the costs of this transmission facility.

63 The revisions proposed by PacifiCorp were not agreed to in the recent collaborative to evaluate potential changes to the WCA methodology.[106] Moreover, as discussed below, the Company has failed to justify these one-sided changes to the WCA methodology and GRID that allocate more power costs to Washington ratepayers than is reasonable.

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[105] Attachment A, line 60. Staff also rejected the Company's proposal to reduce the capacity of Company-owned wind resources. Gomez, Exh. No. DCG-1CT at 5:7-8. PacifiCorp conceded the Staff adjustment. Duvall, Exh. No. GND-10T at 11:4-14.

Staff does not contest the Company's proposal to include the full cost of a 200 MW point-to-point Idaho Power wheeling contract in exchange for an increase in capacity of the Jim Bridger plant. Gomez, Exh. No. DCG-1T at 7:10-19. Staff also supports the following proposed changes to GRID: 1) adding Leaning Juniper, Goodnoe Hills and Chehalis plants to the WCA; 2) hydro generation modeling to account for reserve capability; and 3) adding the cost of holding reserves to integrate non-owned wind facilities. Gomez, Exh. No. DCG-1CT at 17:21-18:2.

[106] Dalley, Exh. No. RBD-2.

A. The Commission Should Maintain "Situs" Allocation and Exclude the Cost of Purchased Power Contacts with QFs Located in Oregon and California

64 In prior cases using the WCA cost allocation methodology, the Company did not include in Washington rates the cost of purchased power contracts with QFs located in Oregon and California. Instead, PacifiCorp applied an allocation approach that included only the cost of contracts with QFs located in Washington.[107]

65 In this rate case, PacifiCorp proposes to include the cost of power purchased from Oregon and California QFs and allocate a portion of that cost to Washington.[108] This is a significant change considering that 74 percent of QF power for 2014 comes from contracts entered in the last 5 years at avoided cost rates for Oregon and California.[109] The Company's proposal increases Washington net power costs by $10.7 million.[110]

66 PacifiCorp puts forward several arguments to support its new treatment. It claims the proposal is fair to Washington customers because the Oregon and California QF contracts physically deliver power to meet Washington load just like any other resource in the WCA.[111] It argues the proposal is consistent with Washington energy policy supporting the development of renewable and distributed energy.[112] Likewise, it claims that excluding these resources from Washington rates is contrary to the Public Utilities Regulatory Policy Act ("PURPA") of 1978 and denies the Company cost recovery for resource acquisitions mandated by PURPA.[113]

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[107] Duvall, Exh. No. GND-1CT at 5:9-10.
[108] Duvall, Exh. No. GND-1CT at 5:10-12.
[109] Duvall, Exh. No. GND-7CT at 19:22-20:3.
[110] Gomez, Exh. No. DCG-1CT at 9:7-10.
[111] Duvall, Exh. No. GND-1CT at 5-6 and Duvall, Exh. No. GND-7CT at 17:1-11.
[112] Duvall, Exh. No. GND-7CT at 14:8-12. See also Gomez, Tr. 478:18-479:8. The Company quotes a recent statement of Chairman David Danner in an order adopting amendments to the Commission's interconnection rules in WAC Chapter 480-108 ("By streamlining these rules we are advancing Washington's policies that encourage renewable energy, including distributive generation."). Duvall, Exh. No. GND-7CT at 14:17-19. PacifiCorp takes the Chairman's words out of context. The cited rulemaking does not address the interconnection of QFs with the facilities of an electrical company. See WAC 480-108-001(4).
[113] Duvall, Exh. No. GND-1CT at 5-6.

PacifiCorp even implied at hearing that cost allocation of QF power is actually irrelevant because the Commission has overriding authority to review any QF contract for prudence.[114]

67 The Company's arguments all miss the mark. The overriding issue the Commission must resolve is the cost of QF power that is reasonable to allocate to Washington. The current "situs" approach protects Washington ratepayers from potential harm caused by divergent approaches among states served by PacifiCorp that impact the cost of QF power. It is, therefore, reasonable for the Commission to reject the Company's proposal and continue to exclude the cost of power from QFs located outside Washington when calculating net power costs.

1. PURPA Authorizes the States to Determine QF Contract Rates

68 Congress enacted Section 210 of PURPA to encourage the development of cogeneration and small power production by non-utility power producers called "qualified facilities" or "QFs".[115] PURPA requires electric utilities to purchase energy offered by QFs at rates that are just and reasonable to consumers and that reflect no greater than the "incremental cost" that the utility would have otherwise incurred to generate or purchase the power supplied by the QF.[116]

69 The Federal Energy Regulatory Commission ("FERC") has adopted regulations to implement PURPA. The regulations define "incremental costs" as the full "avoided cost" of electric energy or capacity or both, which, but for the purchase from the QF, the utility would generate itself or purchase from another source.[117] QF rates must equal but not exceed full avoided cost.

[114] Gomez, Tr. 477:9-14.
[115] *FERC v. Mississippi*, 456 U.S. 742, 750 (1982).
[116] 16 U.S.C. §824a-3(a), (b) and (d).
[117] 18 C.F.R. §292.101(6).

70 PURPA requires states to implement FERC's regulations for investor-owned utilities.[118] FERC's regulations establish numerous guidelines that "shall, to the extent practical, be taken into account" when establishing QF avoided cost rates, but otherwise delegate to each state the discretion to choose the actual methodology and calculation of appropriate QF contract rates.[119] The Supreme Court has confirmed the latitude afforded states under PURPA:

> FERC has adopted regulations relating to the purchases and sales of electricity to and from cogeneration and small power facilities (citations omitted). These afford state regulatory authorities and non-regulated utilities latitude in determining the manner in which the regulations are to be implemented. Thus, a state commission may comply with the statutory requirements by issuing regulations, by resolving disputes on a case-by-case basis, or by taking any other action reasonably designed to give effect to FERC's rules.[120]

As we explain in the next section, this Commission and the Oregon commission have used their discretion by adopting different and unique approaches for determining the price a utility must pay for power from a QF.[121]

2. Washington and Oregon Have Adopted Divergent PURPA Approaches for Determining the Cost of Purchases from QFs

71 PacifiCorp argues that Washington is the only state served by the Company that does not allocate the cost of purchases from QFs located in other states.[122] However, that distinction is justified by differences in the approach for pricing QF power between Washington and the Company's other states in the WCA.[123]

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[118] 16 U.S.C. §824a-3(f).
[119] 18 C.F.R. §292.304(e). These factors include the ability of the utility to dispatch the QF, the expected or demonstrated reliability of the QF, and the duration of the utility's contract with the QF. The Company, therefore, is wrong to argue that PURPA mandates the precise methodology for determining avoided cost prices for QF contracts. See Duvall, Exh. No. GND-7CT at 8:8-9.
[120] *FERC v. Mississippi*, 456 U.S. 742, 751 (1982).
[121] Staff testified that the policies adopted by California are similar to Oregon and that PacifiCorp's service territory in California is small. Gomez, Exh. No. DCG-5CX. The Company did not rebut that assertion.
[122] Duvall, Exh. No. GDN-7CT at 22:3-8.
[123] The Company attempted to show that the QF policies of Washington and Oregon are similar: to advance distributed generation. Gomez, Tr. 478:14-483:24. The issue, however, is not so much whether the policies are similar, but whether the states' approaches to implementing them are similar. Moreover, the Company relied for its

a. Washington

72 To fulfill its obligations under PURPA, this Commission has adopted a competitive contracting process in which investor-owned utilities solicit bids from QFs.[124] The record in this case summarizes the process.[125]

73 All investor-owned utilities must file a standard contract tariff for purchases from QFs with a generation capacity of one megawatt or less.[126] QFs may then accept a purchasing utility's standard offer contract, without filing a bid, regardless of the generation technology used.[127] The Commission has approved tariffs implementing a standard offer contract for all three investor-owned utilities. Avista's tariff applies to QFs with a generating capacity of one MW or less. PacifiCorp's Schedule 37 applies to QFs of two MW or less. PSE's tariff applies to QFs of five MW or less.[128]

74 The Commission does not require a specific standard contract length. However, a utility may enter into QF contracts for up to a 20-year term or longer.[129] The companies' tariffs include published standard contract term lengths. PSE's standard contract extends for ten years. PacifiCorp's standard contract extends for five years.[130]

75 The tariffs offering standard contract rates for QF power are based on avoided costs, as are utility offers to QFs of larger capacity generation. The companies are required annually to file a schedule of estimated avoided costs. The estimates are based upon the utility's most recent

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argument on a Commission report (Gomez, Exh. No. 7CX) addressing numerous issues. Purchases from QFs are only one issue on a long list of issues. The Company's reliance on the report is grossly overstated.

[124] WAC Chapter 480-107.

[125] Gomez, Exh. No. 7CX at 10 and 26.

[126] WAC 480-107-095(1).

[127] WAC 480-107-095(2).

[128] Gomez, Exh. No. 7CX at 10.

[129] WAC 480-107-075(3).

[130] The Company attempted to show that its standard offer contract was extended from five to ten years. Gomez, Tr. 484:6-485:13. This is a mischaracterization. The tariff includes an avoided cost price stream over ten years, but states expressly that the listed avoided costs are fixed for only five years. Gomez, Tr. 484:14-485:13.

project proposals received under a Request for Proposals, estimates included in the company's current Integrated Resource Plan, the results of the utility's most recent competitive bidding process, and projected market prices for power.[131]

b. Oregon

76 The Public Utility Commission Oregon ("OPUC") has adopted a more particularized approach to establishing rates and terms for purchases of QF generation.[132] It requires its utilities to offer standard offer contracts to QFs with a generation capacity up to 10 MW, not 1 MW as this Commission has required.

77 The OPUC has established a maximum standard contract term of 20 years, similar to this Commission. However, in Oregon, a QF is allowed to select fixed pricing for the first 15 years, but is required to select a market price option for the remaining 5 years. This Commission has not been so prescriptive.

78 Regarding the calculation of avoided costs for standard offer contracts, the OPUC requires different methods for different utilities depending on whether the utility is in a resource deficient or sufficient position.[133] The OPUC requires PacifiCorp to reflect the variable and fixed costs of a natural gas-fired combined cycle combustion turbine when the utility is in a resource deficient position. It requires PacifiCorp to use monthly on- and off-peak forward market prices to calculate avoided costs when the company is in a resource sufficient position.

79 The OPUC requires PacifiCorp to offer three pricing options for standard offer contracts. They are: 1) the Fixed Avoided Cost Price Method; 2) the Banded Gas Market Index Option;

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[131] WAC 480-107-055.
[132] *In the Matter of the Public Utility Commission of Oregon Staff's Investigation Relating to Electric Utility Purchases from Qualifying Facilities*, Docket UM 1129, Order 05-584, 242 PUR4th 140 (2005).
[133] The utilities are PacifiCorp, PGE and Idaho Power.

and 3) the Gas Market Index Method. PacifiCorp's filed tariffs in Oregon reflect all of these options in Schedule 37.[134]

80 The OPUC has also developed very detailed requirements for negotiation of non-standard contracts with QFs greater than 10 MW.[135] These include specific procedures and timelines for contract negotiation; pricing provisions that distinguish between "legally enforceable" and "as available" contract terms; contract terms to address matters such as termination, scheduling of outages and availability during emergencies; and the impact on the calculation of avoided costs for integration costs for renewable resources, line losses and the treatment of transmission and distribution-related savings and costs. PacifiCorp's Schedule 38 addresses the process in Oregon for negotiating non-standard QF contracts greater than 10 MW.[136]

3. Policy Choices in Oregon and California Have Resulted In PacifiCorp Paying Higher Prices for QF Power

81 The potential impact on customers in Washington from the divergent QF pricing approaches of Oregon and California is not theoretical. The policies of these other states have resulted in PacifiCorp incurring higher costs for QF contracts in Oregon and California. The Company's response to Staff Data Request 293 shows the Oregon and California QF contracts would result in net power costs ████ million *less* if they were re-priced at Washington avoided cost rates.[137]

82 Clearly, the Company incurred additional costs for power from QFs located in Oregon and California as a result of choices made in those states that affect the calculation of avoided cost. The only reasonable and fair option to ensure that the impacts of those decisions

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[134] http://www.pacificorp.com/es/cg/cqfp.html.
[135] *In the Matter of the Public Utility Commission of Oregon Staff's Investigation Relating to Electric Utility Purchases from Qualifying Facilities*, Docket UM 1129, Order 07-360, 2007WL2413015 (Or. P.U.C.)
[136] http://www.pacificorp.com/es/cg/cqfp.html.
[137] Exh. No. B-4, Attachment 293-2, CONF.xlxs. The Company's rebuttal filing included ████████ of California and Oregon QF costs. Re-priced at Washington avoided cost rates would derive costs of ████████████. The difference is ████████.

do not adversely impact Washington ratepayers is to exclude the cost of power from QFs located outside Washington when calculating net power costs.

83 This treatment is not unfair to the Company because it does not deny the Company cost recovery for resource acquisitions mandated by PURPA. PacifiCorp may seek to recover the costs imposed by the PURPA aproaches of California and Oregon directly from its customers in those jurisdictions. If the Company fails to do so, any under-recovery that may occur due to inconsistent cost allocation methods between Washington and other states in the WCA is a risk the Company agreed would be borne by its owners, not by ratepayers.[138]

B. The Company Failed to Demonstrate that the Imputed Value of Sales to the East Control Area Should Be Eliminated

84 When the Commission adopted the WCA methodology, it approved a Staff adjustment to impute benefits to the WCA of market sales to the ECA considering transmission availability and market prices.[139] The Commission conditioned approval of the WCA methodology on the Staff adjustment because the adjustment allowed for the "indirect inclusion of eastside benefits and costs if purchases or sales between the control areas are economic."[140] This was consistent with the Commission's overall belief that the WCA methodology is:

> [S]traightforward and easy to understand. It is flexible enough to accommodate allocation of indirect benefits and costs when they are quantified and demonstrated.[141]

85 PacifiCorp agreed to the adjustment, which:

- Based the imputed sale on transfers of power from Jim Bridger to the ECA (net of allocation);
- Reduced the sale amount by 40 percent to account for competition from other generators selling power into the ECA; and

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[138] *WUTC v. PacifiCorp,* Docket UE-050684, Order 04, ¶56 (April 17, 2006).
[139] *WUTC v. PacifiCorp,* Docket UE-061546, Order 08 at ¶45 (June 21, 2007).
[140] *WUTC v. PacifiCorp,* Docket UE-061546, Order 08 at ¶47 (June 21, 2007).
[141] *WUTC v. PacifiCorp,* Docket UE-061546, Order 08 at ¶56 (June 21, 2007).

- Set the sale price at Mid-C, plus a share of a margin equal to the difference between Mid-C and Four Corners market prices.[142]

86 In this case, the Company modeled over $51 million in imputed sales from the WCA to the ECA for the 2014 rate year.[143] However, it now opposes imputing any of these benefits, arguing that the adjustment is not straightforward and requires the development of additional data not otherwise required for the WCA method.[144] It also asserts that the assumptions underlying the adjustment are no longer valid today.[145]

87 However, the Company did not provide quantifiable evidence to support any of these statements. Nor did it offer a viable substitute for the adjustment it agreed to in the prior case.

88 More important, the adjustment recognizes the limited transmission path between control areas and the material benefit received by the ECA from resources paid for by WCA customers. That was an integral and crucial piece of the WCA allocation methodology that the Commission approved in Docket UE-061546.[146] Nothing in that regard has changed. The Company's proposal to remove that imputed sale should be rejected.

C. The Company Failed to Demonstrate Any Benefits to Washington Ratepayers That Would Justify Inclusion of the DC Intertie

89 The DC Intertie is a BPA-owned transmission line that sends power from the Pacific Northwest to the Los Angeles area using high voltage direct current. When the Company models GRID purchases or sales over the DC Intertie, the point of transfer is the Nevada-Oregon Border ("NOB") market hub.[147]

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[142] Gomez, Exh. No. DCG-1CT at 14:8-13.
[143] Gomez, Exh. No. DCG-1CT at 15, n.34.
[144] Duvall, Exh. No. GND-7CT at 24:4-11.
[145] Duvall, Exh. No. GND-7CT at 24:12-25:12.
[146] Gomez, Exh. No. DCG-1CT at 16:3-6.
[147] Gomez, Exh. No. DCG-1CT at 20:7-13.

90 In the 2010 rate case, the Company proposed to allocate to the WCA the cost of the DC Intertie, but did not include any purchases at the NOB market hub. The Commission rejected that proposal.[148]

91 In this case, the Company updated GRID to include the DC Intertie capacity and the NOB market hub. However, this change increases Washington transmission expense by $1.1 million,[149] but results in only $9,700 of power sales to serve customers in central Oregon.[150]

92 Clearly there is a continued mismatch between costs and benefits in the Company's proposal that is not alleviated by simply turning on the NOB market hub in GRID and generating a miniscule amount of power sales to serve Oregon load.[151] The inclusion of sales at the NOB hub simply does not justify Washington ratepayers absorbing the cost of the DC Intertie.

93 The Company should seek recovery of the cost of this resource through situs allocation with Oregon or take the Commission's advice in the last rate case and completely retire or write the DC Intertie off its books.[152] PacifiCorp's adjustment should be rejected.

IV. POWER COST ADJUSTMENT MECHANISM

94 PacifiCorp requests a PCAM without dead-bands or sharing bands. This is an improper design that allows the Company to collect or credit all of the differences between actual net power costs and the amount of net power costs in base rates.[153] The Commission should reject the proposal.

95 PacifiCorp dismisses dead-bands and sharing bands as "poor regulatory policy" that penalizes the Company because net power cost variability is largely outside of its control and,

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[148] *WUTC v. PacifiCorp*, Docket UE-100749, Order 06 at ¶152 (March 25, 2011).
[149] Gomez, Exh. No. DCG-1CT at 20:21-21:7.
[150] Duvall, Exh. No. GND-8 at 2, System Balancing Purchases, NOB. This is down from the Company's direct case which included $970,000 of power sales to serve Oregon customers. Gomez, Exh. No. DCG-1CT at 20:22.
[151] Duvall, Exh. No. GND-1CT at 21:12-13.
[152] *WUTC v. PacifiCorp,* Docket UE-100749, Order 06 at ¶151 (March 25, 2011).
[153] Duvall, Exh. No. GND-1CT at 26:2-29:16.

therefore, bands do not motivate the utility towards greater efficiency.[154] Apparently, then, all of the Company's other state commissions practice poor regulatory policy since each of the PCAMs they have approved contain sharing bands.[155] Moreover, Avista and PSE, the two utilities PacifiCorp would like the Commission to emulate, both have PCAMs with sharing bands and dead-bands.[156] The Company's proposal in this case is at odds with all of the mechanisms approved by this Commission and the commissions of the Company's other jurisdictions.

96 The Commission has also rejected the Company's argument, stating:

> [P]ower cost recovery mechanisms should also apportion risk equitably between ratepayers and shareholders. In striking that balance, we consider risks already allocated through the normalization process, a utility's financial condition and other circumstances affecting a utility's ability to recover its prudent expenditures. Deadbands and sharing bands are useful mechanisms, not only to allocate risk, but to motivate management to effectively manage or even reduce power costs.[157]

The Company continues to ignore these Commission directives on PCAM design. Its claim that power cost distribution is no longer asymmetrical[158] is irrelevant.[159]

97 This is not to say that Staff opposes any PCAM for PacifiCorp. The Company faces variability in net power costs sufficient to justify such a mechanism.[160] The expanded role of renewable resources is an additional element supporting a PCAM.[161]

98 However, the Company failed to comply with the fundamental requirement that a PCAM should include dead-bands and sharing bands. Therefore, the real obstacle to a PCAM is the Company's insistence on a mechanism that is not properly designed. Staff is not the problem.

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[154] Duvall, Exh. No. GND-1CT at 31:20-22-31:1-7 and Duvall, Exh. No. GND-7CT at 54:5-9 and 55:3-15.
[155] Griffith, Exh. No. WRG-2.
[156] *WUTC v. Avista Corp*., Docket UE-011595, Order 05 at ¶¶34-40 (June 18, 2002) and *WUTC v. Puget Sound Energy,* Inc., Dockets UE-011570/UG-011571, Order 12 at ¶¶22-24 (June 20, 2002).
[157] *WUTC v. PacifiCorp*, Docket UE-050684, Order 04 at ¶¶96-97 (April 17, 2006).
[158] Duvall, Exh. No. GND-1CT at 48-49.
[159] Gomez, Tr. 493:3-12.
[160] Gomez, Exh. No. DCG-1CT at 23:15-16, citing *WUTC v. PacifiCorp,* Docket UE-061546, Exhibit 261 (APB-1T) at 32:16-33:10 (Testimony of Alan P. Buckley). See also Gomez, Exh. No. DCG-6CX (annual net power cost variability is $67 million compared to $26 million from the 2006 rate case).
[161] Gomez, Exh. No. DCG-1CT at 23:16-18.

99 Finally, the entire issue of inter-state cost allocations is being examined for all states in the MSP.[162] Staff is participating in that process.[163] Any resulting changes may have major impacts on costs used to develop a baseline for a PCAM. It is premature to approve a PCAM for this Company now just because the MSP is in its early stages.

V. NON-POWER COST ALLOCATION

A. Background and Summary of Company and Staff Proposals

1. Background

100 The West Control Area inter-jurisdiction cost allocation methodology ("WCA method") consists of numerous factors to allocate the costs of PacifiCorp's six-state operations to its operations in Washington. Application of the WCA method results in the Washington per books amounts for revenues, expenses, and rate base, which form the baseline of a general rate case.[164] If these factors do not reasonably represent the cost to serve customers, their application can materially distort reporting of the Company's financial performance in Washington.[165]

101 The WCA method was adopted by the Commission in Docket UE-061546.[166] The Commission also ordered a five-year trial period for the WCA method. The trial period was extended to allow a collaborative on cost allocation.[167] PacifiCorp, Staff, Public Counsel, and the Industrial Customers of Northwest Utilities engaged in the collaborative, which ended in October 2012. They did not reach consensus on any cost allocation alternatives, nor did they comprehensively review the WCA for specific modification.

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[162] Daley, Exh. No. RBD-2 at 7-8.
[163] White, Exh. No. KAW-1CT at 7:20.
[164] White, Exh. No. KAW-2.
[165] White, Exh. No. KAW-1CT at 6:11-17.
[166] *WUTC v. PacifiCorp,* Docket UE-061546, Order 08 at ¶¶43-58 (June 21, 2007).
[167] *WUTC v. PacifiCorp*, Docket UE-111190, Order 07, Settlement Stipulation at ¶¶28-29 (February 21, 2012).

2. Overview of Company Proposal

102 The Company proposes several modifications to the WCA method. Three of them impact the calculation of net power costs and are opposed by Staff, as discussed in Section III.

103 Additional modifications proposed by PacifiCorp affect non-power costs primarily through the development of the Control Are Generation West ("CAGW") allocation factor. These revisions are offered as being consistent with the Company's cost of service ("COS") study and cost allocation procedures of other states served by PacifiCorp. They are as follows:

- Changing the weighting used to calculate the CAGW allocation factor from 75 percent demand over 25 percent energy to 38 percent demand over 62 percent energy.
- Using the highest 100 winter hours and highest 100 summer hours ("200 CP") to calculate the demand-related base components within the CAGW allocation factor.[168]

3. Overview of Staff Recommendation

a. Primary Staff Recommendation

104 Staff recommends that the Commission reject the Company's revisions to the WCA method and set rates based upon the approved methodology. That is because PacifiCorp did not provide a comprehensive review of the WCA method. In particular, it created inconsistencies between the CAGW and System Generation ("SG") allocation factors and failed to address the System Overhead ("SO") allocation factor. Given these deficiencies, there is no basis to conclude that the Company's selective revisions fairly allocate total system costs to Washington. Staff's use of the existing WCA cost allocation methodology reduces the Company's revenue requirement by approximately $800,000.[169]

105 Staff is interested in evaluating potential revisions to the WCA method. Therefore, it recommends that the Commission order PacifiCorp to submit: 1) a Report on general plant and

[168] Dalley, Exh. No. RBD-1 at 6:7-19.
[169] White, Exh. No. KAW-CT at 10:5-7.

administrative and general ("A&G") expenses;[170] and 2) additional calculations regarding the CAGW and SG allocation factors.[171]

106 The Report should be submitted at least 90 days before the Company files its next general rate case.[172] This will allow sufficient time to run allocation factor adjustments, given the significant modeling difficulties associated with that effort. The Report should include the following information:

- A thorough analysis and breakdown of the following FERC Accounts:
  - General Plant: Accounts 389-399.
  - Intangible Plant: Account 303.
  - Administrative and General: Accounts 920-935.
- Support for the continued use of the SO factor, if the Company so proposes.
- Consideration of alternatives to the SO factor, including:
  - The System Net Plant factor.
  - A multi-factor allocator such as the "4-Factor".[173]
- Consideration of the SNP allocation factor to apportion property taxes as recommended by Public Counsel.[174]

107 The additional calculations recommended by Staff for the CAGW and SG factors will also facilitate the continued evaluation of cost allocation. The calculations should be filed with PacifiCorp's next general rate case and may best be included as an appendix to the WCA Cost Allocation Manual.[175] These calculations should include:

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170 White, Exh. No. KAW-1CT at 20:15-21:4.
171 White, Exh. No. KAW-1CT at 22.
172 White, Exh. No. KAW-1CT at 21:6-22.
173 The 4-Factor allocation factor is used by Avista and weights equally: 1) customer count; 2) direct labor to O&M; 3) O&M charged directly to transmission and distribution; and 4) directly-assigned net plant. White, Exh. No. KAW-1CT at 19:1-11.
174 Coppola, Exh. No. SC-1CT at 6:1-3.
175 White, Exh. No. KAW-1CT at 22:1-7.

- The calculation of SC based on 200 CP-Total system data.
- The calculation of SG based on the revised SC percentage and weightings based on a 200 CP-Total System peak credit ratio.
- The calculation of CAGW based on 200 CP – WCA peak credit ratio.
- Identification of and updates to any factors derived from the SG or CAGW allocation factors such as:
  - Jim Bridger Generation ("JBG").
  - System Net Plant Transmission ("SNPT").
  - Wheeling Revenue – Generation ("WRG").
  - Wheeling Revenue – Energy ("WRE").
  - System Overhead ("SO").
  - System Net Plant ("SNP").

108 COS issues have been settled in this case, but may be contested in the next case. The information required by Staff's primary recommendation will be an important part of that evaluation, especially given the Company's interest in matching COS with the WCA method.

b. Secondary Staff Recommendation

109 If the Commission adopts any of the Company's proposed revisions to the WCA method, Staff recommends that the Commission also adopt the following additional modifications:

- Use of the peak credit ratio to weight the SG allocation factor, because this factor is conceptually related to the CAGW allocation factor the Company proposes changing.
- Use of 200 CP (the top 100 winter hours plus the top 100 summer hours) in the calculation of all generation- and transmission-related allocation factor components, because the Commission prefers the use of a greater number of data points when determining the cost causation of generation and transmission resources.[176]

[176] *WUTC v. Washington Natural Gas Company*, Dockets UG-940034/UG-940814, Supplemental Order 05 at 9 (April 11, 1995).

- Use of total system (WCA) hours when calculating the weighting for total system (WCA) allocation factors, because there should be matching between the weightings and the balances of the accounts being allocated between jurisdictions.

- Replacement of the SO allocation factor with System Net Plant ("SNP") to allocate general and intangible plant and general A&G expenses between jurisdictions, because the current allocation factor is based on gross plant that unreasonably shifts costs to slower growing jurisdictions, including Washington.

These modifications cannot fully anticipate all issues that the Report or COS review may expose. They are Staff's best effort at this time should the Commission revise the WCA method now.

B. The Selective Revisions Proposed by PacifiCorp Are Not the Result of the Necessary Comprehensive Review

110 The record is clear that PacifiCorp was selective in the allocation revisions it proposes. This lack of comprehensive review is evidenced by the Company's inconsistent treatment of the CAGW and SG allocation factors, and its failure to address the SO allocation factor.

1. A Comprehensive Review of the WCA Method Has Not Yet Occurred

111 The lack of a comprehensive review of the WCA method underlies Staff's primary recommendation to maintain current allocations and require the Company to prepare a Report on the WCA method for use in the next general rate case.

112 The Company argues that a comprehensive review of the WCA method has already occurred in the prior collaborative and as part of Staff's investigation in this case.[177] However, the fact that Staff conducted discovery, made field visits and examined the WCA cost allocation manual, may mean that Staff attempted to conduct the comprehensive review the Company failed to conduct It does not mean, however, that a comprehensive review was completed or could reasonably have been completed. As Staff explained, sufficient time was not available for

[177] Dalley, Exh. No. RBD-3T at 4:7-15.

it to conduct a comprehensive review after all other preliminary discovery was completed and given all other issues raised by the filing.[178]

113 Moreover, a comprehensive review of the WCA method does not end with the identification of concerns regarding current allocation factors, as occurred in the collaborative.[179] It must also provide for the development of new allocation factors and consideration of their impact on the WCA method as a whole. The Company explained that creating a new allocation factor within the revenue requirement models presents significant difficulties. [180] Staff's recommendation to maintain the status quo in this case, but require a Report that will assist in examining possible revisions, isolates allocation issues and impacts so that a comprehensive review can occur in the next case.

2. Company Inconsistencies between the CAGW and SG Allocation Factors

114 The SG allocation factor is used to allocate generation- and transmission-related costs that cannot be assigned to a specific control area.[181] The CAGW allocation factor is used to allocate generation- and transmission-related costs that are assigned to the WCA.[182] In the approved WCA method, the weighting for both factors is 75 percent demand and 25 percent energy ("75/25").

115 Therefore, both factors are similar conceptually because they apportion generation- and transmission-related resources between demand costs and energy costs. Nevertheless, the

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[178] White, Exh. No. KAW-1CT at 3:15-18.
[179] Dalley, Exh. No. RBD-2.
[180] Dalley, Exh. No. RBD-5CX. For example, Staff considered developing a new blended allocation factor for the apportionment of general A&G expense. The Company stated that creating a new allocation factor would "require updates to almost every tab in both the Regulatory Allocation Model ("RAM") and Jurisdictional Allocation Model ("JAM"), in addition to updating the defined ranges in the macros."
[181] McDougal, Exh. No. SRM-5 at 7.
[182] McDougal, Exh. No . SRM-5 at 11.

Company proposes a "peak credit ratio" (38 percent demand and 62 percent energy, or "38/62") for the CAGW factor.[183] It maintains the 75/25 weighting for the SG factor.

116 This imbalanced revision is significant. The CAGW allocation factor increases two basis points when the weightings are changed from 75/25 to 38/62. This means that 0.02 percent more costs that are allocated through that factor are apportioned to Washington. This change also impacts several other allocation factors based on CAGW.[184]

117 By PacifiCorp not similarly changing the SG allocation factor from 75/25 to 38/62, that allocation factor remains 23 basis points higher, meaning that .23 percent more costs that are allocated through that factor are apportioned to Washington.[185] This change has additional impacts, including the calculation of the SO allocation factor. Both of Staff's recommendations address these impacts by providing consistent treatment. Staff's primary recommendation maintains both allocation factors at the current level of 75/25. Staff's secondary recommendation uses a peak credit ratio for both CAGW and SG.

118 The Company argues that there is a logical basis for the inconsistency between the CAGW and SG factors it proposes: that its calculation of the SG factor is included in the 2010 Protocol used by its other five jurisdictions and a cost allocation short-fall could ensue if Washington did not follow suit.[186] This Commission is not beholden to the actions of other states, nor should such considerations override the importance of consistent treatment within the

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[183] McDougal, Exh. No . SRM-5 at 11.
[184] These other factors are Jim Bridger Generation ("JBG"), System Net Plant Transmission ("SNPT"), Wheeling Revenue – Generation ("WRG"), and Wheeling Revenue – Energy ("WRE").
[185] McDougal, Exh. No. SRM-5 at 7. For example, Staff considered developing a new blended allocation factor for the apportionment of general A&G expense. The Company stated that creating a new allocation factor would "require updates to almost every tab in both the Regulatory Allocation Model ("RAM") and Jurisdictional Allocation Model ("JAM"), in addition to updating the defined ranges in the macros." Dalley, Exh. No. RBD-5CX.
[186] Dalley, Exh. No. RBD-3T at 7:19-8:10.

WCA method. Any variation in cost allocation methodologies between Washington and other states in the Company's service territory is a risk the Company accepted.[187]

119 Moreover, the Company's demonstration of an allocation "gap" in cost recovery is based on a comparison between its filing using the 2010 Protocol versus the WCA method.[188] This demonstration is meaningless since only the approved WCA method can show the costs necessary to serve Washington's customers, unless and until the Company proves that another methodology will result in just, reasonable and sufficient rates and the Commission rules in favor of that alternative. Here, PacifiCorp has not made the case for the 2010 Protocol upon which its allegation of a cost recovery gap is based.[189]

120 In fact, the Company states that, "[s]ince the Commission adopted the WCA [method], the Company's operations have not changed significantly."[190] Therefore, ECA resources found previously by the Commission to not be used and useful for service in Washington,[191] must remain not used and useful. Any showing of what the 2010 Protocol would allocate to Washington is irrelevant since the 2010 Protocol would allocate to Washington costs related to these ECA resources. Only the appropriate costs allocated to Washington, as determined by the Commission, are capable of representing fair, just and reasonable rates in Washington.

121 At hearing, the Company stated for the first time that changes to the WCA method are meant to address attrition.[192] However, attrition is measured by comparing the revenue requirement as determined by the allocation methodology to the revenues collected by the

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[187] *WUTC v. PacifiCorp,* Docket UE-050684, Order 04, ¶56 (April 17, 2006).
[188] Dalley, Exh. No. RBD-3T at 12:3-13.
[189] In fact, Staff asked the Company to rerun its revenue requirement models to reflect the 2010 Protocol. The Company objected initially to that request as unduly burdensome and not reasonably calculated to lead to the discovery of admissible evidence. Dalley, Exh. No. RBD-6CX at 1. It was not until *after* the Company filed rebuttal that PacifiCorp provided the requested analysis. Dalley, Exh. No. RBD-6CX at 2.
[190] Dalley, Exh. No. RBD-2 at 7.
[191] *WUTC v. PacifiCorp,* Docket UE-050684, Order 04, ¶62 (April 17, 2006).
[192] Griffith, Tr. 133:6-10.

Company. Changing the allocation methodology just alters the targeted revenue requirement; thus, it cannot be used to address attrition. PacifiCorp may have been inappropriately using "attrition" to mean anything that results in increased revenues to the Company whether or not those revenues are supported by an appropriate allocation methodology.

122 Finally, PacifiCorp argues that Staff itself is being inconsistent because its secondary recommendation to use the 200 coincident peaks for the CAGW and SG allocation factors results in weightings of 27 percent demand and 73 percent energy, compared to Staff's primary recommendation to maintain the 75/25 weightings from the approved WCA method.[193] This is interesting to hear from the Company since Staff's modified CAGW factor would allocate more costs to Washington than PacifiCorp's proposal.[194] This also nullifies the Company's claim that "all" of Staff's allocation factors are "designed to reduce Washington's share of costs."[195]

123 More important, unlike the Company proposal, there is a logical basis for the directional change between the CAGW and SG allocation factors under Staff's secondary proposal: Washington's relative demand and energy components in the WCA versus the Company's total system.[196] On a WCA basis, Washington's energy component is higher (22.6481 percent) compared to its demand component (22.5913 percent).[197] On a total system basis, Washington's energy component is lower (7.57 percent) compared to its demand component (8.20 percent).[198] Therefore, changing the weightings from a heavier emphasis on demand to a heavier emphasis on energy results in opposite directional changes to CAGW versus SG. As long as the demand/energy weightings are consistent between the CAGW and SG factors, those directional

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[193] Dalley, Exh. No. RBD-3T at 9:1-13.
[194] Dalley, Exh. No. RBD-8CX. The Company's revised CAGW factor is 22.6265 percent, compared to Staff's higher factor of 22.6328 percent.
[195] Dalley, Exh. No. RBD-3T at 6:1-2.
[196] White, Exh. No. KAW-1CT at 12:16-13:3.
[197] McDougal, Exh. No. SRM-5 at 11.
[198] McDougal, Exh. No. SRM-5 at 7.

changes will be in balance and the results will be fair and reasonable. That is the case for either Staff's primary or secondary recommendation. If, as PacifiCorp argues, it is important to maintain consistency between cost allocation and COS, Staff's secondary recommendation is successful and maintains internal consistency within the WCA method.

3. Company Failure to Revise the SO Allocation Factor

124 The SO allocation factor is used to allocate general and intangible plant and general A&G expenses that cannot be directly assigned. General and intangible plant and general A&G expenses are common costs not directly involved in production, transmission, and distribution, or the provision of customer services. The current SO factor is based on each state's percentage of total Company gross plant.[199]

125 PacifiCorp's proposed revisions to the WCA method do not address the SO factor. This is surprising given that the allocation of A&G costs has been contested before the Commission.[200] It remains a cause for concern for the Company, which stated that previous proposals to modify the WCA method have resulted in the "inconsistent application of allocation factors among cost categories," particularly for A&G expenses.[201]

126 Moreover, because the SO factor is based on gross plant, it reflects account balances when plant was placed in service, which may include expenditures that occurred decades ago. This is inappropriate because older plant is less likely related to current operations that focus on areas of higher growth. Thus, an allocation factor based on gross plant is more likely to over-allocate costs to states with slower growth, such as Washington.

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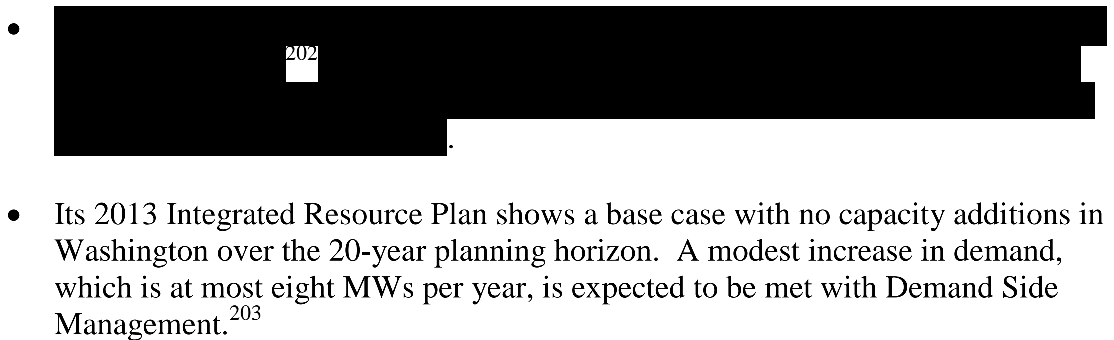
[199] McDougal, Exh. No. SRM-5 at 7.
[200] See White, Exh. No. KAW-1CT at 16, n.30, citing, Lazar, Jim, *Cost of Service for the Electric and Natural Gas Industries: An Historical Review of Decisions by the Washington Utilities and Transportation Commission, 1978-1994* at 9 (November, 1994).
[201] Dalley, Exh. No. RBD-2 at 6.

127 In contrast, Staff's secondary recommendation proposes an allocation factor based on net plant, which reduces the balances for older plants by removing depreciation accumulated during years the plant was in service. Newer plant, which has had fewer years to accumulate depreciation, will have a larger impact. This is appropriate since more recent plant additions are more directly related to the current operations and focus of a company.

128 Indeed, PacifiCorp's operations show the benefit of basing the SO allocation factor on net plant, as Staff proposes, in order to account for the Company's current operations:

- 
- Its 2013 Integrated Resource Plan shows a base case with no capacity additions in Washington over the 20-year planning horizon. A modest increase in demand, which is at most eight MWs per year, is expected to be met with Demand Side Management.[203]

129 This trend of disparate plant additions in Washington versus other states in the WCA and states outside the WCA is shown clearly in responses to Bench Request 3.[204] Similarly, the Company's year-ended 2012 Form 10-K states that "PacifiCorp's Energy Gateway Transmission Expansion Program represents . . . new high-voltage transmission lines, with an estimated cost exceeding $6 billion, primarily in Wyoming, Utah, Idaho and Oregon . . .The transmission line segments are intended to: (a) address customer load growth . . ." [205]

130 The Company does not dispute these trends. Rather, it again argues that the SO factor is used in its other states and, therefore, abandoning its use in Washington creates an allocation gap

[202] White, Exh. No. KAW-1CT at 17:18-22.
[203] White, Exh. No. KAW-3.
[204] Exh. No. BR-3.
[205] See, White, Exh. No. KAW-1CT at 18:5-11.

that can lead to cost under-recovery.[206] Again, this is irrelevant. The effect of inconsistent cost allocation methods between Washington and other states in the WCA is a risk the Company agreed would not be borne by ratepayers.[207]

131 PacifiCorp disputes Staff's position, arguing that the SO factor already allocates more recent investments at higher cost levels to jurisdictions with faster growth, and states with slower growth are allocated less costs.[208] However, the allocation of general and intangible plant and general A&G expenses should be based on how resources are used to support other services during the test period.[209] An allocation factor based on net plant, as Staff proposes, better reflects test period relationships because it does not rely on inflationary or other external factors. It, instead, relies on regulatory practice of reflecting depreciation.

132 In summary, an allocation factor based on net plant will produce more accurate and equitable results than the current SO factor based on gross plant that over-allocates costs to slower growing jurisdictions. A comprehensive review of the WCA method will capture this issue. The Company's proposals in this case do not do so.

C. The Report Staff Recommends Lays the Groundwork for a Comprehensive Review of the WCA Method

133 As noted above, Staff recommends a Report with specific information to be filed at least 90 days before the Company's next general rate case. The issues raised by Staff regarding the selective revisions proposed by PacifiCorp highlight the need for the Report, as does Staff's inability in this case to explore entirely new allocation factors and their impacts.

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[206] Dalley, Exh. No. RBD-3T at 7:1-10.
[207] *WUTC v. PacifiCorp,* Docket UE-050684, Order 04, ¶56 (April 17, 2006).
[208] Dalley, Exh. No. RBD-3T at 7:11-17.
[209] See White, Exh. No. KAW-1CT at 16:13-16, citing, *National Association of Regulatory Utility Commissioners, "Electric Utility Cost Allocation Manual"* at 105-106 (January 1992).

134 The Company argues that the current MSP provides Staff a better option to gather information about inter-jurisdictional issues.[210] However, the MSP addresses primarily the 2010 Protocol.[211] Specific questions about the WCA method employed in Washington are not the focus and, therefore, the MSP is unlikely to provide a forum to examine revisions to the WCA method. Moreover, while Staff has committed to participate in the MSP going forward, it was not invited to MSP meetings since the completion of the collaborative in October 2012.[212] Any prior opportunity in the MSP to explore the WCA method has been lost.

135 PacifiCorp claims that the timing of the Report recommended by Staff effectively imposes a three-month stay-out period for the next rate case.[213] This is not the case if the Company files an expedited rate filing, explained in the next section. That filing would be based on allocation factors the Commission adopts in the current proceeding. If the Company does not file an ERF, but wishes to file a full general rate case within three months after the completion of this case, Staff is amenable to the Report being filed concurrently with that next case.

136 Finally, the Company is wrong to suggest that the Report Staff recommends is overly burdensome and duplicative of the report the Company already provided in this case.[214] The Report seeks only specific and narrow information regarding certain existing allocation factors and alternatives the Company may propose. That information has not yet been provided.

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[210] Dalley, Exh. No. 3T at 5:6-11.
[211] Dalley, Tr. 275:22-276:11.
[212] Dalley, Exh. No. RBD-7CX. The only invitations were to individual commissioners and, even then, the meeting was only a general open forum to hear reports from PacifiCorp staff about activities under the 2010 Protocol.
[213] Dalley, Exh. No. 3T at 4:17-19.
[214] Dalley, Exh. No. 3T at 4:4-7 and 4:21-5:3.

D. Conclusion on Non-Power Cost Allocation

137 The Company argues that its proposed modifications to the WCA method are only interim measures and that Staff is unwilling to accept these "incremental improvements" in the allocation of inter-jurisdictional costs.[215] The accusation is untrue.

138 Staff is fully open to modifying the WCA method to correct inconsistencies or otherwise improve the accuracy and equity of that methodology. However, Staff is not willing to make changes that are one-sided, not supported by a comprehensive review of the WCA method, and are offered merely as a means to create consistency with the Company's other jurisdictions.

139 The Commission should reject the Company's selective revisions to the WCA method and order the Report and calculations recommended by Staff. If the Commission adopts any of the Company's proposals it should also adopt Staff's secondary revisions. They at least make progress toward a consistent approach to cost allocation.

VI. MAJOR CAPITAL PLANT ADDITIONS

140 The Company's Adjustment 8.4 pro forms rate base for five "major" plant additions:[216]

- Soda Springs Fish Passage ("Soda Springs"), completed October, 2012;
- Swift Fish Collector ("Swift"), completed November, 2012;
- Prospect In-Stream Flow/Automation system ("Prospect"), completed December, 2012;
- Merwin Fish Collector ("Merwin"), expected completion in February 2014;[217] and
- Jim Bridger Unit 2 turbine upgrade, completed in May, 2013.

141 Staff recommends a "bright line" standard that would include only plant additions that were in service on January 11, 2013, the date the Company filed this general rate case, followed

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[215] Dalley, Exh. No. 3T at 11:5-12.
[216] A major plant addition is one that is greater than $10 million. McDougal, Exh. No.SRM-1T at 22:16-17.
[217] McDougal, Exh. No. SRM-6T at 19:5-7. The Company initially projected an in-service date for Merwin of December 2013. McGuire, Exh. No. CRM-1T at 8, n.15.

by a timely expedited rate filing to recover plant additions completed after that date.[218] Therefore, Staff Adjustment 8.4 includes Soda Springs, Swift and Prospect because they were in service on January 11, 2013.[219] Using that same cut-off date, Staff rejects the Company's adjustments for Merwin and the Jim Bridger turbine upgrade.[220]

142 Staff's adjustments also correct depreciation expense and accumulated reserve, and remove projected O&M expenses for Merwin and Swift. All of Staff's pro forma rate base and related expense adjustments are presented in column (b) of Exhibit No. CRM-2.

143 Staff's bright line standard for capital plant additions is not arbitrary. It is a reasonable, practical and predictable application of the rule that a pro forma adjustment must "give effect for the test period to all known and measurable changes that are not offset by other factors."[221]

A. Staff's Proposed Cut-Off Date Affords the Commission a Consistent and Practical Standard by Which to Include a Pro Forma Rate Base Adjustment

144 Commission practice has been highly variable regarding pro forma adjustments to rate base. Its decisions have ranged from rejecting all pro forma plant additions,[222] to allowing pro forma plant additions that were projected to be placed into service well into the rate year.[223] Likewise, company requests for pro forma capital plant additions and Staff responses to those requests have been inconsistent.

145 This proceeding, therefore, affords an opportunity for the Commission to establish clear guidance for an acceptable pro forma rate base addition: Staff's "bright line" cut-off that capital

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[218] Reynolds, Tr. 403:20.
[219] Staff conducted a full prudence review of these hydro projects and concluded that they all met applicable Commission standards with reasonable project costs through January 13, 2013. Williams, Exh. No. JMW-1CT.
[220] Unlike the hydro projects that Staff did review for prudence, Staff did not conduct a full prudence review of Merwin and the Jim Bridger turbine upgrade. That review was unnecessary at this time because neither project met the in-service cut-off date Staff recommends.
[221] WAC 480-07-510(3)(iii).
[222] *WUTC v. Puget Sound Energy, Inc.*, Dockets UE-060266/UG-060267, Order 08 at ¶¶49-52 (January 5, 2007).
[223] *WUTC v. Avista Corp.,* Dockets UE-090134/UG-090135/UG-060518, Order 10 at ¶¶80-81 (December 22, 2009).

plant must be in service on the date of the Company's tariff filing.[224] This standard will promote consistency and reliability,[225] which are general themes the Company also supports.[226]

146 Staff's standard is also pragmatic. The Commission itself has acknowledged this benefit of a cut-off date, stating that the "dictates of practicality require that Staff's audit must conclude at some point in time before the conclusion of the rate review."[227] Indeed, the Commission has stated that increases to rate base "should be auditable by Staff . . . well before the date set for Response Testimony."[228] Support has been expressed for a cut-off date that is near in time to the initial filing of a company's proposed tariff revisions:

> In all but exceptional cases, any rate base addition . . . must satisfy the known and measurable requirement at the time the company makes its filing. This gives Staff and other parties adequate time to evaluate the adjustments . . ."[229]

Staff's bright line standard addresses the Commission's concerns. PacifiCorp has made no effort to show exceptional circumstances justifying alternative treatment.

147 The Commission has also noted the burden on Staff of evaluating a continuously evolving case, stating that a cut-off date beyond the filing date of a rate case "is tantamount to requiring either a continuous audit during the pendency of a rate proceeding or acceptance of budgeted or forecast data as known and measurable."[230] The Commission has stated that components of pro forma adjustments to rate base are often "based simply on estimates or forecasts, which may have been updated one or more times during the course of the proceeding," and that this "has placed a burden on Staff and other parties to continuously evaluate updated

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[224] McGuire, Tr. 448:6-8.
[225] McGuire, Tr. 447:21-25.
[226] Griffith, Exh. No. WRG-1T at 10:15-18 and McDougal, Exh. No. SRM-6T at 20:19-20.
[227] *WUTC v. Avista Corp.,* Dockets UE-090134, UG-090135/UG-060518, Order 10 at ¶78 (December 22, 2009).
[228] *WUTC v. Puget Sound Energy, Inc*., Dockets UE-090704/UG-090705, Order 11 at ¶33 (April 2, 2010).
[229] *WUTC v. Puget Sound Energy, Inc*., Dockets UE-090704/UG-090705, Order 11, ¶33 (April 2, 2010).
[230] *WUTC v. Avista Corp.,* Dockets UE-090134/UG-090135/UG-060518, Order 10 at ¶78 (December 22, 2009).

information, which may impact the quality of the record upon which the Commission must base its decisions."[231] Staff's approach in this case resolves these issues.

148 The Company focused on the fact that the turbine upgrade for Jim Bridger is "used and useful" for service because it went into operation in May 2013.[232] But that is precisely the point: the upgrade was placed in service less than one month before Staff's response case was due on June 21, 2013.[233] Evaluation of the upgrade, therefore, would have required Staff to review continuously updated cost information for over five months after the Company filed its case up until the last push before the entire Staff case was due. That is a burden to Staff and the Commission that is cured by Staff's proposed in service cut-off date.

B. Projected O&M Expenses for Swift and Merwin Should Be Disallowed Because They Do Not Meet the "Known and Measurable" Standard

149 The Company objects to Staff's recommendation to exclude from rates projected O&M expenses for Swift and Merwin.[234] However, Merwin is not projected to be in service until February 2014, so the Company has no operational data whatsoever for that facility. O&M expense for that facility remains entirely an estimate.

150 The Company does have operational data for Swift, but only for a little over half a year through June 2013.[235] Indeed, PacifiCorp acknowledged at hearing that it "missed the mark" in its O&M expense forecast.[236] It cut its projection of annual O&M expense for Swift by over 100 percent from $756,000 to $344,000 over the course of this case.[237] Thus, O&M expense for Swift remains largely an estimate.

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[231] *WUTC v. Puget Sound Energy, Inc*., Dockets UE-090704/UG-090705, Order 11 at ¶33 (April 2, 2010).
[232] Reynolds, Tr. 405:6-12.
[233] Griffith, Exh. No. WRG-1T at 11:16-18.
[234] Tallman, Exh. No. MRT-2T at 2-5.
[235] Tallman, Exh. No. MRT-2T at 4:7.
[236] Tallman, Tr. 331:7-332:20.
[237] Tallman, Exh. No. MRT-2T at 4:8-11.

151 The Commission has stated that "the amount [of a pro forma adjustment] cannot be an estimate, a projection, the product of a budget forecast, or some similar exercise of judgment – even informed judgment – concerning future revenue, expense or rate base."[238] Projected O&M expenses for Merwin and Swift clearly fall into the category of what is not allowed for a pro forma expense adjustment. Staff's recommendation to remove those estimates should be adopted by the Commission.

C. PacifiCorp is Not Harmed by Staff's In-Service Cut-Off Date for Capital Plant Additions

1. Staff's Proposal Does Not Contribute to Alleged Under-Earning Caused by Regulatory Lag

152 The Company asserts that Staff's in-service cutoff date is "punitive"[239] and contributes to under-earning associated with regulatory lag.[240] PacifiCorp's argument is misguided. For any investment where the financial benefit is greater than the cost, the Company will begin to recover its investment the moment the plant is placed in service, even if the Commission has not yet authorized recovery through rates.[241] A delay in recovery of the turbine upgrade at Jim Bridger, therefore, does not contribute to any under-earning associated with regulatory lag.

153 Staff admits this is true only if the effect of the upgrade is not reflected in the power cost model. Staff has not removed the corresponding generation from net power costs.[242] Therefore, if the Commission adopts the Staff recommendation to exclude the Jim Bridger turbine upgrade at this time, it should also require the Company's compliance filing to remove that upgrade from

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[238] *WUTC v. Puget Sound Energy, Inc*., Docket UE-090704, Order 11, ¶26 (April 2, 2010); and *WUTC v. Avista Corp.*, UE-090134, Order 10, ¶45 (December 22, 2009).
[239] McDougal, Exh. No. SRM-6T at 20:20-22.
[240] Griffith, Exh. No. WRG-1T at 2:1-5.
[241] McGuire, Tr. 451:17-452:5.
[242] McGuire, Tr. 459:2-4 and 20-22.

net power costs. This will ensure that the delay in rate recovery of the turbine upgrade will not contribute to any under-earning.

2. Staff's ERF Provides Timely Rate Recovery of Capital Plant Additions

154 Staff recommends an expedited rate filing that allows PacifiCorp to update its rate base and related expenses in a timely way after all 2013 capital plant additions are complete and the associated costs are known and measureable.[243] Under the Staff proposal, the Company may submit an ERF in 2014 within two months of filing its standard Commission-basis report ("CBR"). The ERF will be based on an enhanced CBR ("ECBR") using the same fiscal period as the CBR and using the authorized rate of return, revenue allocations, and rate design the Commission orders in this general rate case.

155 Once the ERF, accompanying work papers and the supporting testimony are filed, Staff will review the filing with the goal of rates becoming effective within 4 to 6 months. By holding certain controversial elements constant, such as rate of return, revenue allocations and rate design, Staff should be able to conduct its review on this expedited basis.

156 Thus, the Company is not disadvantaged by the in-service cut-off date Staff proposes for capital plant additions. PacifiCorp's proposal for a tariff rider to include Merwin in rates once that plant is in-service [244] is unnecessary in light of the ERF Staff recommends.

157 The Company states that the specifics of the Staff proposal are unclear.[245] This criticism ignores the detailed description Staff provided of the enhancements to the CBR upon which an ERF would be based.[246]

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[243] Reynolds, Exh. No. DJR-1T at 12:6-23.
[244] Griffith, Exh. No. WRG-1T at 12:9-11.
[245] Griffith, Exh. No. WRG-1T at 9:4-5.
[246] Exhibit No. DJR-3.

158 PacifiCorp admits that the ERF would be "workable" if it would allow a rate increase of 3 percent or more.[247] The ERF proposed by Staff can exceed 3 percent.[248] Staff's proposal has the additional benefit of not requiring the Company to comply with all of the filing requirements in WAC 480-07-510 that would otherwise apply to a "general rate case".[249]

159 The Company argues that an ERF below 3 percent is of limited value unless a proper rate baseline is set in this case, which PacifiCorp assumes is its proposed increase of 12.1 percent.[250] The Company's assumption is misguided. The Commission's order in this case will approve increased rates that are just, fair, reasonable and sufficient. It is, therefore, irrelevant whether that increase, plus the ERF increase, produces the 12.1 percent increase requested by PacifiCorp. Indeed, for this very reason, the Company admitted at hearing that an ERF under 3 percent is "doable" and "could be a mechanism to use going forward."[251]

160 Finally, the Company implied that the ERF proposed by Staff will delay recovery of 2013 capital plant additions until the end of 2014, similar to a full-blown general rate case filed early next year.[252] Any implication that Staff intended such a stay-out is unwarranted.[253]

161 Moreover, the Company described a worst case scenario that would be of its own design. It could, instead, file the ERF on a schedule that would allow Staff to complete its review and present its recommendation so that new rates could take effect well before the 2014 winter heating season, which will provide maximum financial advantage to the Company.[254]

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[247] Griffith, Exh. No. WRG-1T at 10:5-6.
[248] Reynolds, Exh. No. DJR-1T at 12:14-17.
[249] Reynolds, Exh. No. DJR-1T at 12:15-17.
[250] Griffith, Exh. No. WRG-1T at 10:6-13.
[251] Griffith, Tr. 122:12-123:6.
[252] Reynolds, Tr. 409:9-12.
[253] Reynolds, Tr. 409:5-8 and 410:21-24.
[254] Reynolds, Tr. 407:20-25 and Tr. 426:7-19. A properly-filed ERF also need not be set for hearing. It could be approved at a public open meeting, which would assist in its timely resolution.

162 In short, the Company should embrace the ERF proposed by Staff. Its failure to do so only exhibits its own resistance to new regulatory thinking.

VII. RATE BASE BALANCES: EOP v. AMA

163 The Company included restating adjustments to reflect electricity plant at EOP balances rather than AMA balances.[255] The Commission should reject this proposal and maintain AMA rate base balances, as Staff recommends.

164 First, the Commission's favored treatment is to determine test period rate base using AMA plant balances.[256] This upholds the matching principle of ratemaking because AMA balances accurately match rate base over the course of the test year with revenue and expenses incurred over that same period. EOP rate base balances are less than optimal without corresponding end of period adjustments to revenues and expenses.[257] The Company did not include those corresponding adjustments.

165 The Commission has acknowledged that "utilization of average rate base [is] not cast in stone." However, a party proposing an EOP rate base has the burden to prove it is an appropriate regulatory tool to address:

- Abnormal growth in plant;
- Inflation and/or attrition;
- Regulatory lag; or
- Failure of utility to earn its authorized rate of return over an historical period.[258]

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[255] McDougal, Exh. No. SRM-6T at 26:9-11.
[256] Erdahl, Exh. No. BAE at 6:16-7:2.
[257] Erdahl, Exh. No. BAE at 7:17-19, citing, *WUTC v. Washington Natural Gas Company,* Cause No. U-80-111, Third Supplemental Order at 5-7 (September 24, 1981).
[258] *WUTC v. Washington Natural Gas Company,* Cause No. U-80-111, Third Supplemental Order at 5-7 (September 24, 1981).

166 PacifiCorp did not carry this burden. It made no attempt to show it is experiencing unusual plant growth in Washington. In fact, the clear evidence is that growth in distribution and transmission plant is attributable to operations outside Washington and the WCA.[259]

167 Company witness Richard P. Reiten provided broad statements concerning the "primary factors driving the need for a price increase."[260] However, he made no connection between these assertions and the need to diverge from an AMA rate base.

168 Mr. Griffith attempted to prove that PacifiCorp has been unable to earn its authorized return over an historical period.[261] We have explained in Section I that his presentation is unsubstantiated and, if anything, shows improved earnings in recent periods that would not justify EOP rate base.

169 The Company argues that Staff supported recently the use of EOP rate base for PSE and Avista to address attrition and regulatory lag.[262] Again, each of these cases involved settlements that embody "give and take" of a non-precedential nature on many issues. The Company should not be excused from its burden of proof by inappropriate reliance on those cases.

170 Finally, Staff agrees there is reason to address the impacts of regulatory lag on PacifiCorp. Staff has proposed the ERF for that very reason. It is a better remedy than the Commission abandoning its established and appropriate use of an AMA rate base in this case.

VIII. REMAINING RATEMAKING ADJUSTMENTS

171 The majority of the differences between Staff and Company ratemaking adjustments result from controversies related to jurisdictional cost allocation[263] or EOP versus AMA rate base

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[259] Exh. No. B-3, Response to Bench Request No. 7.
[260] Reiten, Exh. No. RPR-1T at 3:14-5:2.
[261] Griffith, Exh. No. WRG-1T at 3, Table 1.
[262] Griffith, Exh. No. WRG-1T at 11:2-10.
[263] Attachment A, lines 35-50.

balances.[264] Those controversies are addressed in separate sections above, as are contested Adjustment 5.1.1, Net Power Costs – Pro Forma, and Adjustment 8.4, Major Plant Additions.

172 Adjustment 7.1, Interest True Up, is contested only because of differences regarding the weighted cost of debt and total rate base. Adjustment 9.1, Production Factor, is contested only because of differences in Adjustment 5.1.1, Net Power Costs – Pro Forma, and Adjustment 8.4, Major Plant Additions.

173 The final contested adjustment is the Company's proposal to include incentive compensation in Adjustment 4.3, General Wage Increase – Pro Forma. Staff opposes that proposal. We address that issue here.

174 We also address the Company's treatment of investor-supplied working capital ("ISWC") in Adjustment 8.13, Working Capital, which also relates to Adjustments 8.5/8.5.1, Miscellaneous Rate Base Adjustment and Adjustment 8.1, Jim Bridger Mine Rate Base. As discussed in this section, Staff agrees with PacifiCorp's treatment of ISWC.

175 Staff and the Company agree on the net-to-gross conversion factor (0.61940).

A. Adjustment 4.3, General Wage Increase – Pro Forma

176 There are two elements of the Company's general wage adjustment. First, PacifiCorp applies a one to two percent general wage increase to various labor groups (union, non-exempt and officer/exempt) to June 2013. Staff does not oppose this proposal.

177 Second, the Company increases test period incentive pay by the non-union wage increase percentage of about two percent. Staff opposes this aspect of the adjustment.[265]

178 Various reasons support the Staff position. First, incentive compensation is based on achieving annual performance measurements. Therefore, incentive compensation is always at

[264] Attachment A, lines 53-56.
[265] Huang, Exh. No. JH-1T at 10:6-21.

risk and can be higher or lower depending on performance each year. It is inappropriate to assume a particular level of incentive pay above test period amounts, as the Company has done in its adjustment.

179 Second, always adjusting compensation upward by the non-union wage increase percentage removes the incentive aspect of the program. "Incentive" compensation becomes nothing more than another form of base salary increase. Ratepayers should not be held responsible for amounts paid above test period amounts when those amounts do not reward exceptional performance.

180 Finally, incentive paid (per book) during the test year is representative and fair to recover from ratepayers. Therefore, Staff's adjustment removes only the incentive compensation expense above the test period amount.

B. Adjustment 8.13, Investor-Supplied Working Capital

181 The Company adopts the ISWC methodology. This is a balance sheet approach PacifiCorp the Commission has accepted as most appropriate for determining working capital.[266]

182 PacifiCorp also proposes two refinements to the calculation of ISWC for post-retirement pension benefits and derivatives. Both adjustments are conveniently made within a single calculation of ISWC.[267] The ISWC methodology ($7 million) and the proposed refinements for post-retirement benefits ($7.5 million) and derivatives ($14 million), add $28.5 million to PacifiCorp's rate base for Washington operations.[268]

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[266] Stuver, Exh. No. DKS-1T at 1:22-2:3. See also *WUTC v. PacifiCorp*, Docket UE-100749, Order 06 at ¶291 (March 25, 2011).
[267] Zawislak, Exh. No. TWZ-1T at 8:3-4.
[268] Zawislak, Exh. Nos. TWZ-2 and TWZ-3.

1. Post-Retirement Pension Benefits

183 The Company proposes that regulatory assets and liabilities for post-retirement benefits be included in the current assets and current liabilities columns of the ISWC calculation, rather than in the investment columns. Staff supports the Company's proposal because it achieves a proper balance of ratepayer interests and allows investors to earn a return on the net unamortized funds they contributed to employee post-retirement benefits.[269] The proposal is also consistent with Docket UT-950200. In that case, the Commission allowed U S WEST Communications, Inc. a $70 million increase in rate base for the prudently incurred Pension Asset (offset by a $38 million decrease in rate base as a result of a negative ISWC calculation).[270]

2. Derivatives

184 PacifiCorp proposes that derivatives, on a net basis, be included in the investments column of the ISWC calculation as non-operating or "non-utility" investment, rather than the current assets and current liabilities columns.[271]

185 This refinement is consistent with the accounting order in Docket UE-010453, authorizing the establishment of a regulatory asset or liability for the effects of certain derivative and hedging accounting rules. The order made clear that the future non-cash impacts of that accounting must be excluded from cost of service:

> Therefore, the Commission accepts the proposed accounting for derivatives and hedging activities as contained in PacifiCorp's petition. Acceptance of the accounting treatment of these activities in no way makes determination on the prudence of any energy contract or derivative for rate making purposes. The future non-cash impacts of the accounting

[269] Zawislak, Exh. No. TWZ-1T at 3:20-22.
[270] See Zawislak, Exh. No. TWZ-1T at 7:16-8:2, citing, *WUTC v. U S WEST Communications, Inc*., Docket UT-950200, Fifteenth Suppl. Order at 70 (April 11, 1996).
[271] Stuver, Exh. No. DKS-1T at 6:4-7:17 and Exh. No. TWZ-3 at 1:30, 2:63-65, 3:126, and 3:143-146.

convention imposed by FAS 133/138 will be excluded from the Commission's determination of cost of service with respect to the contracts.[272]

186 Whether the Company finds itself in a net gain or net loss position on the balance sheet is almost entirely dependent upon the timing of the valuations presented on the balance sheet. Therefore, the refinement proposed for derivatives protects ratepayers from the unintended consequence of potential losses by allocating these items to "non-utility" investments. In this way, the Commission is assured that a double-recovery (or, conversely, a double-penalty, as in this case) will be avoided.[273]

3. Public Counsel's Criticism of the Proposed ISWC Refinements Should Be Rejected

187 Public Counsel opposes PacifiCorp's proposals for post-retirement benefits and derivatives. The claim is that 45 FERC accounts would need to be reclassified for working capital purposes, and many of those accounts are long-term in nature and pertain to other jurisdictions than Washington.[274]

188 However, the FERC uniform system of accounts is used only for accounting purposes.[275] Such accounting "should not be construed as indicative of their treatment by this commission for ratemaking purposes."[276] Therefore, additional FERC accounts can be analyzed in a refined ISWC calculation without changing accounting systems.

189 Furthermore, working capital is calculated on a "total company" basis to include all of the Company's jurisdictions.[277] Therefore, it is appropriate to use PacifiCorp's total company

[272] *In the Matter of the Petition of PacifiCorp for an Accounting Order Authorizing the Establishment of a Regulatory Asset or Liability to Account for the Effects of Certain Derivative and Hedging Financial Accounting Rules,* Docket UE-010453, Order Granting Accounting Petition at ¶7 (April 25, 2001).
[273] Zawislak, Exh. No. TWZ-1T at 9:11-18.
[274] Coppola, Exh. No. SC-1CT at 28:8-29:5.
[275] WAC 480-100-203.
[276] WAC 480-100-999(1)(b).
[277] Zawislak, Exh. No. TWZ-1T at 5:6-14.

balance sheet to calculate ISWC.[278] Both Staff and the Company agree on the allocation of total Company results to Washington.[279]

190 In sum, the ISWC calculation is a full balance sheet approach that comprehensively identifies allowable working capital. This case provides an excellent opportunity to improve that methodology through the refinements PacifiCorp proposes and Staff supports.

IX. SETTLEMENT ON COST OF SERVICE, RATE SPREAD AND RATE DESIGN; LOW INCOME BILL ASSISTANCE

191 On August 21, 2013, the Parties filed a Partial Settlement on Cost of Service, Rate Spread and Rate Design, along with supporting testimony. Staff asks the Commission to adopt and approve the settlement in its entirety for the reasons stated in that testimony.

192 With respect to low income bill assistance ("LIBA"), the Company proposes to: 1) increase the number of participants from 4,720 to 5,192 via two-year certification; 2) increase the eligibility certification fee paid to community action agencies; and 3) increase the participant benefit by 26 percent, which is two times the residential increase proposed by the Company.

193 Staff agrees with the first two proposals because they are consistent with the five-year plan approved by Commission Order 07 in Docket UE-111190.[280] The third proposal is also

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[278] See Zawislak, Exh. No. TWZ-2 and Exh. No. TWZ-3.
[279] See Exhibit No. TWZ-3 at 4:171-172.
[280] Williams, Exh. No. JMW-1CTat 23:21-22, citing, *WUTC v. PacifiCorp*, Docket UE-111190, Order 07 at ¶¶17-18 and Settlement Stipulation at ¶¶25-26 (March 30, 2012). Parties to the Settlement Agreement were PacifiCorp, Staff, Public Counsel, the Industrial Customers of Northwest Utilities, and The Energy Project.

consistent in principle with that Order because it increases participant funding by twice the residential increase. The final amount of the increase will be based on the Commission's final order in this case, using that same formula.

DATED this 1st day of October 2013.

Respectfully submitted,

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