

**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

PACIFICORP'S OPENING BRIEF

REDACTED

October 1, 2013

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I. INTRODUCTION

1 In this case, PacifiCorp d/b/a Pacific Power & Light Company (PacifiCorp or the Company) requests a revenue requirement increase of \$36.9 million, or 12.1 percent overall,¹ and the approval of a power cost adjustment mechanism (PCAM).² PacifiCorp's proposed rates provide a reasonable baseline to allow the Company to recover the costs of serving its Washington customers.

2 PacifiCorp's proposal in this case includes changes in the regulatory tools used to establish PacifiCorp's retail rates, but these changes are not new to this Commission, nor do these changes require the Commission to alter its established policies or precedent. Instead, PacifiCorp asks the Commission to continue its history of flexibility in ratemaking when needed to appropriately balance the interests of the utility and its customers.

3 The Company has under-recovered its costs in Washington for many years, despite frequent general rate case filings and the Company's commitment to controlling its costs, maintaining a common equity level to support current credit ratings, and mitigating rate increases, a commitment that has yielded significant savings in operations and maintenance (O&M) expenses and long-term debt costs. In preparing this case, the Company identified those regulatory conventions that have most significantly contributed to the Company's inability to recover the cost to serve its Washington customers. The Company then developed and proposed discrete remedies in this case to target these issues, with a focus on solutions that the Commission has already adopted in other cases (at times with support from one or more of the parties to this case).

4 No party to this case disputes the fact that PacifiCorp currently faces a revenue deficiency. Yet Staff and intervenors propose significantly reducing the amount of the revenue

¹ PacifiCorp's request of \$36.9 million represents a reduction of approximately \$5.8 million from its initial filing. The components of this reduction are outlined in Mr. McDougal's revenue requirement testimony; the largest components are a decrease in net power costs (NPC) and an increase in revenues associated with renewable energy tax credits.

² On August 21, 2013, the parties filed a Partial Settlement Regarding Cost of Service, Rate Spread, and Rate Design that resolved all issues on these subjects. The parties also filed supporting testimony. Therefore, this brief does not address these issues.

requirement increase, with proposals ranging from \$13.6 million (Staff’s position based on the revised issues list) to only \$10.8 million (Boise White Paper LLC’s (Boise) position). The difference relates primarily to three subjects: (1) cost of capital, including the rate of return on equity (ROE) and the equity percentage in the capital structure; (2) net power costs (NPC), including PacifiCorp’s proposed change in the allocation of the Company’s power purchase agreements (PPAs) with qualifying facilities (QFs) located in Oregon and California; and (3) the Company’s pro forma plant additions. The parties also oppose a PCAM for PacifiCorp.

5 In this case, PacifiCorp developed an extensive record and strong policy arguments to support its position on each of the contested issues:

- PacifiCorp seeks an ROE of 10.0 percent, a small increase from its current authorized ROE of 9.8 percent, in recognition of rising interest rates and other capital market conditions. PacifiCorp’s equity ratio of 52.2 percent reflects its actual capital structure, now recognized in rates in every PacifiCorp jurisdiction except Washington. PacifiCorp’s cost of capital components appropriately balance safety and economy and produce an ROR of 7.75 percent, only one basis point higher than its current authorized ROR of 7.74 percent.
- PacifiCorp proposes including an allocated share of PPAs with QFs in California and Oregon in Washington NPC. This change treats QF PPAs the same as all other Company generation resources (including PPAs with non-QF resources), provides customers the benefits of additional QF generation, and supports the Commission’s policy encouraging renewable and distributed generation.
- PacifiCorp demonstrated that the parties’ proposed disallowance of prudent costs that have been reflected in PacifiCorp’s NPC for many years (such as Boise’s adjustments to Generation & Regulation Initiative Design Tools Model (GRID) market caps and Bridger coal costs) are unwarranted and increase the risk of PacifiCorp’s undisputed and significant NPC under-recovery.
- PacifiCorp included five major pro forma plant additions in this case. With the exception of the Merwin Fish Collector, all of these projects are in service today. Inclusion of these resources minimizes regulatory lag, which the Commission has observed it has the “responsibility to mitigate . . . to the extent possible.”³ The Commission has allowed such pro forma plant additions in the past on a case-by-case basis, and the circumstances in this case support allowing these plant additions now, instead of deferring recovery to a subsequent rate case or other filing.

³ *WUTC v. Puget Sound Energy*, Docket UE-121697 et al., Order 07 ¶ 46 (June 25, 2013) (quoting *WUTC v. Wash. Nat. Gas Co.*, 44 P.U.R.4th 435, 438 (Sept. 24, 1981)).

- PacifiCorp needs a PCAM to address its NPC variability, which has increased with the enactment of Washington’s renewable portfolio and emission performance standards.

6 The Company appreciates Staff’s proposal to help address PacifiCorp’s undisputed revenue shortfall through authorization of an expedited rate filing process (or ERF) for PacifiCorp. PacifiCorp’s goal in this case is to first establish an appropriate baseline revenue requirement that gives the Company a reasonable opportunity to recover the cost to serve its Washington customers. Once this appropriate baseline is established, alternative ratemaking mechanisms such as the ERF can be explored.

7 In this case, PacifiCorp established that it needs a baseline revenue requirement increase of \$36.9 million to recover its costs to serve Washington customers. PacifiCorp also established that its proposed changes to certain ratemaking approaches all fit within the existing regulatory framework in Washington and are well-supported by the facts and law. For these reasons, PacifiCorp respectfully requests that the Commission approve PacifiCorp’s proposed rate increase of \$36.9 million.

II. LEGAL STANDARDS

8 In setting rates in a general rate case, the Commission determines whether the rates proposed by the utility are fair, just, reasonable, and sufficient.⁴ To be just and reasonable, rates must include compensation necessary to provide safe and reliable electric service⁵ and “a rate of return sufficient to maintain [the utility’s] financial integrity, attract capital on reasonable terms, receive a return comparable to other enterprises of corresponding risk,”⁶ and support the utility’s creditworthiness.⁷ The Commission’s duty in a general rate case is to “determine an appropriate balance between the needs of the public to have safe and reliable electric and natural gas services

⁴ RCW 80.28.020.

⁵ RCW 80.28.010.

⁶ *WUTC v. Avista Corp.*, Docket Nos. UE-991606, *et al.*, Third Supp. Order ¶ 324 (2000); *WUTC v. PacifiCorp*, Docket UE-050684, Order 04 ¶ 235 (Apr. 17, 2006).

⁷ *See Fed. Power Comm’n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944).

at reasonable rates and the financial ability of the utility to provide such services on an ongoing basis.”⁸

9 The Supreme Court of Washington has found that it is “just as important in the eye of the law” that rates provide “reasonable compensation” for a utility as it is that rates are just and reasonable for customers. The Court states that “Every statutory element must be recognized in the fixing of rates or the result will be to defeat the legislative purpose.”⁹ The court also explained that the effect of the Commission disallowing a prudently incurred operating expense is to reduce the actual rate of return of the utility.¹⁰ Disallowing expenses therefore “has the very real effect, among others, of increasing the risks of investing in the utility”¹¹ and denying the utility a reasonable opportunity to earn a fair rate of return as mandated under the *Hope* and *Bluefield* precedents.¹²

III. COST OF CAPITAL

10 The Company recommended an overall rate of return of 7.75 percent in this case, based on the following cost of capital components:

Component	Percent of Total	Percent Cost	Weighted Average
Long-Term Debt	47.5%	5.29%	2.51%
Preferred Stock	0.28%	5.48%	0.02%
Common Stock Equity	52.22%	10.00%	5.22%
Total	100.00%		7.75%

Staff contests the Company’s recommended ROE, cost of debt, and proposed capital structure; Boise contests ROE and capital structure.

11 The Company’s recommended ROR of 7.75 percent is reasonable. It is virtually the same as the Company’s currently authorized ROR of 7.74 percent, reflecting a substantial decrease in the Company’s cost of debt and only a small increase in the Company’s ROE. The

⁸ *WUTC v. Puget Sound Energy*, Docket UE-090704 et al., Order 11 ¶ 18 (Apr. 2, 2010).

⁹ *Wash. ex rel. Puget Sound Power & Light Co. v. Dept. of Pub. Works of Wash.*, 179 Wash. 461, 466 (1934).

¹⁰ *People’s Org. for Wash. Energy Res. v. WUTC*, 104 Wn.2d 798, 810-11 (1985) (en banc).

¹¹ *Id.* at 11.

¹² *Hope*, 320 U.S. at 603; *Bluefield Water Works & Improvement Co. v. Pub. Serv. Comm’n of W. Va.*, 262 U.S. 679, 692 (1923).

Company's recommendation is slightly below the current ROR of 7.77 percent for Puget Sound Energy, Inc. (PSE) and just above the current ROR of 7.64 percent for Avista Corporation d/b/a Avista Utilities (Avista).¹³ By comparison, Staff recommends an overall ROR of only 7.03 percent and Boise recommends an ROR of only 7.25 percent, which are both outside the range of reasonable RORs based on recent Commission decisions.¹⁴ Moreover, Staff's and Boise's recommended RORs are even lower if the Company's updated cost of long-term debt is reflected in the calculation (7.00 percent and 7.21 percent, respectively).¹⁵

A. PacifiCorp's Proposed Rate of Return on Equity is Reasonable

12 Parties challenge the Company's proposed ROE of 10.00 percent. Staff recommends an ROE of 9.00 percent and Boise recommends an ROE of 9.20 percent. An ROE of 10.00 percent most accurately captures prevailing economic and market conditions, including interest rate increases of approximately 120 basis points during the pendency of this case.¹⁶ The Commission has recognized the correlation between interest rate levels and the cost of equity.¹⁷

1. Rising Interest Rates Have Increased PacifiCorp's Cost of Equity

13 At hearing, both Staff witness Kenneth L. Elgin and Boise witness Michael P. Gorman acknowledged that PacifiCorp's cost of equity had increased since the filing of Staff and Boise testimony on June 21, 2013.¹⁸ The increase is due largely to the Federal Reserve's announcement in June 2013 that it would end its bond-purchasing policies once the economy showed sufficient improvement.¹⁹ The Federal Reserve's prior policies have held interest rates artificially low and, in anticipation and response to the Federal Reserve's June announcement,

¹³ Williams, Exh. No. BNW-14T 5 Table 2.

¹⁴ *Id.* 11 Table 5, 15 Table 7.

¹⁵ Elgin, TR. 205:10-13; Gorman, TR. 176:7-10.

¹⁶ Hadaway, TR. 148:17-18.

¹⁷ *WUTC v. Puget Sound Energy*, Docket UE-111048 et al., Order 08 ¶ 85 (May 7, 2012) ("Treasury and bond yields have decreased, and interest rates are expected to remain low for some time. Utility stocks enjoy favorable market sentiment in such an environment. There is no apparent need to increase ROE in these circumstances."); *WUTC v. PacifiCorp*, Docket UE-100749, Order 06 ¶ 92 (Mar. 25, 2011) ("Given the relatively low interest rates in the current economic climate, it is fair to assume a general downward trend of ROEs[.]").

¹⁸ Gorman, TR. 246:6-9; Elgin, TR. 268:7-9.

¹⁹ Hadaway, Exh. No. SCH-10T 3:18 – 4:28.

interest rates have increased dramatically.²⁰ As of the hearing, the single “A” utility bond yield was 4.87 percent, the highest level in over two years.²¹

14 In light of the changes in market conditions since Messrs. Elgin and Gorman filed their rebuttal testimony, both witnesses updated their range of reasonable ROEs at hearing. Mr. Elgin testified that a conservative ROE update would increase his results by 25 basis points.²² Similarly, Mr. Gorman testified that if he had updated his analysis as of the hearing, the range of reasonable ROE would be 9.1 percent to 9.7 percent—an increase of the upper end of his range of 45 basis points.²³ Company witness Dr. Samuel C. Hadaway’s updated analysis likewise resulted in an increased reasonable range of 9.6 percent to 10.4 percent.²⁴

15 Comparing current interest rate levels with those in the Commission’s most recent rate case orders provides further evidence of increasing equity costs. The Commission last approved PacifiCorp’s current 9.8 percent ROE in March 2011.²⁵ In March 2011, single “A” utility bond yields were 4.34 percent.²⁶ As of the hearing in this case, single “A” bond yields were over 50 basis points higher, at 4.87 percent.²⁷ As Mr. Gorman testified, an increase in single “A” bond yields is “observable evidence” that PacifiCorp’s cost of equity has increased.²⁸ Indeed, Mr. Gorman’s testimony in this case compared utility bond yields as of March 2011 to those prevailing in June 2013 as evidence that PacifiCorp’s ROE has decreased.²⁹ Because utility bond yields are now higher than in March 2011, by Mr. Gorman’s own analysis, PacifiCorp’s ROE has increased since the Commission approved PacifiCorp’s current 9.8 percent ROE.

16 The Commission’s June 25, 2013 decision in PSE’s expedited rate filing supports the same conclusion. In that case, a majority of the Commission rejected proposed changes to

²⁰ *Id.* 5 Table 1; Hadaway, TR. 248:14-16.

²¹ *Id.* 248:14-18.

²² Elgin, TR. 268:7-9.

²³ Gorman, TR. 245:16–246:9.

²⁴ Hadaway, TR. 270:15–271:3.

²⁵ *WUTC v. PacifiCorp*, Docket UE-111190, Order 07 (Mar. 30, 2012).

²⁶ Gorman, Exh. No. MGP-1T 4 Table 1.

²⁷ Hadaway, TR. 248:14-18.

²⁸ Gorman, TR. 181:12-18.

²⁹ Gorman, Exh. No. MGP-1T 4 Table 1.

PSE’s 9.8 percent ROE after concluding that, based on “current financial market conditions,” a 9.8 percent ROE was still within the range of reasonable ROEs.³⁰ In the PSE case, Public Counsel recommended an ROE of 9.5 percent based on a conclusion that corporate bond yields had declined 50 to 125 basis points since PSE’s 9.8 percent ROE was set by the Commission in May 2012.³¹ Mr. Gorman, testifying on behalf of the Industrial Customers of Northwest Utilities (ICNU) (of which Boise is a member), also focused on utility bond yields, *i.e.*, “observable market evidence,” as part of his risk premium analysis and recommended an ROE of 9.3 percent.³² Mr. Gorman testified that corporate bond yields were 25 to 40 basis points lower than May 2012 when the Commission set PSE’s ROE at 9.8 percent and that “such significant declines indicate that PSE’s current capital cost is much lower” as of April 2013.³³ In the 2012 PSE case, Mr. Gorman recommended an ROE of 9.7 percent.³⁴ Utility bond yields are now roughly 70 basis points higher than they were at the time of the PSE expedited rate filing and 50 basis points higher than when the Commission set PSE’s ROE in May 2012.³⁵

17 Similarly, in December 2012, the Commission approved a stipulation with a 9.8 percent ROE for Avista, concluding that this ROE was within the range of reasonableness.³⁶ In that case, Mr. Elgin originally recommended an ROE of 9.0 percent ROE, in part, because the “current interest rate environment will continue to keep the cost of capital low.”³⁷ At the time Mr. Elgin filed his testimony, September 2012, utility bond yields were roughly 85 basis points lower than yields at the time of hearing in this case.³⁸

³⁰ *WUTC v. Puget Sound Energy*, Docket UE-121697 et al., Order 07 ¶ 58 (June 25, 2013).

³¹ *Id.* ¶ 49, n. 61.

³² *Id.* ¶ 50; Gorman, Exh. No. MPG-30CX 4:12 – 5:2.

³³ *WUTC v. Puget Sound Energy*, Docket UE-121697 et al., Order 07 ¶ 50 (June 25, 2013); Gorman, Exh. No. MPG-28CX 4:1-13.

³⁴ Gorman, TR. 183:15–184:4; Gorman, Exh. No. MPG-29CX 2:16 – 3:13.

³⁵ Hadaway, TR. 248:14-18; Gorman, Exh. No. MPG-28CX 4, Table 5.

³⁶ *WUTC v. Avista*, Docket UE-120436 et al., Order 09 ¶ 74 (Dec. 26, 2012).

³⁷ Elgin, KLE-6CX 3:6 – 5:17-18.

³⁸ Hadaway, Exh. No. SCH-1T 8 Table 1.

2. The Commission Should Rely on Risk Premium Analysis Because Current Rapidly Changing Market Conditions are Not Fully Captured in the DCF Model

18 While the Commission generally relies primarily on the Discounted Cash Flow (DCF) model to determine ROE,³⁹ the Commission has also been clear that it “value[s] each of the methodologies used to calculate the cost of equity and do[es] not find it appropriate to select a single method as being the most accurate or instructive.”⁴⁰ Given today’s rapidly changing capital markets, the Commission should give limited weighting to the DCF results.⁴¹ The DCF model relies on backward looking stock price data to establish its dividend yield component,⁴² and therefore does not reflect the more recent increases in capital costs that all parties acknowledge.⁴³ The fact that DCF results are going down at the same time that interest rates are increasing so dramatically—and are expected to continue to increase—is a strong indication that the current DCF results are unreliable.⁴⁴

19 Unlike the DCF model, the risk premium method does accurately capture the current interest rate environment and is therefore a more reliable indicator of current ROEs.⁴⁵ Dr. Hadaway provided three updated risk premium studies that support an ROE in the range of 9.6 percent to 10 percent.⁴⁶ The highest result is the forward-looking study, which relied on projected interest rates for 2014.⁴⁷ Dr. Hadaway relied on futures trading to establish his projected interest rates to better reflect current market expectations for 2014.⁴⁸

³⁹ See, e.g., *WUTC v. PacifiCorp*, Docket UE-050684, Order 04 ¶ 261 (Apr. 17, 2006).

⁴⁰ *WUTC v. PacifiCorp*, Docket UE-100749, Order 06 ¶ 91 (Mar. 25, 2011); *WUTC v. PacifiCorp*, Docket UE-100749, Order 07 ¶ 22 (May 12, 2011) (different methods can be more useful “depending on the economic and capital market conditions at a specific time”); *WUTC v. Puget Sound Energy*, Docket UE-111048 et al., Order 08 at n. 77 (May 7, 2012).

⁴¹ Hadaway, TR. 148:16–149:9.

⁴² *Id.* 240:13-18; Hadaway, Exh. No. SCH-1T 22:15-18; Gorman, Exh. No. MPG-1T 19:13-17.

⁴³ Hadaway, TR. 220:14-20.

⁴⁴ *Id.* 231:9-22.

⁴⁵ Hadaway, Exh. No. SCH-10T 23:16-23.

⁴⁶ *Id.* 23:10-14.

⁴⁷ Hadaway, TR. 232:20–233:12.

⁴⁸ *Id.* 254:3-12.

20 Mr. Gorman’s risk premium studies resulted in an ROE range of 9.05 percent to 9.44 percent⁴⁹ While these results were higher than those from his DCF analysis, they were still understated because Mr. Gorman failed to take into account the well-established and empirically verified tendency for equity risk premiums to increase when interest rates are low and decrease when they are high.⁵⁰ Dr. Hadaway’s testimony provided thorough and complete regression analysis to demonstrate this inverse relationship, which is altogether ignored in Mr. Gorman’s testimony.⁵¹ In the Company’s 2010 rate case, the Commission was not persuaded that Dr. Hadaway’s regression-based adjustment was appropriate because the Commission was “skeptical that such a precise formula based on future estimated projections of inflation can yield such a precise result.”⁵² But even if the Commission is not persuaded that such a precise adjustment is reasonable, Dr. Hadaway’s testimony has demonstrated, through basic comparisons of actual risk premium levels relative to alternative interest rate levels, that this inverse relationship exists and should be factored into a proper risk premium study.⁵³

3. Staff’s and Boise’s Proposed ROEs are Substantially Below Comparable ROEs

21 The Commission has looked at comparative data to inform its ROE analysis,⁵⁴ observing that it was “mindful of the direction in *Bluefield* that” a utility’s ROE must be equal to that of utilities with comparable risk.⁵⁵ Here, Staff’s and Boise’s recommended ROEs of 9.0 percent and 9.2 percent, respectively, are unreasonably low when compared to Commission orders in the

⁴⁹ Gorman, Exh. No. MPG-1T 33:13-14.

⁵⁰ Hadaway, Exh. No. SCH-10T 19:14 – 20:12..

⁵¹ Hadaway, Exh. No. SCH-1T 26:14 – 28:10; Hadaway, Exh. No. SCH-8.

⁵² *WUTC v. PacifiCorp*, Docket UE-100749, Order 06 ¶ 86 (Mar. 25, 2011).

⁵³ Hadaway, Exh. No. SCH-10T 20 Graph 1; Hadaway, TR. 258:2–259:7.

⁵⁴ *WUTC v. Avista*, Docket UE-050482, Order 05 n. 45 (Dec. 21, 2005) (average of authorized returns in other jurisdictions serves as a “useful check on the reasonableness of any range of cost of equity estimates derived for Avista”); *WUTC v. PacifiCorp*, Docket UE-050684, Order 04 ¶ 263 (Apr. 17, 2006) (“such comparative data serve as a useful reference on the reasonableness of results from financial analyses applied to a particular company”); *WUTC v. PacifiCorp*, Docket UE-100749, Order 06 ¶ 92 (Mar. 25, 2011).

⁵⁵ *WUTC v. PacifiCorp*, Docket UE-050684 Order 04 ¶ 263 (Apr. 17, 2006), quoting *Bluefield*, 262 U.S. at 692 (“A public utility is entitled to . . . earn a return . . . equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties.”).

last three years addressing ROE, all of which have allowed ROEs of 9.8 percent.⁵⁶ While the most recent ROE decisions involving PSE and Avista resulted from settlements, these settlements were contested, and the Commission’s orders explicitly addressed the reasonableness of a 9.8 percent ROE. Furthermore, the Commission has looked to approved settlements when examining comparable ROEs awarded other utilities.⁵⁷

22 In addition, national data indicates that the average authorized ROE for the first two quarters of 2013 was 9.8 percent.⁵⁸ When compared to ROEs awarded by this and other state commissions, Staff’s and Boise’s ROE recommendations fail the Commission’s “common sense” test.⁵⁹

23 In support of his unreasonably low recommendation, Mr. Elgin testifies that the “Federal Reserve has been explicit that its monetary policy is designed to stimulate economic activity and will continue for the foreseeable future . . . As a result, capital costs will remain low for an extended period of time . . .”⁶⁰ Only two days before Mr. Elgin filed his testimony, however, the Federal Reserve announced a dramatic policy shift which resulted in a rapid increase in interest rates.⁶¹ Mr. Elgin’s very low recommended ROE should be rejected because it is explicitly premised on an assumption that has proven to be false.⁶²

4. The Company’s Use of Long-Term GDP Growth Rates in Its DCF Analysis is Reasonable

24 Messrs. Elgin and Gorman criticize Dr. Hadaway’s use of a long-term GDP average to forecast growth rates in his multi-stage DCF analysis. As a practical matter, these criticisms may now be moot because, under present market conditions, Dr. Hadaway recommends that the Commission discount the entire range of DCF results and rely on the risk premium approach. To

⁵⁶ Hadaway, Exh. No. SCH-10T 2:18-20.

⁵⁷ See e.g. *WUTC v. PacifiCorp*, Docket UE-050684, Order 04 ¶ 263 (Apr. 17, 2006).

⁵⁸ Hadaway, Exh. No. SCH-10T 2:21 – 3:2, 7:14 – 8:5.

⁵⁹ *WUTC v. Puget Sound Energy*, Docket UE-040640 et al., Order 06 ¶ 80 (Feb. 18, 2005) (equity awards in other jurisdictions serve as a check that is “useful to fulfill the common sense approach”).

⁶⁰ Elgin, Exh. No. KLE-1T 8:3-8.

⁶¹ Hadaway, Exh. No. SCH-10T 6:8-10.

⁶² *Id.* 10:2-9.

the extent that the Commission does look to DCF results, however, the Commission should employ the realistic and reasonable growth rates Dr. Hadaway proposes.

25 Mr. Elgin claims that the use of data for time periods before 1990 unreasonably skews Dr. Hadaway's results.⁶³ But these witnesses fail to acknowledge that Dr. Hadaway's growth rate gives considerably more weight to the recent 10- and 20- year periods⁶⁴ because more recent data has a greater effect on investor expectations.⁶⁵ Moreover, the use of historical data to identify economic trends and relationships is the basis of most econometric forecasts.⁶⁶ This is especially true in the case of DCF modeling because it requires a long-term constant growth rate.⁶⁷ And the Commission has explicitly endorsed the use of forecasts *and historical data* when determining growth rates for DCF analysis.⁶⁸

26 In the Company's 2010 rate case, the Commission did not rely on Dr. Hadaway's long-term GDP growth rates in his DCF analysis because of the "uncertainty in capital markets."⁶⁹ Rather, the Commission "gave more weight to short-term growth rates because those rates will be verifiable in the near future."⁷⁰ In this case, it is reasonable to once again rely on long-term growth rates for the DCF model because the economy has improved and more normal economic conditions are expected to prevail.⁷¹

27 Critical of Dr. Hadaway's use of long-term historical data to develop a long-term forecast, Mr. Gorman testified that instead the GDP growth rate should be based on short-term forecasts (five to 10 years).⁷² However, these forecasts give too much weight to outlier data from the financial crisis and unusually low rates of inflation.⁷³ The Commission has observed

⁶³ Elgin, Exh. No. KLE-1T 51:5-12.

⁶⁴ Hadaway, Exh. No. SCH-1T 24:20-21.

⁶⁵ Hadaway, Exh. No. SCH-10T 13:9-11; Elgin, Exh. No. KLE-1T 52:7-11.

⁶⁶ Hadaway, Exh. No. SCH-10T 13:5-7.

⁶⁷ See Elgin, Exh. No. KLE-1T 23:21-23.

⁶⁸ See *WUTC v. Puget Sound Energy*, Docket UE-090704 et al., Order 11 ¶ 300 (Apr. 2, 2010) (DCF results are persuasive when based upon "both forward-looking estimates and historical data").

⁶⁹ *WUTC v. PacifiCorp*, Docket UE-100749, Order 07 at ¶ 29 (May 12, 2011).

⁷⁰ *Id.*

⁷¹ Hadaway, Exh. No. SCH-10T 22:3-10.

⁷² Gorman, Exh. No. MPG-1T 46 Table 7; 47:5-6.

⁷³ Hadaway, Exh. No. SCH-10T 13:11 – 14:2.

that near-term growth rates that are unsustainably high do not reflect what investors could reasonably expect over the long-term.⁷⁴ Because the DCF analysis assumes a growth rate for the long-term, it is unreasonable to use a forecast that is unduly influenced by recent events that are not expected to persist long-term.⁷⁵

5. Mr. Elgin's Proxy Group is Unreliable

28 Mr. Elgin's ROE studies rely on a proxy group of only eight utilities.⁷⁶ In the Company's 2010 rate case, the Commission rejected Mr. Elgin's proxy group of seven companies because narrowing a larger group to a smaller group, as Mr. Elgin has done, "necessarily requires significant subjective analysis[.]"⁷⁷ The "smaller the proxy group, the greater possibility for bias to be introduced due to subjective factors."⁷⁸ According to the Commission, this results in a proxy group of "questionable statistical reliability."⁷⁹ Mr. Elgin's proxy group in this case suffers from the same deficiencies and should once again be rejected.⁸⁰

29 Mr. Elgin removed companies from Dr. Hadaway's proxy group (accepted by Mr. Gorman) if the utilities had nuclear generation investments or had non-comparable unregulated operations.⁸¹ As Mr. Gorman made clear at the hearing, however, none of the companies that Mr. Elgin removed have sufficient unregulated operations to warrant their removal, and the risk associated with nuclear generation is simply not an issue today.⁸²

B. PacifiCorp's Proposed Capital Structure is Reasonable and Appropriately Balances Safety and Economy

30 The capital structure established by the Commission for ratemaking purposes must balance "debt and equity on the bases of economy and safety."⁸³ This balances the economy of

⁷⁴ *WUTC v. Puget Sound Energy*, Docket UE-111048 et al., Order 08 ¶ 86 (May 7, 2012).

⁷⁵ Hadaway, Exh. No. SCH-10T 13:11 - 14:2, 16:18 - 17:9.

⁷⁶ Elgin, Exh. No. KLG-1T 17:19-20.

⁷⁷ *WUTC v. PacifiCorp*, Docket UE-100749, Order 07 ¶ 78 (May 12, 2011).

⁷⁸ *Id.*

⁷⁹ *Id.*

⁸⁰ Hadaway, Exh. No. SCH-10T 9:5-8.

⁸¹ Elgin, Exh. No. KLE-1T 21:5-7.

⁸² Gorman, TR. 242:14-243:11.

⁸³ *WUTC v. Puget Sound Energy*, Docket UE-040640 et al., Order 06 ¶ 27 (Feb. 18, 2005).

lower-cost debt versus the safety of higher-cost common equity.⁸⁴ Consistent with these standards, the Company proposed to use its actual capital structure consisting of 52.22 percent common equity. Staff and Boise propose hypothetical capital structures consisting of a common equity ratio of 46.0 percent and 49.1 percent, respectively.

1. The Company's Actual Equity Ratio Properly Balances Safety and Economy

31 The Company's proposed capital structure is based upon the average of the five quarters ended June 30, 2013,⁸⁵ and the equity ratio is consistent with actual equity levels since the end of 2011.⁸⁶ The Company's current equity level is necessary to maintain the Company's current credit rating and ensures continued access to low-cost capital, particularly during a period of significant capital expenditures.⁸⁷

32 The Company's actual capital structure is also economical because it results in a reasonable overall ROR that is in line with the RORs recently approved by the Commission.⁸⁸ Moreover, the Company's credit rating allows it access to low-cost debt. Illustrating this point, the Company's cost of long-term debt decreased between the filing of the Company's direct and rebuttal case from 5.37 percent to 5.29 percent,⁸⁹ and it is now well below PSE's and Avista's allowed cost of long-term debt of 6.16 percent⁹⁰ and 5.72 percent,⁹¹ respectively. If the Company were capitalized in conformance with the recommendations of Staff or Boise, it is unlikely that the Company would have been able to access such low-cost debt.

2. The Evidence Does Not Support Staff's Proposed Equity Ratio

33 Staff proposes a 46 percent equity ratio because Mr. Elgin claims that the equity ratios for his ROE proxy group demonstrate that PacifiCorp's actual equity ratio is too high.⁹² But

⁸⁴ *Id.*

⁸⁵ Williams, Exh. No. BNW-14T 6 Table 2.

⁸⁶ Williams, Exh. No. BNW-1T 14:1-9.

⁸⁷ *Id.* 3:9-14, 13:7-13; Williams, TR. 221:15-23.

⁸⁸ Williams, TR. 224:5-25.

⁸⁹ Williams, Exh. No. BNW-14T 5:4-5.

⁹⁰ *WUTC v. Puget Sound Energy*, Docket UE-121697 et al., Order 07 ¶ 220 (June 25, 2013).

⁹¹ Williams, Exh. No. BNW 14T 13:3 n. 22.

⁹² Elgin, Exh. No. KLE-1T 11:20 – 12:19.

Mr. Elgin’s analysis is flawed. Mr. Elgin first identifies utilities in his proxy group that have equity ratios similar to PacifiCorp (53.3 percent, 52.1 percent, and 52.6 percent), but then Mr. Elgin disregards those results by assuming that the actual equity ratio would be less if he had taken into account the utilities’ unregulated operations.⁹³ To the contrary, after accounting for these utilities’ unregulated operations, their equity ratios are 55.3 percent, 48.95 percent, and 51.39 percent—a range that squarely supports PacifiCorp’s equity ratio.⁹⁴

34 Mr. Elgin then claims that four of his proxy utilities have equity ratios of about 46 percent.⁹⁵ However, it appears that Mr. Elgin’s analysis examined the parent company’s book equity percentage, which would be similar to examining MidAmerican Energy Holdings Company (MEHC) or Berkshire Hathaway to determine PacifiCorp’s equity ratio.⁹⁶ Correcting for Mr. Elgin’s error shows that all of the utilities he discusses have equity ratios well in excess of 50 percent, closer to PacifiCorp’s proposed equity ratio than either Mr. Elgin’s or Mr. Gorman’s.⁹⁷ Thus, the capitalization of Mr. Elgin’s ROE proxy group supports adoption of PacifiCorp’s actual equity ratio.

35 Mr. Elgin’s recommended equity ratio also fails to properly balance safety and economy. Mr. Elgin fails to account for safety because his proposal would, by his own admission, support a three-step credit rating downgrade for PacifiCorp.⁹⁸ This downgrade would likely result in increased borrowing costs for PacifiCorp, as well as potential limitations on access to capital.⁹⁹

36 Mr. Elgin’s recommended equity ratio is also inconsistent with recent Commission precedent. In the Company’s 2010 rate case, Mr. Elgin recommended an equity ratio of 46.5 percent, which the Commission concluded was “too low.”¹⁰⁰ Similarly, Mr. Elgin recommended an equity ratio of 46.0 percent in PSE’s 2011 rate case, a recommendation that

⁹³ *Id.* 12:9-14.

⁹⁴ Williams, Exh. No. BNW-14T 9:1-9.

⁹⁵ Elgin, Exh. No. KLE-1T 12:15-19.

⁹⁶ Williams, Exh. No. BNW-14T 8:5-13.

⁹⁷ *Id.* 7:1 – 8:4.

⁹⁸ Elgin, Exh. No. KLE-1T 13:12-18; Williams, Exh. No. BNW-14T 9:12-22.

⁹⁹ Williams, Exh. No. BNW-14T 9:12 – 10:22; Williams, TR. 153:21-24.

¹⁰⁰ *WUTC v. PacifiCorp*, Docket UE-100749, Order 06 ¶ 41 (Mar. 25, 2011).

was likewise rejected as too low.¹⁰¹ Mr. Elgin’s recommended equity ratio in this case is clearly unreasonable as it is even lower than his recommendation in PacifiCorp’s 2010 rate case.

3. The Record Does Not Support Boise’s Hypothetical Capital Structure

37 Boise proposed a capital structure with 49.1 percent common equity. Mr. Gorman bases his recommendation on the fact that the Commission adopted a hypothetical 49.1 percent equity ratio in the Company’s last two rates cases.¹⁰² However, in the last litigated case, the Commission adopted Mr. Gorman’s recommended equity ratio because he provided the “most reasonable approach for calculating the equity component . . . by ascertaining the equity used to support plant investment.”¹⁰³ Here, Mr. Gorman performed no analysis to ascertain what he believed to be the equity PacifiCorp used to support plant investment.¹⁰⁴ Without evidentiary support for his recommendation, it should be rejected.

38 Mr. Gorman’s recommended equity ratio in this case is also inconsistent with his approach to PacifiCorp’s capital structure in other jurisdictions.¹⁰⁵ Mr. Gorman acknowledged that he recommends a hypothetical capital structure for PacifiCorp only in Washington. Just last year, during the time period that the Company used to calculate its actual capital structure in this case, Mr. Gorman accepted an equity component of 52.1 percent in PacifiCorp’s Utah rate case.¹⁰⁶ Mr. Gorman acknowledged that he withdrew his adjustments to the Company’s actual capital structure in that case and did not challenge it as either unsafe or uneconomical.¹⁰⁷

39 Mr. Gorman claims that his recommended equity ratio in this case is safe because it “has been reviewed by credit ratings agencies” and has contributed to PacifiCorp’s current rating levels.¹⁰⁸ However, Mr. Gorman admitted that he only assumed his recommended equity ratio had been reviewed by rating agencies because it was reflected in the Commission’s last rate

¹⁰¹ *WUTC v. Puget Sound Energy*, Docket UE-111048 et al., Order 08 ¶ 56 (May 7, 2012).

¹⁰² Gorman, Exh. No. MPG-1T 13: 3-4.

¹⁰³ *WUTC v. PacifiCorp*, Docket UE-100749, Order 06 ¶ 42 (Mar. 25, 2011).

¹⁰⁴ Williams, Exh. No. BNW-14T 14:6-7.

¹⁰⁵ See Gorman, Exh. Nos. MPG-25CX, 26CX, and 27CX.

¹⁰⁶ Gorman, TR. 192:16 – 194:24.

¹⁰⁷ *Id.* at 190:15 – 191:2, 192:23 – 193:4.

¹⁰⁸ Gorman, Exh. No. MPG-1T at 13, lines 4-6.

order.¹⁰⁹ Further, Mr. Gorman admitted that rating agencies examine PacifiCorp on a consolidated basis.¹¹⁰ The Company's credit ratings are a result of the Company's overall, actual capitalization and not the hypothetical equity ratio Mr. Gorman recommends here. If the Company were actually capitalized at Mr. Gorman's recommended level, PacifiCorp would be downgraded.¹¹¹

4. Adoption of the Company's Actual Equity Ratio Will Provide the Company a Better Opportunity to Earn its Authorized ROR

40 The Commission recognizes that increasing a utility's equity component is a tool that can be used to address under-earning.¹¹² In PSE's 2011 rate case, the Commission increased PSE's equity component from 46 percent to 48 percent to provide additional regulatory support so that PSE could earn its authorized ROE:

Retaining PSE's current equity ratio of 46 percent while the Company is actually capitalized at 48 percent and may be experiencing attrition could be viewed unfavorably by the financial markets and ratings agencies. By raising the equity ratio from its current authorized level to the level it expects during the rate year, we improve PSE's opportunity to earn its full authorized return during a period of high capital expenditures.¹¹³

41 The Commission observed that an upward adjustment of the equity share in the capital structure was one of "several possible responses that the Commission could make to address a demonstrated trend of under earning due to circumstances beyond the Company's ability to control."¹¹⁴ The Commission continued that it "remains open to, and will consider fairly, specific proposals supported by adequate evidence showing them to be an appropriate response to PSE's economic and financial circumstances including, if demonstrated, under earnings due to attrition."¹¹⁵ In that case, the evidence demonstrated that PSE's earnings during the test year were 370 basis points below its authorized ROR and that its equity returns fell from 9.1 percent

¹⁰⁹ Gorman, Exh. No. MPG-24CX.

¹¹⁰ Gorman, TR. 188:11-18.

¹¹¹ Williams, Exh. No. BNW-14T 14:13-21.

¹¹² *WUTC v. Puget Sound Energy*, Docket UE-111048 et al., Order 08 ¶ 491 (May 7, 2012).

¹¹³ *Id.* ¶ 56.

¹¹⁴ *Id.* ¶¶ 489-491.

¹¹⁵ *Id.* ¶ 491.

in 2007 to 4.8 percent in 2010, even though its authorized ROE was above 10 percent during those years.¹¹⁶

42 In PSE’s ERF case, the Commission rejected a downward adjustment to PSE’s equity ratio and adopted specific measures identified in the 2011 rate case to address PSE’s attrition.¹¹⁷ In the ERF case, no party prepared an attrition study, but the Commission concluded that “there is ample evidence in the record of such earnings attrition, caused in substantial part by continuing growth in capital investments.”¹¹⁸ The specific evidence cited by the Commission was Staff’s testimony that PSE had not achieved its authorized ROR for electric operations since 2006, and for natural gas operations since at least 2004.¹¹⁹ Staff’s analysis further demonstrated that, even with the rate increase resulting from PSE’s 2011 rate case, PSE’s electric earnings were about 70 basis points below the authorized rate of return granted in May 2012.¹²⁰

43 Relying on the Commission’s decision in PSE’s 2011 case, in Avista’s 2012 rate case Mr. Elgin testified in support of a stipulation that “it would be unreasonable for Staff to ignore the effects of attrition,”¹²¹ which the Commission has defined “broadly to mean any situation in which a rate-regulated business fails to achieve its allowed earnings.”¹²² In Avista’s case, Staff used “attrition as a tool to analyze the Company’s opportunity to earn a fair return.”¹²³ Unlike the 2011 PSE case, however, Staff did not proposed an upward adjustment to Avista’s equity ratio because Staff directly measured attrition.¹²⁴

44 Here, the record demonstrates that the Company is currently earning an ROE in Washington of only 4.69 percent for the test period.¹²⁵ The Company’s per books ROE has been on average 6.04 percent less than its authorized ROE over the last seven years.¹²⁶ Indeed, Staff’s

¹¹⁶ *Id.* ¶ 483.

¹¹⁷ *WUTC v. Puget Sound Energy*, Docket UE-121697 et al., Order 07 ¶¶ 48, 62 (June 25, 2013).

¹¹⁸ *Id.* ¶ 47.

¹¹⁹ *Id.* n. 59.

¹²⁰ *Id.*

¹²¹ Elgin, Exh. No. KLE-7CX 3:4-6.

¹²² *WUTC v. Puget Sound Energy*, Docket UE-121697 et al., Order 07 at n. 23 (June 25, 2013).

¹²³ Elgin, Exh. No. KLE-7CX 3:18-20.

¹²⁴ Elgin, Exh. No. KLE-6CX 6:13-16.

¹²⁵ McDougal, Exh. No. SRM-7 1.1:60.

¹²⁶ Griffith, Exh. No. WRG-IT 3 Table 1.

own analysis found that on a pro forma basis, the Company is earning an overall ROR of only 5.93 percent—181 basis points below its currently authorized ROR.¹²⁷ In this case, Staff has not proposed a separate attrition adjustment that would obviate the need to address under-earning through the use of the Company's actual equity ratio. Therefore, to help address the Company's persistent under-earning, the Commission should approve the use of the actual capital structure.

5. The Commission Should Exclude Short-Term Debt Because the Company Has None

45 As part of Mr. Elgin's hypothetical capital structure, he proposed that the Commission impute four percent short-term debt into PacifiCorp's capital structure. Consistent with the Commission's decision in PacifiCorp's 2010 rate case, the Commission should again reject Staff's proposal to impute short-term debt.¹²⁸ The Company's actual capital structure for the quarter ends used to determine the capital structure in this case included no short-term debt.¹²⁹ The lack of short-term debt indicates that it is not a permanent source of financing rate base.¹³⁰ And even though the Company does not actually rely on short-term debt, customers nonetheless receive the benefits of short-term interest rates through the Company's pollution control revenue bonds, which are a component of long-term debt but the rates are reset daily or weekly.¹³¹

46 Further, it is reasonable for the Company to not rely on short-term debt to finance rate base. The Company's use of long-term debt has allowed it to lock in historically low interest rates that will continue to provide customer benefits well into the future.¹³² In addition, Mr. Gorman testified that many utilities do not rely on short-term debt and instead finance in a more conservative manner to lock in low interest rates and mitigate risk associated with refinancing short-term securities.¹³³ According to Mr. Gorman, the use of exclusively long-term debt is

¹²⁷ Huang, Exh. No. JH-1T 3:11-12.

¹²⁸ *WUTC v. PacifiCorp*, Docket UE-100749, Order 06 ¶ 43 (Mar. 25, 2011).

¹²⁹ Williams, Exh. No. BNW-14T 12:12-13.

¹³⁰ Williams, Exh. No. BNW-1T 17:2-4.

¹³¹ Williams, TR. 225:10-23.

¹³² *Id.* 226:5-12.

¹³³ Gorman, TR. 226:21 – 227:19.

“generally consistent with a conservative utility financing structure.”¹³⁴ Therefore, Mr. Gorman did not propose the imputation of short-term debt.¹³⁵

47 Inclusion of short-term debt in the capital structure is also inequitable because it would double-count short-term debt as financing both rate base and construction-work-in-progress (CWIP).¹³⁶ Mr. Gorman acknowledged that “[a]lmost all utilities use short-term debt to some extent to finance their [CWIP].”¹³⁷ Because CWIP is financed using short-term debt but not included in rate base, the imputation of short-term debt to finance rate base balances would double count that debt.

6. The Commission Should Approve the Company’s Actual Cost of Long-Term Debt

48 The Commission should adopt the Company’s actual cost of long-term debt, along with the Company’s actual capital structure. This ensures that customers receive the full benefits associated with the Company’s credit ratings.¹³⁸ Mr. Elgin proposes that the Commission impute Avista’s cost of debt as a proxy for PacifiCorp’s actual cost of debt to account for his recommendation that the Company downgrade its credit rating.¹³⁹ Mr. Elgin’s proposal to impute Avista’s cost of debt to PacifiCorp is completely unprecedented. His calculation of Avista’s debt costs is erroneous because he proposes to impute what he claims is Avista’s actual cost of debt, 5.34 percent, rather than the 5.72 percent cost of debt the Commission approved in Avista’s last rate case.¹⁴⁰ Moreover, Mr. Elgin’s proposal is inconsistent with his other cost of capital proposals because he does not recommend the imputation of Avista’s ROE (9.8 percent) or ROR (7.64 percent).¹⁴¹

¹³⁴ *Id.*

¹³⁵ *Id.*

¹³⁶ Williams, Exh. No. BNW-1T 16:11-21.

¹³⁷ Gorman, TR. 227:9-15.

¹³⁸ Williams, Exh. No. BNW-14T 13:7-15.

¹³⁹ Elgin, TR. 214:17–215:3.

¹⁴⁰ Williams, Exh. No. BNW-14T 12:21 – 13:3; Elgin, TR. 213:18–214:5.

¹⁴¹ Elgin, TR. 213:2-9.

C. Credit Metrics Under Staff's and Boise's Cost of Capital Proposals

1. Staff's Proposed Hypothetical Equity Ratio Would Cause a Downgrade to the Company's Credit Rating

49 The Company's current equity ratio is intended to allow it to maintain its current credit ratings and results in lower overall financing costs to customers.¹⁴² PacifiCorp's current credit rating allows it uninterrupted access to capital markets and reduces immediate and future borrowing costs.¹⁴³

50 Mr. Elgin testified that his recommended 46 percent equity ratio is "sufficient to achieve a corporate crediting rating of "BBB" and an "A"- secured rating[.]"¹⁴⁴ Because PacifiCorp is currently rated higher than "BBB", Mr. Elgin recommends a capital structure that he acknowledges will result in a credit downgrade of at least three steps.¹⁴⁵ However, it is quite possible that credit ratings agencies would view such an increase in leverage more negatively than Mr. Elgin assumes, and therefore the consequences of actual capitalization at Mr. Elgin's recommended level could be even worse.¹⁴⁶ Even assuming Mr. Elgin was correct and the Company was downgraded only three steps, that downgrade would result in significant increases in borrowing costs.¹⁴⁷ Mr. Elgin tests the safety of his cost of capital recommendations using the Company's earnings before interest and taxes (EBIT).¹⁴⁸ As even Mr. Elgin admits, however, ratings agencies do not rely on this metric.¹⁴⁹

2. Boise's Analysis of the Safety of its Cost of Capital Recommendations is Unpersuasive

51 Mr. Gorman defends his cost of capital recommendations by claiming that his recommendations will support an investment grade bond rating for PacifiCorp.¹⁵⁰ However, Mr. Gorman's conclusion is undercut by his reliance on flawed analysis. First, Mr. Gorman's

¹⁴² Williams, Exh. No. BNW-1T 3:9-14; 13:7-13, Williams, TR. 221:15-23.

¹⁴³ Williams, Exh. No. BNW-1T 4:6-20.

¹⁴⁴ Elgin, Exh. No. KLE-1T 47:1-3.

¹⁴⁵ Williams, Exh. No. BNW-14T 9:13-20.

¹⁴⁶ *Id.*

¹⁴⁷ *Id.* 10:1-22, 13:10-15.

¹⁴⁸ Elgin, Exh. No. KLE-1T 38:4-8.

¹⁴⁹ *Id.* 38:10-15.

¹⁵⁰ Gorman, Exh. No. MPG-1T 40:2-6.

analysis fails to account for the actual adjustments made by ratings agencies when determining PacifiCorp’s credit metrics.¹⁵¹ For example, S&P imputes nearly \$850 million of debt to PacifiCorp’s published results.¹⁵² Mr. Gorman admits that he imputed only \$275 million.¹⁵³ Second, Mr. Gorman excluded significant interest expense from his analysis.¹⁵⁴ Third, Mr. Gorman ignored the specific guidance from ratings agencies related to PacifiCorp and instead applies general industry criteria, and Mr. Gorman entirely ignored a key metric applicable to PacifiCorp.¹⁵⁵ Fourth, Mr. Gorman’s analysis ignores the Company’s actual earnings in Washington and assumes, without evidentiary support, that the Company will actually earn its authorized ROR in Washington.¹⁵⁶ Fifth, Mr. Gorman ignores entirely the impact of the expiration of bonus depreciation, even though ratings agencies consider forecast results that include the period after bonus depreciation expires.¹⁵⁷ Sixth, and most fundamentally, Mr. Gorman’s analysis purports to support an “A”- bond rating, even though the Company’s current rating is “A”.¹⁵⁸

52 The impact of Mr. Gorman’s flawed credit metrics analysis is demonstrated simply by comparing his results to the Company’s actual metrics. Mr. Gorman’s testimony indicates that S&P found that the Company has a current debt-to-EBITDA ratio of 4.3.¹⁵⁹ Mr. Gorman claims that if the Commission approves his cost of capital recommendations, which would **lower** the Company’s ROE by 60 basis points, the lower cost of capital recommendation would actually improve the Company’s debt-to-EBITDA ratio to 3.2.¹⁶⁰ The fact that Mr. Gorman reaches such an unreasonable conclusion undercuts the credibility of his analysis.

¹⁵¹ Williams, Exh. No. BNW-14T 15:13-14.

¹⁵² *Id.* 15:14 – 16:3.

¹⁵³ *Id.*; Gorman, TR. 197:7-10.

¹⁵⁴ Williams, Exh. No. BNW-14T 16:4-6.

¹⁵⁵ *Id.*, 16:7-11.

¹⁵⁶ Williams, Exh. No. BNW-14T 16:12-17.

¹⁵⁷ *Id.* 16:18 – 17:2.

¹⁵⁸ *Id.* 17:3-14.

¹⁵⁹ Gorman, Exh. No. MPG-1T 13: 8-17.

¹⁶⁰ Gorman, Exh. No. MPG-1T 42:14-17.

IV. NET POWER COSTS

53 The Company is requesting NPC of \$570.3 million on a west control area basis, or \$129.1 million on a Washington-allocated basis. With the adjustments accepted by the Company and the updates reflected in the Company’s rebuttal testimony, NPC decreased by \$10.3 million on a west control area basis and \$2.3 million on a Washington-allocated basis compared to the Company’s initial filing. The Company’s proposed NPC, including the change in the allocation of QF contracts, increases current Washington NPC by approximately \$5 million.¹⁶¹

A. Allocation of QF Contracts in the West Control Area to Washington

54 PacifiCorp proposes to include in Washington rates an allocated share of the costs and benefits associated with the Company’s power purchase agreements (PPAs) with California and Oregon QFs. Under the current west control area inter-jurisdictional allocation methodology (WCA), only the costs of QFs that are physically located in Washington are included in rates.

1. Inclusion of Oregon and California QFs in Washington Rates is Consistent with the Principles of the WCA

55 The proposed change to allocation of QF contracts under the WCA is intended to ensure that QF resources are treated the same as all other generating resources in the Company’s west control area. Under the current WCA, all generation resources that are physically located within the Company’s west control area—except for Oregon and California QF contracts—are included in Washington rates.¹⁶² The WCA is based on the premise that all generation resources in the west control area and those generation resources outside the west control area that have sufficient transmission capacity to the west control area are included in Washington rates.¹⁶³ The Commission found that the “the WCA method is a solid foundation for determining the resources that actually serve load in Washington” because it is based “on the generation resources that are actually used to keep the west control area in balance with its neighboring control areas.”¹⁶⁴

¹⁶¹ Duvall, Exh. No. GND-7CT 1:18-20.

¹⁶² Dalley, Exh. No. RBD-2.

¹⁶³ Duvall, Exh. No. GND-7CT 17:1-11.

¹⁶⁴ *WUTC v. PacifiCorp*, Docket UE-061546, Order 08 ¶ 53 (June 21, 2007).

56 Like all generation resources in the west control area, Oregon and California QF contracts provide undifferentiated generation that PacifiCorp relies on to serve and balance the entire west control area.¹⁶⁵ Therefore, consistent with the allocation of other west control area generation resources, QF contracts should also be included in Washington rates.

57 Inclusion of a share of PacifiCorp's Oregon and California QFs in Washington rates is consistent with the Commission's treatment of other utilities' out-of-state QF contracts. For example, Avista's Washington rates include an allocated share of the costs and benefits of a contract with a QF located in Avista's Idaho service territory.¹⁶⁶

58 Public Counsel argues that PacifiCorp has failed to provide any analysis showing how Washington load is served by contracts with QFs from outside the state.¹⁶⁷ Contrary to Public Counsel's argument, however, power flow studies are not required to demonstrate that QFs from Oregon and California are used and useful for serving Washington customers. In the Company's 2005 rate case, the Commission interpreted the phrase "used and useful for service in this state" from RCW 80.04.250 to mean that the resource provides "benefits to ratepayers in Washington, either directly (e.g., flow of power from a resource to customers) and/or indirectly (e.g., reduction of cost to Washington customers through exchange contracts or other tangible or intangible benefits)."¹⁶⁸ The Commission rejected arguments that the Company "must demonstrate each resource in the system provides a direct benefit, i.e., electron flow, to be considered used and useful for service in this state."¹⁶⁹

59 Instead, the Commission required a demonstration that a resource provides "tangible and quantifiable benefits to Washington" before the resource can be included in rates.¹⁷⁰ Indirect benefits can include avoided costs, off-system sales revenues, or other system-wide benefits.¹⁷¹

¹⁶⁵ Duvall, Exh. No. GND-1CT 5:17-21.

¹⁶⁶ *Id.* 6:13-14.

¹⁶⁷ Coppola, Exh. No. SC-1CT 17:1-7.

¹⁶⁸ *WUTC v. PacifiCorp*, Docket UE-050684, Order 04 ¶ 50 (Apr. 17, 2006).

¹⁶⁹ *Id.* ¶ 68.

¹⁷⁰ *Id.*

¹⁷¹ *Id.* n. 72.

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In the case of Oregon and California QF contracts (all of which are renewable resources), the record demonstrates that these resources benefit Washington customers by providing undifferentiated generation to serve Washington load and enabling PacifiCorp to avoid generation costs that would otherwise be incurred in the absence of these resources. Other benefits of renewable QF contracts include system diversity, increased transmission reliability, reduced environmental impact, and promotion of Washington's energy policies to mitigate greenhouse gas emissions and climate change.

2. The QF Contract Prices are Reasonable and Do Not Harm Customers

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As Staff acknowledged at hearing, if the Commission allocates PacifiCorp's west control area QF contracts to Washington, the Commission retains the authority to determine if the costs associated with these QF contracts are reasonable.¹⁷² Here, the record demonstrates that overall QF costs are reasonable when compared to non-QF PPAs and other Washington QF contracts. The average price for the Oregon and California QFs is approximately \$77 per MWh, only \$5 per MWh higher than the average price of all west control area PPAs.¹⁷³ The Company has non-QF PPAs with prices of \$75 per MWh and \$97 per MWh and no party challenged the reasonableness of these PPA prices.¹⁷⁴ Further, the average QF contract price is reasonable compared to Washington QF contracts that are currently included in rates. Rates resulting from the Company's 2011 rate case included the costs and benefits of a 25-year QF contract with the City of Walla Walla with calendar year 2014 prices of \$156.90 per MWh.¹⁷⁵ In addition, PSE's rates include Washington QF contracts with average prices of \$73 to \$97 per MWh.¹⁷⁶

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Moreover, the Commission's prudence standard examines whether a PPA is reasonable based upon what a utility knew or reasonably should have known when the contract was executed.¹⁷⁷ Similarly, when states establish QF contract prices, the Public Utilities Regulatory

¹⁷² Gomez, TR. 477:9-14.

¹⁷³ Duvall, TR. 302:9-303:4.

¹⁷⁴ *Id.*

¹⁷⁵ Duvall, Exh. No. GND-7CT 19:14-16.

¹⁷⁶ Duvall, Exh. No. GND-1CT 6:11-12.

¹⁷⁷ *WUTC v. Puget Sound Energy*, Dockets UE-111048 et al., Order 08 ¶ 408 (May 7, 2012).

Policies Act (PURPA) mandates that the prices not exceed the utility's avoided costs as determined at the time that the contract is executed.¹⁷⁸ No party has alleged that any of the Oregon or California QF prices were in excess of PacifiCorp's avoided cost price or otherwise unreasonable at the time that the QF contract was executed.¹⁷⁹

3. Washington's Energy Policies are Substantially Aligned with Oregon and California

63 Staff, Boise, and Public Counsel all claim that Oregon and California QF contracts should be excluded from rates because the PPAs reflect policy choices made by Oregon and California that are contrary to policy choices made by Washington.¹⁸⁰ Examination of the states' energy policies, however, demonstrates that Washington, like Oregon and California, has policies supporting the development of emission-free renewable resources.¹⁸¹ The Oregon and California QFs in this case are entirely renewable, and the inclusion of the costs and benefits of these resources in rates supports *Washington* energy policy.

64 Staff relies on a 2005 distributed generation report from the Public Utility Commission of Oregon (OPUC) to argue that Oregon's QF policies are inconsistent with Washington's.¹⁸² However, a comparison of the Oregon report and a similar report from this Commission in October 2011, *Report on the Potential for Cost-Effective Distributed Generation* in Docket UE-110667, reveals that the two states' policies are consistent.¹⁸³ The OPUC report was intended to "identify and remove regulatory barriers to the development of distributed generation." Similarly, the Commission's report was intended to "identify and develop a set of policy actions to advance distributed energy in Washington" and to provide "available options to

¹⁷⁸ See e.g., 16 U.S.C. §§ 824a-3(b), (d); 18 C.F.R. § 292.304(a)(2), (d); *American Paper Institute, Inc. v. American Elec. Power Service Corp.*, 461 U.S. 402, 413 (1983).

¹⁷⁹ Duvall, Exh. No. GND-7CT 21:6 – 22:2.

¹⁸⁰ Gomez, Exh. No. DCG-1CT 10:12-14; Deen, Exh. No. MCD-1CT 6:18-23; Coppola, Exh. No. SC-1CT 18:2-4.

¹⁸¹ Duvall, Exh. No. GND-7CT 14:2 – 15:11; Duvall, TR. 301:1-302:8.

¹⁸² Gomez, Exh. No. DCG-5CX. Staff indicated that because the Company's California service territory is so small, California has adopted policies consistent with Oregon for PURPA implementation.

¹⁸³ See Gomez, Exh. No. DCG-7CX.

encourage the development of cost-effective distributed generation in areas served by investor-owned utilities.”¹⁸⁴

65 Staff also relies heavily on the different contract lengths between the states to support its claim that Oregon and California PURPA policies are inconsistent with Washington.¹⁸⁵ According to Staff, the OPUC report recommended that the “OPUC should extend the contract length for [QFs],” which the OPUC then extended to allow standard contracts with 15 years of fixed prices.¹⁸⁶ However, this Commission’s report made a similar recommendation—that the Commission “[p]rovide greater certainty for developers of distributed generation through longer duration standard offer PURPA contracts established under utility tariffs, such as [PSE’s] Schedule 91.”¹⁸⁷ “PSE’s standard contract rate under Schedule 91 extends for ten years” and includes pricing for 15 years.¹⁸⁸

66 PacifiCorp’s Washington PURPA tariff, Schedule 37, provides a standard contract with five years of fixed prices.¹⁸⁹ QFs can negotiate a contract with terms up to 20 years.¹⁹⁰ At Staff’s request and following the issuance of the Commission’s distributed generation report, PacifiCorp revised Schedule 37 to include 10 years of pricing information.¹⁹¹ At hearing, Staff acknowledged that this additional pricing information helps facilitate the negotiation of longer term PURPA contracts.¹⁹²

67 Moreover, the Oregon and California QF contracts at issue in this case are all renewable QFs and most are eligible to satisfy PacifiCorp’s obligations under Washington’s Energy Independence Act (EIA).¹⁹³ The fact that Oregon and California QF contracts are eligible to satisfy PacifiCorp’s EIA obligations demonstrates that the Washington legislature views these

¹⁸⁴ Gomez, Exh. No. DCG-5CX; Gomez, Exh. No. DCG-7CX at 4.

¹⁸⁵ See Gomez, Exh. No. DCG-1CT 13:4-7; Gomez, TR. 501:11–503:4.

¹⁸⁶ Gomez, Exh. No. DCG-5CX.

¹⁸⁷ Gomez, Exh. No. DCG-7CX 6.

¹⁸⁸ *Id.* 29; Duvall, Exh. No. GND-7CT 19:12-14.

¹⁸⁹ Duvall, Exh. No. GND-7CT 19:11-12.

¹⁹⁰ Gomez, TR. 485:20-22.

¹⁹¹ Gomez, Exh. No. DCG-4CX 1.

¹⁹² Gomez, TR. 485:9-25.

¹⁹³ See RCW 19.285.030(11). “Eligible renewable resources” do not include freshwater hydro resources.

resources as regional resources serving Washington, not local resources intended to serve only Oregon and California.

4. Cost Recovery of QF Contracts is Consistent with PURPA

68 PURPA requires utilities to purchase the energy and capacity from QF contracts at rates that are just and reasonable to consumers, not discriminatory, and not in excess of the utilities' avoided cost.¹⁹⁴ Regarding cost recovery, Section 210(m)(7)(A) of PURPA requires FERC to “ensure that an electric utility that purchases electric energy or capacity from a [QF] . . . recovers all prudently incurred costs associated with the purchase.”¹⁹⁵ Modification of the WCA to include in Washington rates the costs of all QFs serving Washington customers, including those QFs that are physically located in Oregon and California, is consistent with PURPA's cost recovery provisions.

C. The Imputed East Control Area Sale should be Removed from the WCA

69 When the Commission approved the WCA in 2007, the Commission concluded that an imputed sale to the east control area was a reasonable estimate that relies on practical and understandable assumptions.¹⁹⁶ In this case, the Company proposes the removal of the assumed sale from PacifiCorp's west balancing authority area (PACW) to its east balancing authority area (PACE) because the assumptions underlying the sale are no longer valid and the modeling of the sale is convoluted and unrealistic.¹⁹⁷ As part of the calculation for the east control area sale, transfer volumes from the Jim Bridger plant to the east control area are reduced by 40 percent to account for competition from other generators selling power to PACE.¹⁹⁸ However, the markets

¹⁹⁴ See 16 U.S.C. §§ 824a-3(b), (d) (rates for purchases by utilities must be at the avoided cost).

¹⁹⁵ 16 U.S.C. § 824a-3(m)(7); see also *Freehold Cogeneration Associates, L.P. v. Board of Regulatory Commissioners of the State of New Jersey*, 44 F.3d 1178, 1194 (3d Cir. 1995) (“[A]ny action or order by the [state commission] to reconsider its approval or to deny the passage of those rates to [the utility's] retail consumers under purported state authority was preempted by federal law.”).

¹⁹⁶ *WUTC v. PacifiCorp*, Docket UE-061546, Order 08 ¶ 53 (June 21, 2007).

¹⁹⁷ Duvall, Exh. No. GND-7CT 24:4-20.

¹⁹⁸ *Id.* 24:14-16.

serving PACE have changed dramatically since 2007, most notably due to the significant increase of zero-fuel-cost wind generation in Wyoming.¹⁹⁹

70 In addition, the imputed sale relies on out-of-date and unreasonable assumptions regarding wheeling costs and therefore fails to account for the wheeling costs that PacifiCorp would actually incur if it were engaging in the fictional transaction.²⁰⁰ Because the imputed sale is entirely fictional, there is no realistic basis for imputing the sale nor is there any reasonable foundation for modeling the sale.²⁰¹ For all these reasons, the east control area sale should be removed from the WCA.

D. The Commission Should Reject Public Counsel’s Hedging Adjustment

71 The Company’s hedging contracts are reasonable and entered into in compliance with the Company’s risk management guidelines.²⁰² While no party has challenged the prudence of the Company’s hedging contracts or underlying hedging policies that governed those contracts, Public Counsel recommends that the Commission remove the Company’s hedging costs.²⁰³

72 Public Counsel argues that hedging costs are speculative and fail the known and measurable test. At hearing, however, Public Counsel’s witness Mr. Coppola acknowledged that the vast majority of the hedges that purportedly fail the known and measurable test are natural gas hedges.²⁰⁴ Mr. Coppola then admitted that hedging costs are based on the forward cost of natural gas and that forward natural gas costs are not subject to the known and measurable standard.²⁰⁵ Indeed, in a sentence from a Commission order that Mr. Coppola omitted from his testimony (even though he quoted verbatim the rest of the paragraph)²⁰⁶, the Commission was

¹⁹⁹ *Id.* 24:12 – 25:2.

²⁰⁰ *Id.* 25:3-12.

²⁰¹ Duvall, Exh. No. GND-1CT 9:9-19.

²⁰² Duvall, Exh. No. GND-7CT 27:20 – 28:17.

²⁰³ Coppola, Exh. No. SC-1CT 19:14-19.

²⁰⁴ Coppola, TR. 517:15-17.

²⁰⁵ *Id.* 517:18-21, 518:1-5, 520:15-19.

²⁰⁶ Coppola, Exh. No. SC-1CT 25:1-10 (omitting last sentence from paragraph 26 of Order 11 in Docket UE-090704).

clear that there are exceptions to the known and measurable standard, “such as using the forward costs of gas in power cost projections[.]”²⁰⁷

73 The Commission previously rejected an adjustment very similar to Public Counsel’s. In PSE’s 2009 rate case, the Commission rejected a proposed adjustment by Staff and ICNU to remove hedging costs from PSE’s base rates. The Commission concluded that “hedging is an appropriate tactic to manage fuel cost risk [and] it is appropriate for the cost of hedges to be included in power cost rates.”²⁰⁸ The Commission observed that “[w]hile it is true that the intrinsic value of hedges will vary with the actual cost of gas, this does not make hedging costs any less known and measurable than the market cost of gas” used to determine NPC.²⁰⁹ More recently, in May 2013, the Commission rejected another hedging adjustment proposed by Mr. Coppola in the natural gas utilities’ PGA dockets and affirmed the value of hedging as a “means to dampen the effects of price swings in the wholesale natural gas market, which has exhibited extreme price volatility at times in the past and remains volatile today.”²¹⁰ Mr. Coppola’s adjustment leaves the Company’s Washington customers unhedged from price volatility.

E. The Commission should Affirm the Application of a Reasonableness Standard for Coal from the Bridger Coal Company

1. Bridger Coal Costs are Reasonable

74 Utility transactions with affiliates are included in rates if the terms of the transaction are reasonable.²¹¹ Here, the Company fuels its Jim Bridger plant with coal supplied by an affiliate mine, Bridger Coal Company (BCC).²¹² No party has challenged the reasonableness of the Company’s coal costs.²¹³ The Company supplies the Jim Bridger plant with a blend of coal from

²⁰⁷ *WUTC v. Puget Sound Energy*, Dockets UE-090704 et al., Order 11 ¶ 26 (Apr. 2, 2010).

²⁰⁸ *Id.* ¶ 153; *see also WUTC v. PacifiCorp*, Docket UE-061546, Order 08 ¶ 117 (June 21, 2007) (PacifiCorp’s strategy of hedging electricity purchases is prudent).

²⁰⁹ *WUTC v. Puget Sound Energy*, Dockets UE-090704 et al., Order 11 ¶ 154 (Apr. 2, 2010); *WUTC v. Puget Sound Energy*, Dockets UE-111048 et al., Order 08 ¶ 241 (May 7, 2012) (affirming treatment of hedging costs).

²¹⁰ *WUTC v. Cascade Natural Gas Corp.*, Docket UG-121592, Order 02 n. 1 (May 1, 2013).

²¹¹ RCW 80.16.030.

²¹² Crane, Exh. No. CAC-1CT 4:7-12.

²¹³ *Id.* 7:4 – 9:18.

BCC and a third-party contract with the Black Butte mine to ensure a diversified fuel supply.²¹⁴ Over the years, BCC and Black Butte prices have fluctuated relative to each other, but on balance the Company's long-term fuel supply strategy has resulted in the acquisition of a reasonably priced, stable supply of coal for the Jim Bridger plant.²¹⁵ For 2014, BCC's prices have increased to reflect reclamation activities, and Black Butte's prices have increased to reflect contract-specific consumer and producer price indices.²¹⁶

75 The Company demonstrated that there are no lower cost alternatives to BCC coal available in 2014.²¹⁷ For 2014, Black Butte has a small amount of coal available to the market, enough only to meet a small fraction of Jim Bridger's fuel requirements.²¹⁸ The other two mines in the southwest Wyoming market similarly could not replace BCC's fuel supply, and coal from these mines is priced much higher than BCC coal after considering transportation costs.²¹⁹ The lack of lower priced alternatives further confirms the reasonableness of the Company's fueling strategy and the 2014 coal costs for the Jim Bridger plant.

2. The Commission Should Reject Boise's Request to Change to the Lower of Cost or Market Standard for Pricing BCC Coal

76 Although Boise does not challenge the reasonableness of BCC coal costs, Boise proposes an adjustment that would re-price BCC coal at the 2014 Black Butte contract price.²²⁰ Boise claims that Washington Commitment 12 from the MEHC acquisition order requires the application of a lower of cost or market pricing standard to BCC coal.²²¹ However, the Commission has not traditionally applied the lower of cost or market standard to transactions between PacifiCorp and BCC.²²² On the contrary, extending back to at least the 1980s, the Commission has allowed PacifiCorp to purchase coal from BCC at the actual, prudent costs of

²¹⁴ *Id.* 7: 5-8.

²¹⁵ *Id.* 7:16-22.

²¹⁶ Duvall, Exh. No. GND-1CT 14:2-12.

²¹⁷ Crane, Exh. No. CAC-1CT 8:1 – 9:10.

²¹⁸ *Id.* 8:8-12.

²¹⁹ *Id.* 8:13 – 9:10.

²²⁰ Deen, Exh. No. MCD-1CT 23:7-8.

²²¹ *Id.* 22:3-11.

²²² Crane, Exh. No. CAC-1CT 5:1 – 6:8.

production, plus a return component on the investment in the Bridger mine limited to PacifiCorp's current authorized rate of return (ROR).²²³ Under this approach, if BCC earns a margin over PacifiCorp's authorized ROR, it must credit this margin back to PacifiCorp through a reduced transfer price.²²⁴ The Commission used this methodology because integrating BCC into PacifiCorp for ratemaking "recognizes that price comparisons are not controlling in the analysis of affiliated transactions; rather, it is the cost of the commodity, including the element of return or profit, which must be examined."²²⁵

77 The Commission has never applied Washington Commitment 12 to transactions between BCC and PacifiCorp and there is no need to do so here.²²⁶ Washington Commitment 12 is designed to protect customers by preventing cross-subsidization of affiliates by customers.²²⁷ Mr. Deen argues that his adjustment is necessary to ensure "ratepayers are protected from affiliate abuse by the Company paying an unreasonable price which would allow the affiliate and parent corporation to achieve above market profits."²²⁸ But there is no risk of cross-subsidization or affiliate abuse related to BCC coal because of the unique regulatory treatment consolidating BCC with PacifiCorp for ratemaking purposes.²²⁹ Thus, BCC is not treated as an affiliate at all; it is treated as if PacifiCorp itself were mining the coal.²³⁰

78 Further, even if the Commission were to apply Washington Commitment 12 as Boise recommends, the record does not support Boise's proposed adjustment.²³¹ Washington Commitment 12 applies "if a readily identifiable market for the goods, services, or assets exists."²³² In this case, however, there is no "readily identifiable market" for coal in southwest Wyoming. The Company has demonstrated that there are no lower cost alternatives to BCC coal

²²³ *Id.* 5:18-21; see, e.g., *WUTC v. Pac. Power & Light Co.*, Cause No. U-86-02, 78 P.U.R.4th 84 (Sept. 19, 1986).

²²⁴ Crane, Exh. No. CAC-1CT 6:1-2.

²²⁵ *WUTC v. Pac. Power & Light Co.*, Cause No. 82-12, 52 P.U.R.4th 148 (Mar. 23, 1983).

²²⁶ Crane, Exh. No. CAC-1CT 6:9-12.

²²⁷ *Id.* 6:13-16.

²²⁸ Deen, Exh. No. MCD-1T 21:23 – 22:2.

²²⁹ Crane, Exh. No. CAC-1CT 6:16-19.

²³⁰ *Id.*

²³¹ The value of Boise's proposed adjustment is also wrong because it fails to account for deferred taxes. *Id.* 9:19 – 10:5.

²³² Deen, Exh. No. MCD-1CT 22:8-11.

79 available in 2014, and Boise’s market analysis is deficient for focusing on only one southwest
Wyoming mine.

80 The evidence in this case demonstrates that Black Butte mine does not have sufficient
excess capacity to supply the Jim Bridger plant.²³³ For 2014 BCC will supply approximately
[REDACTED] million tons of coal to the Jim Bridger plant.²³⁴ The record in this case shows that the Black
Butte mine *may* have approximately [REDACTED] million tons of excess production capacity in 2014,
which is less than [REDACTED] percent of the Jim Bridger’s plant 2014 production target.²³⁵

81 Boise’s market rate analysis is also deficient because it focuses exclusively on the Black
Butte mine and fails to consider the costs of coal supply from other mines in southwest
Wyoming in determining the “market rate.” PacifiCorp has demonstrated that BCC’s costs
compare favorably to these other mines.²³⁶

82 Boise also fails to consider the vintage of the Black Butte pricing that it claims is a
“market rate” for 2014. If the Company could obtain additional coal supply from the Black
Butte mine for 2014, the price would be higher than the current contract price, which is now
several years old.²³⁷ Furthermore, purchases of additional Black Butte coal would result in a
drop in BCC deliveries and an increase in BCC costs on a per-ton basis.

F. The DC Intertie Contract Is Used and Useful in the Test Year

83 Staff and Boise recommend an adjustment to remove the costs associated with the
Company’s DC Intertie contract from NPC. Boise relies on the Commission’s decision in the
2010 rate case, and Staff argues that the costs of the contract outweigh the benefits and that the
DC Intertie serves only Oregon loads.²³⁸ These arguments are unpersuasive. Since the 2010 rate
case, the Company has refined GRID to clearly demonstrate the actual benefits provided by the

²³³ Crane, Exh. No. CAC-1CT 8:8-12.

²³⁴ *Id.* 8:3-4.

²³⁵ *Id.* 8:8-12.

²³⁶ *Id.* 9:13 – 9:10.

²³⁷ *Id.* 10:10-16.

²³⁸ Deen, Exh. No. MCD-1CT 6:8-14 (incorrectly characterizing DC Intertie as a WCA allocation issue); Gomez,
Exh. No. DCG-1CT 21:11-19.

84 DC Intertie. In 2011, the OPUC rejected ICNU’s DC Intertie adjustment, concluding that a long-
term contract should be viewed in broader terms than a snapshot of benefits in a particular
year.²³⁹

85 The DC Intertie contract is used and useful because it facilitates the Company’s
transactions at the Nevada Oregon Border (NOB) market hub, which have consistently occurred
over the last five years and are expected to continue into the future.²⁴⁰ Although the Company
has always transacted at NOB, GRID’s topology did not previously include this hub.²⁴¹ The
Company has modified GRID’s topology, and now these transactions are specifically captured in
GRID.²⁴² No party disputes that these transactions occur.

86 The DC Intertie benefits Washington customers by taking advantage of the load diversity
between California and the Pacific Northwest to provide valuable energy *and capacity*
benefits.²⁴³ Staff’s analysis fails to account for the capacity benefits.²⁴⁴ Indeed, without the DC
Intertie PacifiCorp would be required to obtain another capacity resource.²⁴⁵ The DC Intertie is
included in the preferred portfolio in the Company’s Integrated Resource Plan (IRP) and is an
integral piece of the Company’s overall transmission system.²⁴⁶

87 The fact that the DC Intertie serves Oregon loads does not reduce the benefits provided to
Washington customers because the use of the DC Intertie frees other resources to serve
Washington customers.²⁴⁷ Moreover, inclusion of the DC Intertie in Washington rates is
consistent with the WCA and Staff’s own testimony that the “WCA is not based, and never has
been based, on actual power flow studies.”²⁴⁸ If the Commission applied Staff’s rationale, it
would constitute a fundamental change in the WCA, and consistency would require the removal

²³⁹ *In the Matter of PacifiCorp d/b/a Pacific Power 2012 Transition Adjustment Mechanism*, Docket UE 227, Order No. 11-435 at 26 (Nov. 4, 2011).

²⁴⁰ Duvall, Exh. No. GND-7CT 44:1-6.

²⁴¹ *Id.* 43:14-19.

²⁴² *Id.*

²⁴³ *Id.* 43: 7-13.

²⁴⁴ *See* Gomez, Exh. No. DCG-1CT 20:21 – 21:4.

²⁴⁵ Duvall, Exh. No. GND-7CT 44:7-13.

²⁴⁶ *Id.*; *see also id.* 44:7-13.

²⁴⁷ *Id.* 45:8-19.

²⁴⁸ Gomez, Exh. No. DCG-1CT 10:6-7.

from Washington rates of the benefits of several of the Company's low-cost hydro resources that also serve Oregon.²⁴⁹

88 In the 2010 rate case order, the Commission noted that PacifiCorp has an obligation to market available transmission capacity that it is not using to recover some of its costs.²⁵⁰ However, the DC Intertie is not marketable under BPA's policies, and the Company cannot otherwise terminate the DC Intertie contract because it is linked to the Company's AC Intertie agreement, which provides significant benefits to customers.²⁵¹

G. The Commission Should Reject Boise's Proposed Jim Bridger Heat Rate Adjustment

89 Boise proposes an adjustment to reduce the heat rate for Jim Bridger Units 1 and 2 to reflect increased efficiency resulting from recent turbine upgrades. Boise proposes to replace the actual heat rates derived using a 48-month average with the heat rate derived using a 24-month average from Jim Bridger Unit 1.²⁵² However, customers receive the benefits of the efficiency gains for the units as the actual unit heat rates are incorporated into the historical average used to calculate the normalized heat rate.²⁵³ Thus, there is no need for Boise's adjustment. Moreover, Boise's adjustment is speculative and unsupported, and PacifiCorp has already lowered NPC by reflecting the increased generation capacity from the turbine upgrade.

90 Boise's adjustment is entirely speculative because it replaces 48 months of actual heat rate data for Unit 2 with only 24 months of actual heat rate data from Unit 1.²⁵⁴ Not only does Boise's adjustment use less historical data, but it also uses historical data from a different generating unit. It is speculative to assume that the actual heat rate data from Unit 1 is more representative of the heat rate for Unit 2 than actual data from Unit 2. This is particularly true because the two units did not undergo the same type of turbine upgrade.²⁵⁵

²⁴⁹ Duvall, Exh. No. GND-7CT 45:22 – 46:5.

²⁵⁰ *WUTC v. PacifiCorp*, Docket UE-100749, Order 06 ¶ 152 (Mar. 25, 2011).

²⁵¹ Duvall, Exh. No. GND-7CT 46:10-16.

²⁵² Deen, Exh. No. MCD-1CT 19:12-18, 20:16-20.

²⁵³ Duvall, Exh. No. GND-7CT 49:1-7.

²⁵⁴ Deen, Exh. No. MCD-1CT 19:12-18.

²⁵⁵ Ralston, Exh. No. DMR-1T 3:21 – 4:13.

91 PacifiCorp’s use of 48 months of historical data is consistent with the historical period used to normalize other thermal attributes in the Company’s filing, specifically forced and planned outages.²⁵⁶ It is also how the Company has traditionally calculated its heat rates, even when capital improvements increased or decreased a unit’s performance.²⁵⁷ Here, Boise’s proposed methodology change is not based on superior modeling; instead it is based on Boise’s desired outcome. The Commission should reject this argument as unfairly asymmetrical.

92 Boise’s proposal is also contrary to prior recommendations. In an Oregon case, a witness testifying on behalf of ICNU, of which Boise is a member, recommended that the OPUC reject an adjustment identical to Boise’s “[b]ecause the Company’s method allows for a continuous heat rate adjustment to take place, [so] there is no need for pro-forma adjustments in this type of situation.”²⁵⁸

93 Moreover, the data set that Boise proposes for its heat rate adjustments for both Units 1 and 2 reflect Unit 1’s reduced heat rate that followed a planned outage where the turbine was upgraded and normal maintenance occurred.²⁵⁹ Therefore, Boise’s adjustment is based not only on the incremental efficiency improvements related to the turbine upgrade but also the efficiency improvements that normally occur after a maintenance overhaul.

H. GRID’s Market Caps are Necessary to Accurately Model Market Transactions

94 Market caps are a critical input to GRID because they reflect actual wholesale power market constraints and limit GRID’s default assumption of unlimited market depth for short-term firm (STF) sales.²⁶⁰ In assuming unlimited market depth for STF transactions GRID does not consider load requirements, all actual transmission constraints, market illiquidity, or assumptions about market prices that would preclude sales at the static forecast price.²⁶¹ Market caps are necessary to account for these actual market constraints to ensure that GRID does not model

²⁵⁶ Duvall, Exh. No. GND-7CT 47:13-16.

²⁵⁷ *Id.* 50:4-12.

²⁵⁸ *Id.* 48:18-22.

²⁵⁹ *Id.* 49:8-16.

²⁶⁰ *Id.* 30:9-18.

²⁶¹ *Id.*

transactions and impute sales revenues that, in reality, are not available to the Company. Further, the Company's market caps are reasonably representative of the Company's actual operations because they are based upon the Company's actual average historical sales levels during the preceding four-year period.²⁶² The Company has used market caps as a part of GRID's basic design since the introduction of the model.²⁶³

95 Boise proposes an adjustment to eliminate the market caps from GRID. Boise claims that the caps are an artificial construct that unreasonably limits the Company's actual transactions.²⁶⁴ On the contrary, market caps are intended to ensure that GRID accounts for actual market illiquidity.²⁶⁵ Boise's witness, Mr. Deen, has previously acknowledged that without market caps, GRID does not account for market liquidity.²⁶⁶ At hearing Mr. Deen changed his prior testimony and now claims that the static forecast prices in GRID inherently account for market liquidity.²⁶⁷ Mr. Deen's changed testimony is unpersuasive because, as he admits, GRID's prices are static and do not account for intra-hour changes in market conditions.²⁶⁸ And this is precisely why GRID requires market caps and AURORA, which is used by Avista and PSE and utilizes dynamic pricing, does not.²⁶⁹

96 The record is also clear that without market caps, GRID models significantly more sales than actually occur, which provides further evidence that without market caps there is no liquidity constraint in GRID.²⁷⁰ Indeed, when market caps are eliminated the modeled sales at California-Oregon Border (COB) are 139 percent greater than the four-year average.²⁷¹ Mr. Deen claims that the limitations of PacifiCorp's generation and transmission resources limit market transactions in the absence of market caps.²⁷² However, the evidence demonstrates that

²⁶² *Id.* 36:8-10.

²⁶³ *Id.* 31:10-13.

²⁶⁴ Deen, Exh. No. MCD-1CT 12:2-3.

²⁶⁵ Duvall, Exh. No. GND-7CT 30:13-18.

²⁶⁶ Deen, Exh. No. MCD-18CX 4:6-10.

²⁶⁷ Deen, TR. 542:14-24.

²⁶⁸ Deen, TR. 547:13-18.

²⁶⁹ *Id.* 547:1-18.

²⁷⁰ Duvall, Exh. No. GND-7CT 33:15 – 34:12, 35 Table 1.

²⁷¹ *Id.* 34:1-3.

²⁷² Deen, Exh. No. MCD-1CT 14:22 – 15:2.

without market caps, there is no constraint on sales because most of the additional sales consist or market transactions, not sales of generation from the Company's resources.²⁷³ On the other hand, the Company has also demonstrated that *with* market caps, GRID models sales levels that are close to historical actuals.²⁷⁴

97 Elimination of the market caps results in an unreasonable increase in revenue related to market transactions because, without market caps, GRID shifts sales from liquid hubs, with their generally lower market prices, to illiquid hubs, with their generally higher market prices.²⁷⁵ In this case, elimination of market caps shifts sales from Mid-C to COB, which Mr. Deen has admitted is the less liquid hub.²⁷⁶ Although Mr. Deen claims that in "another case with different market conditions and constraints and fuel prices and all the other factors it could be a different pattern," in a 2012 Oregon case, the removal of market caps had the same result as here—sales shifted from illiquid to liquid hubs.²⁷⁷

98 This result is predictable because GRID utilizes static hourly pricing that does not take into account changing load and resource balance or intra-hour changes in market pricing.²⁷⁸ If the Company actually made significant sales at one of the illiquid hubs, the prices at those hubs would decrease due to the increased sales volume.²⁷⁹ But GRID does not capture this phenomenon because it uses static pricing within each hour. When market caps are removed, GRID unrealistically shifts sales from liquid markets to illiquid markets to take advantage of the higher prices in the illiquid markets. Thus, the elimination of market caps results in modeling distortions that are not reasonably representative of the Company's actual operations.²⁸⁰

99 The elimination of market caps also results in an unreasonable further reduction in the Company's NPC.²⁸¹ When examining individual NPC adjustments, Mr. Deen has admitted that

²⁷³ Duvall, Exh. No. GND-7CT 37:1-4, Figure 2.

²⁷⁴ *Id.* 33:15 – 34:12, 35, Table 1.

²⁷⁵ *Id.* 39:4-13; Deen, Exh. No. MCD-18CX 7:23 – 8:5.

²⁷⁶ Deen, TR. 544:4–545:2; Deen, Exh. No. MCD-18CX 6:2-9, 12:18 – 13:4.

²⁷⁷ Deen, TR. 544:24 – 545:2; Deen, Exh. No. MCD-18CX.

²⁷⁸ Deen, TR. 547:13-18.

²⁷⁹ Duvall, Exh. No. GND-7CT 39:4-13.

²⁸⁰ *Id.* 36:8-10.

²⁸¹ *See* Deen, TR. 549:17-20 (all else equal, removal of market caps would have increased NPC under-recovery).

it is relevant whether the Company has been under-recovering its NPC.²⁸² Further, Mr. Deen recognizes that the Company has been consistently under-recovering its NPC in recent years.²⁸³ The Commission has also observed that artificially adjusting revenue from off-system sales is unnecessary absent evidence that a utility's NPC model is biased towards over-recovery.²⁸⁴ Here, GRID is not biased towards over-recovery and market caps are necessary to ensure a reliable estimate of NPC.

I. The Commission Should Approve PacifiCorp's Proposed PCAM

1. PacifiCorp's NPC Variability Justifies the Need for a PCAM

100 The Company needs a PCAM in Washington to address its substantial NPC variability, which is caused primarily by factors outside the Company's control. In the Company's 2006 rate case, the Commission concluded that the "Company is subject to significant power cost variability . . . sufficient to warrant consideration of a PCAM as a means to accommodate this variability in ratemaking."²⁸⁵ In that case, the NPC variability ranged from \$26 to \$48 million.²⁸⁶ The Company's NPC variability is now approximately \$67 million—far exceeding the level the Commission already concluded was sufficient to warrant a PCAM.²⁸⁷ Although Staff does not support a PCAM at this time, Staff agreed that the NPC variability in this case was greater than the variability presented in past cases and sufficient to justify a PCAM.²⁸⁸ Moreover, the Company's NPC variability in Washington is particularly large because NPC costs represent a larger portion of the Company's overall revenue requirement under the WCA.²⁸⁹

101 The Company's NPC variability has been driven in large part by legislative changes that have occurred since the Company's 2006 rate case. In particular, compliance with Washington's EIA and Emissions Performance Standard has increased the Company's dependence on wind and

²⁸² Deen, TR. 547:19–548:7; Deen, Exh. No. MCD-18CX 15:11-17.

²⁸³ Deen, TR. 549:7-9.

²⁸⁴ See *WUTC v. Puget Sound Energy*, Docket UE-090704 et al., Order 11 ¶¶ 172-74 (Apr. 2, 2010).

²⁸⁵ *WUTC v. PacifiCorp*, Docket UE-061546, Order 08 ¶ 71 (June 21, 2007).

²⁸⁶ *Id.* ¶ 68.

²⁸⁷ Gomez, Exh. No. DCG-6CX.

²⁸⁸ *Id.*

²⁸⁹ Duvall, Exh. No. GND-1CT 29:19-20; Duvall, Exh. No. GND-7CT 56:9 – 57:8.

gas-fired generators, which has introduced added NPC variability.²⁹⁰ Since 2006, the Company has added approximately 405 MW of new wind resources and 74 MW of wind PPAs in the west control area and has more than doubled the Company’s natural gas plant capacity.²⁹¹ Staff specifically acknowledged that the “expanded role or renewable resources within the Company’s generation portfolio is an additional element supporting a properly designed PCAM for the Company.”²⁹² And Mr. Coppola testifies that the “Company’s own generation portfolio [has] changed dramatically since 2006.”²⁹³

102 Further, the high degree of variability of PacifiCorp’s NPC is due to factors largely outside of the Company’s control, such as stream flows, wind, market prices, fuel prices, loads, and forced outages.²⁹⁴ In fact, both in pre-filed testimony and at hearing Mr. Deen testifies that “[a]ctual power costs can vary from the normalized forecast for a huge variety of reasons, including variations in weather, load, market prices, and resource performance.”²⁹⁵ Mr. Coppola also identified market prices, gas prices, wind, and hydro as historical sources of NPC variability.²⁹⁶ The Company has no control over any of these factors.

103 Mr. Deen also claims that the influx of wind resources due to the EIA has not increased the Company’s NPC variability because wind integration costs “can be and are forecasted on a reasonable basis.”²⁹⁷ However, this testimony contradicts other portions of Mr. Deen’s testimony where he testifies that, “Forecasting normalized annual generation for large-scale wind projects in the United States is very much a science still in development . . . it is clear that wind power resources can display a high level of variability in inter-annual generation.”²⁹⁸ In light of the dramatic increase in wind development since 2006 and the “high level of variability in inter-annual generation,” the Company’s increased NPC variability is to be expected.

²⁹⁰ Duvall, Exh. No. GND-1CT 31:1-13.

²⁹¹ *Id.* 36:8-17.

²⁹² Gomez, Exh. No. DCG-1CT 23:16-18.

²⁹³ Coppola, Exh. No. SC-1CT 39:1-2.

²⁹⁴ Duvall, Exh. No. GND-1CT 32:1-5.

²⁹⁵ Deen, Exh. No. MCD-1CT 25:20-22; Deen, TR. 549:22-25.

²⁹⁶ Coppola, Exh. No. SC-1CT 39:22 – 40:17.

²⁹⁷ Deen, Exh. No. MCD-1CT 26:15-16.

²⁹⁸ *Id.* 9:4-6.

104 Public Counsel argues that the Company does not have sufficient NPC variability to justify a PCAM.²⁹⁹ Mr. Coppola claims that the “glut of natural gas in the US” will result in stable gas prices,³⁰⁰ and that the Company can expect “a more stable power market environment in the near future.”³⁰¹ However, Mr. Coppola also testifies that gas and electric market prices “can vary significantly from month to month” and that market prices could “spike” in 2014.³⁰² At hearing Mr. Coppola tried to reconcile these contradictory statements by claiming that there is significant *short-term* market variability, but less *long-term* variability.³⁰³ For purposes of a PCAM, however, the relevant variability is short-run variability, not long-term variability.³⁰⁴ Therefore, Mr. Coppola’s acknowledgement of short-term market variability provides additional justification for a PCAM. Moreover, as recently as May 1, 2013, the Commission observed that natural gas prices remain volatile.³⁰⁵

105 The Company’s undisputed evidence regarding its under-recovery of NPC provides further validation of the Company’s demonstration of need. Since the Commission last concluded that the Company had demonstrated a need for a PCAM in its 2006 rate case, PacifiCorp has under-recovered approximately \$55 million in NPC.³⁰⁶ Mr. Deen characterizes this under-recovery as happenstance; however, persistent, annual under-recovery points to a need for additional regulatory support through a PCAM.³⁰⁷

106 Even though Staff agrees that a PCAM is justified, Staff argues against a PCAM until the Company’s current “interstate cost allocation review is complete before considering a PCAM for the Company.”³⁰⁸ However, the Company’s Multi-State Process (MSP) is an ongoing forum that began with the original adoption of the Company’s inter-jurisdictional allocation protocol and is

²⁹⁹ Coppola, Exh. No. SC-1CT 41:9.

³⁰⁰ *Id.* 40:20-22.

³⁰¹ *Id.* 43:21-22.

³⁰² *Id.* 19:15-19.

³⁰³ Coppola, TR. 522:7–523:1.

³⁰⁴ *WUTC v. PacifiCorp*, Docket UE-050684, Order 04 ¶ 91 (Apr. 17, 2006).

³⁰⁵ *WUTC v. Cascade Natural Gas Corp.*, Docket UG-121592, Order 02 n. 1 (May 1, 2013).

³⁰⁶ Duvall, Exh. No. GND-1CT 30 Table 1.

³⁰⁷ Deen, Exh. No. MCD-1CT 25:18-20.

³⁰⁸ Gomez, Exh. No. DCG-1CT 25:16-24.

expected to continue for the foreseeable future.³⁰⁹ Staff’s proposal would therefore result in an indefinite deferral of this issue, which is unreasonable considering Staff does not dispute the need for a PCAM now.

2. PacifiCorp’s Proposed PCAM Design is Reasonable Given the Symmetrical NPC Variability

107 The Company’s proposed PCAM is designed to allow the Company to recover all its prudently incurred costs—no more and no less. For this reason, the risks and benefits from a PCAM without deadbands or sharing bands will fall equally—and fairly—on customers and shareholders.³¹⁰ The Company’s lack of control over many of the NPC variables also makes the Company’s proposed PCAM appropriate. PacifiCorp’s proposed PCAM is also consistent with others across the nation, the vast majority of which do not contain sharing or dead bands, with purchase gas adjustment mechanisms in Washington, and with the treatment of PacifiCorp’s renewable energy credit (REC) revenues.³¹¹

108 In the Company’s 2006 rate case, the Commission concluded that the asymmetrical distribution of NPC variability, largely caused by hydro generation, supported a PCAM design that included sharing and dead bands to more equitably allocate risk.³¹² However, as Mr. Coppola correctly argued, “a conclusion reached by the Commission more than six years ago does not mean it is still relevant today.”³¹³ Based on updated analysis—which was not disputed by any party—the Company has demonstrated that its NPC variability is no longer asymmetrical.³¹⁴ The current symmetrical variability means that deviations in actual NPC from forecast NPC are as likely to be higher as they are to be lower. Therefore, when NPC variability is symmetrical, as in this case, customers and the Company equitably share in the risk and benefits of NCP variability. Staff argues that the proposed lack of sharing and dead bands fails

³⁰⁹ Dalley, TR. 279:9-13.

³¹⁰ *WUTC v. PacifiCorp*, Docket UE-061546, Order 08 ¶ 86 (June 21, 2007) (properly designed PCAM should “equally balance risk with benefit”).

³¹¹ Duvall, Exh. No. GND-5; Duvall, Exh. No. GND-1CT 32:8-19.

³¹² *WUTC v. PacifiCorp*, Docket UE-061546, Order 08 ¶ 86 (June 21, 2007).

³¹³ Coppola, Exh. No. SC-1CT 38:20-21.

³¹⁴ Duvall, Exh. No. GND-1CT 48:1 – 49:2; Duvall, Exh. No. GND-7CT 52:11 – 53: 6.

to “comply with the fundamental design requirements to reflect asymmetry of power cost distribution.”³¹⁵ But Staff did not dispute the Company’s analysis demonstrating that NPC distribution is no longer asymmetrical; therefore Staff’s argument misses the mark. Likewise, Mr. Coppola did not dispute the Company’s symmetrical variability. In fact, Mr. Coppola implicitly acknowledged this symmetry by proposing explicitly symmetrical sharing bands.³¹⁶

109 Although the Company’s proposed PCAM is different from the Avista and PSE PCAMs, the lack of sharing and dead bands is reasonable because of the symmetry of the Company’s NPC variability. The Commission has been clear that PCAMs need to be specifically tailored to each utility’s unique operational circumstances and current market conditions.³¹⁷ The Commission has also found that asymmetrical variability is largely due to hydro variability³¹⁸ and that “PacifiCorp is less reliant on hydroelectric power than Avista and PSE, which may suggest a differently structured PCAM.”³¹⁹ Based on these conclusions it is reasonable for PacifiCorp’s PCAM to not include the sharing and dead bands that are included in Avista’s and PSE’s PCAMs.

110 The Commission has also used sharing and dead bands to provide utilities with incentives to efficiently manage NPC.³²⁰ But in today’s market, the significant drivers of NPC variability are entirely outside the Company’s control.³²¹ Therefore, the presence or lack of sharing and dead bands will provide no incentive to the Company.³²² Rather, sharing and dead bands are unreasonably punitive and unnecessary given the Commission’s existing ability to review for prudence all the Company’s NPC decisions.³²³

³¹⁵ Gomez, Exh. No. DCG-1CT 24:8-10.

³¹⁶ Coppola, Exh. No. SC-1CT 43:1-4.

³¹⁷ *WUTC v. PacifiCorp*, Docket UE-050684, Order 04 ¶ 91 (Apr. 17, 2006); *WUTC v. PacifiCorp*, Docket UE-061546, Order 08 ¶ 83 (June 21, 2007).

³¹⁸ *WUTC v. PacifiCorp*, Docket UE-061546, Order 08 ¶ 85 (June 21, 2007); *see also* Deen, Exh. No. MCD-1CT 28:21-23.

³¹⁹ *WUTC v. PacifiCorp*, Docket UE-050684, Order 04 ¶ 93 (Apr. 17, 2006).

³²⁰ *WUTC v. PacifiCorp*, Docket UE-061546, Order 08 ¶ 83 (June 21, 2007).

³²¹ Duvall, Exh. No. GND-7CT 54:3-23.

³²² *Id.* 55:1-17.

³²³ *Id.*

111 The imposition of sharing and dead bands will also do little to address the Company's persistent NPC under-recovery. Under Boise's proposed PCAM, which includes sharing and dead bands and an earnings test, the Company would have recovered only 21 percent of its NPC under-recovery since 2007.³²⁴ Likewise, under Public Counsel's PCAM, which includes sharing and dead bands, the Company would have recovered only 34 percent.³²⁵ This demonstrates that the imposition of sharing and dead bands or an earnings test simply results in unreasonable disallowances of prudently incurred costs and does little to address the variability that is driving the Company's need for a PCAM.

3. The Company Addressed the Commission's Concerns in the 2006 Rate Case Order

112 In the 2006 rate case, the Commission concluded that before it would approve a PCAM for PacifiCorp, the Company must use actual, rather than computer-generated, costs for the true-up.³²⁶ In this case, as acknowledged by Staff, the Company has addressed this concern and proposed a PCAM that will use actual NPC per the books and records of the Company for the assets included in the west control area.³²⁷

V. PRO FORMA CAPITAL ADDITIONS

113 To address issues related to the timely recovery of infrastructure investments (regulatory lag) and to help narrow the gap between the costs incurred to serve Washington customers and the costs recovered in customer rates, in this case the Company proposes including in rate base the capital costs of five projects placed in service after the end of the historical test period. Staff and Public Counsel object to including two of these projects in rates—the Merwin Fish Collector and the Jim Bridger Unit 2 turbine upgrade.³²⁸

³²⁴ *Id.* 56 Table 2.

³²⁵ *Id.*

³²⁶ *WUTC v. PacifiCorp*, Docket UE-061546, Order 08 ¶ 111 (June 21, 2007).

³²⁷ Duvall, Exh. No. GND-1CT 46:1-12; Gomez, Exh. No. DCG-1CT 24:4-7.

³²⁸ None of the parties addressed the prudence of the Merwin Fish Collector and Jim Bridger turbine upgrade. The Company has, however, provided sufficient evidence to allow the Commission to conclude that the projects were prudent.

114 In its testimony, Staff recognized the flexibility and variability in previous Commission decisions regarding pro forma capital additions, specifically stating “that there is no set rule for the establishment of a cut-off date.”³²⁹ But based on practical concerns about the ability to “perform a continuous audit” while a rate case is pending, Staff nonetheless recommended a cut-off date for capital additions of January 11, 2013, which is the day the Company filed this case.³³⁰ Public Counsel recommends a cut-off date of February 28, 2013, asserting that costs for the Merwin Fish Collector and the Jim Bridger turbine upgrade will be incurred after that date and are therefore not known and measurable.³³¹ Staff also recommends disallowance of O&M expense associated with the Merwin and Swift fish collectors as not known and measurable.³³²

115 Although the Merwin Fish Collector and Jim Bridger turbine upgrade were not in service at the end of the historical test period (or the parties’ proposed capital addition cut-off dates), inclusion of these projects in rates at this time is consistent with the flexibility the Commission has demonstrated in past cases. Inclusion of these projects also minimizes regulatory lag, which the Commission has a “responsibility to mitigate . . . to the extent possible.”³³³

B. The Jim Bridger Unit 2 Turbine Upgrade is In Service and Used and Useful

116 The Jim Bridger Unit 2 upgrade was placed in service in May 2013. It is now used and useful and its costs are known and measurable.³³⁴ The upgrade improves the efficiency of the generating unit by increasing the maximum output without additional fuel and allowing the unit to consume less fuel for the same MW output over the normal operating range of the unit when compared to the previous turbine.³³⁵ The Company’s conservative economic analysis, which examined only the capacity benefits of the upgrade, demonstrated a \$28.9 million customer

³²⁹ McGuire, Exh. No. CRM-1T 7:10.

³³⁰ *Id.* 8:15-17.

³³¹ Coppola, Exh. No. SC-1CT 7:15-18, 22-25.

³³² McGuire, Exh. No. CRM-1T 11:17 – 12:12. The Swift Fish Collector went into service in November 2012, before Staff’s and Public Counsel’s proposed cut-off dates. Staff supports inclusion of the Swift Fish Collector in rate base, but objects to the O&M expenses associated with the collector.

³³³ *WUTC v. Puget Sound Energy*, Docket UE-121697 et al., Order 07 ¶ 46 (June 25, 2013) (quoting *Wash. Nat. Gas Co.*, 44 P.U.R.th 435, 438 (Sept. 24, 1981).

³³⁴ Ralston, TR. 365:3-5; McDougal, Exh. No. SRM-6T 18:23 – 19:3.

³³⁵ Ralston, Exh. No. DMR-1T 5:1-16.

benefit resulting from the upgrade.³³⁶ No party has challenged the Company’s economic analysis related to this turbine upgrade, and no party challenged the inclusion of the benefits associated with the upgrade in the NPC calculation.

117 As Staff testified, Commission practice with respect to pro forma rate base additions has been “highly variable.”³³⁷ The Commission has allowed pro forma capital additions for power production facilities, like the Jim Bridger Unit 2 upgrade, even if the facility entered service after the test period.³³⁸ The Commission allows these types of adjustments when the offsetting factors are captured through NPC modeling.³³⁹ In Avista’s 2009 rate case, the Commission approved a pro forma rate base adjustment relating to a turbine upgrade and mechanical overhaul of a hydro facility that were scheduled to be in service three months into the rate year and 18 months after the conclusion of the test period.³⁴⁰ The Commission found that the project costs were “sufficiently well established” and the turbine upgrade was included in the model used to develop the rate year’s NPC.³⁴¹ Similarly, in PSE’s 2009 rate case, the Commission approved a pro forma rate base adjustment related to a wind plant expansion that entered service 10 months after the end of the test period because it was a generation asset included in the NPC model.³⁴²

118 Here, the Jim Bridger Unit 2 upgrade entered service 11 months after the conclusion of the test period and seven months before the rate year, which is comparable to the timing in the Avista and PSE cases. Moreover, the offsetting factors—the NPC benefits associated with the turbine upgrade—have been accounted for in the Company’s filing.³⁴³ Therefore, consistent with past precedent it is reasonable for the Commission to approve the inclusion of this generation resource in the Company’s rate base.

³³⁶ *Id.* 5:18 – 6:2.

³³⁷ McGuire, Exh. No. CRM-1T 7:1.

³³⁸ *WUTC v. Puget Sound Energy*, Dockets UE-090704 et al., Order 11 ¶ 31 (Apr. 2, 2010).

³³⁹ *Id.*

³⁴⁰ *WUTC v. Avista*, Dockets UE-090134 and UG-090135, Order 10 ¶¶ 12, 58, 80-81 (Dec. 22, 2009).

³⁴¹ *Id.* ¶ 81.

³⁴² *WUTC v. Puget Sound Energy*, Dockets UE-090704 et al., Order 11 ¶¶ 232, n. 24 (Apr. 2, 2010).

³⁴³ *See* Duvall, Exh. No. GND-7CT 50:19 – 51:8.

C. The Merwin Fish Collector is a Known and Measurable Pro Forma Adjustment

119 The Merwin project is necessary to allow fish to bypass the Company's three Lewis River dams located in the state of Washington.³⁴⁴ The project's design was dictated and approved by regulators.³⁴⁵ The installation of this fish collector was necessary for the Company to secure a new FERC license, which will allow the Company to continue to operate the Lewis River dams for an additional 50 years.³⁴⁶ Because of this project, customers will continue to benefit from the Company's emission-free, low-cost hydro generation, which is reflected in the Company's NPC model in this case.³⁴⁷

120 With the exception of the in-service date, the Merwin Fish Collector is no different than the other fish collector projects that Staff thoroughly reviewed in this case. Staff concluded that those projects were prudent and should be included in rates because they were required by FERC licenses and had no offsetting factors that may violate the matching principle.³⁴⁸

121 The Merwin project is expected to enter service in February 2014, approximately two months into the rate year.³⁴⁹ And the costs of the project are governed by contract and are known and measurable. At the time of the hearing in this case, the Company had already spent approximately 90 percent of the total project costs and anticipates that it will expend 99.8 percent by the end of 2013.³⁵⁰ The Company's current projections of project costs are reliable and accurate and aligned with past projections.³⁵¹

122 Like the Jim Bridger Unit 2 upgrade, the inclusion of the Merwin project in rate base is consistent with Commission precedent. The project is required by regulators, is necessary to continue operating generating resources that are included in the NPC calculation, and will be in

³⁴⁴ Tallman, Exh. No. MRT-1T 5:3-5.

³⁴⁵ *Id.* 5:16 – 6:4.

³⁴⁶ *Id.* 5:5-7, Tallman, TR. 328:15-24.

³⁴⁷ Tallman, TR. 328:15-24; *see also* J. Williams, Exh. No. JMW-1T 7:1-10 (other fish collectors provide same benefit).

³⁴⁸ McGuire, Exh. No. CRM-1T 10:10-20; J. Williams, Exh. No. JMW-1T 7:1-10.

³⁴⁹ Tallman, TR. 319:7-10.

³⁵⁰ *Id.* 333:20-24.

³⁵¹ *Id.* 329:4-10.

service during the rate year.³⁵² Including the Merwin Fish Collector in rates “strikes a fair balance preserving the integrity of the rate year, while at the same time allowing for recovery of significant capital expenditures that have occurred” after the end of the test period.³⁵³

D. The Swift and Merwin Fish Collectors’ O&M Costs are Known and Measurable

123 Staff proposes an adjustment to remove the O&M costs for the Swift and Merwin fish collectors because Staff contends the amounts are not based on operational data and are not known and measurable.³⁵⁴ Contrary to Staff’s claims, the Swift O&M expenses are based on eight months of actual operational data and are known and measurable.³⁵⁵ Moreover, the Company’s O&M calculations are accurate even though the Company’s expense levels were lowered in its rebuttal testimony. The reduction in the rebuttal filing was the result of the unique nature of the Swift Fish Collector, particularly the power needed to generate the “river” conditions to attract the fish.³⁵⁶ None of PacifiCorp’s other fish collection facilities require the purchase of electricity, and the errors in the Company’s original O&M estimates were due to the incorrect estimates of the cost to provide this power.³⁵⁷ Because the Company’s rebuttal testimony calculated the O&M expenses based on actual energy usage, it is accurate and reliable and reflects the O&M expenses that are expected during the rate year.

124 For the Merwin project, the O&M expenses are pro forma calculations.³⁵⁸ But unlike Swift, the Merwin project does not use purchased electricity, and therefore the Company anticipates that the estimated O&M expenses for Merwin will be consistent with other similar projects the Company operates.³⁵⁹ As the Company testified, the types of costs estimated for Merwin “are things that we’re doing all the time[.]”³⁶⁰ And like the capital expenses, these

³⁵² See *WUTC v. Avista*, Dockets UE-090134 and UG-090135, Order 10 ¶¶ 12, 58, 60, 69, 80-81 (Dec. 22, 2009). Because the Merwin project is expected to be placed in service in February 2014, only 10 months of expense is included in rates in this case. Staff supported this approach in the 2009 Avista case. *Id.* ¶ 66.

³⁵³ *Id.* ¶ 70.

³⁵⁴ McGuire, Exh. No. CRM-1T 12:1-10.

³⁵⁵ Tallman, Exh. No. MRT-2T 4:4-13.

³⁵⁶ *Id.*; Tallman, TR. 331:17–332:20.

³⁵⁷ *Id.*

³⁵⁸ Tallman, Exh. No. MRT-2T 4:14-19.

³⁵⁹ *Id.* 5:1-9.

³⁶⁰ Tallman, TR. 332:11-12.

O&M expenses are known and measurable and the same policy justifications supporting the inclusion of the capital investment also supports the inclusion of the O&M expenses.

E. An ERF is Inadequate to Address Regulatory Lag

125 Staff proposed the use of an expedited rate filing (ERF) to address regulatory lag associated with the Company’s pro forma capital additions.³⁶¹ While the Company appreciates Staff’s proposal, it is unclear how the proposed ERF squares with regulations governing general rate case filings.³⁶² In addition, it is not clear that Staff’s proposal would adequately address the Company’s concerns over regulatory lag due to the timing of an ERF filing and the length of time for Staff review and the issuance of a Commission order.³⁶³ Under Staff’s proposal, the earliest that the Company could obtain an ERF order would be nearly a year after the Jim Bridger Unit 2 upgrade was in service.³⁶⁴

126 Furthermore, PacifiCorp’s goal in this case is to establish an appropriate baseline revenue requirement that gives the Company a reasonable opportunity to recover the costs to serve its Washington customers. Once this appropriate baseline is established, alternative ratemaking mechanisms such as the ERF can be explored, and PacifiCorp is participating in the current rulemaking to review the Commission’s procedural rules, which is expected to include rules governing ERFs.³⁶⁵

127 In the alternative, the Company has proposed the use of a streamlined separate tariff rider that would become effective once the Merwin Fish Collector is in service. This process would allow the final costs of the project to be reviewed before inclusion in rates and would guarantee that the project was used and useful. Similar approaches have been successfully used in Oregon, California, and Utah to address capital projects coming online during the rate year.³⁶⁶

³⁶¹ Reynolds, Exh. No. DJR-1T 10:20 – 11:5.

³⁶² See, e.g., WAC 480-07-505(1)(a) (defining “general rate proceeding” as filing where the “amount requested would increase gross annual revenue of the company from activities regulated by the commission by three percent or more.”). Although Staff supports waiver of a different rule, WAC 480-07-510, it is unclear if such a waiver would be granted or whether such a waiver would be effective to address the Company’s concerns.

³⁶³ Reynolds, TR. 407:4–412:6.

³⁶⁴ Reynolds, TR. 410:15-20.

³⁶⁵ Docket A-130355 (see March 22, 2013 Notice of Opportunity to File Written Comments).

³⁶⁶ Griffith, Exh. No. WRG-1T 12:7 – 13:2; McDougal, Exh. No. SRM-6T 22:1-19.

VI. WCA ALLOCATION (NON-NPC RELATED)

A. The Company's Proposed WCA Modifications are Reasonable and Consistent with its Cost of Service Study

128 PacifiCorp is proposing discrete changes to the approved WCA methodology to better reflect the costs incurred to serve Washington customers and create greater consistency between the Company's revenue requirement allocations and the cost of service study.³⁶⁷ These changes are also intended to narrow the gap between the 2010 Protocol and the WCA.³⁶⁸

129 Staff's primary recommendation is for the Commission to reject all of the Company's proposed changes to the WCA because changes should not be approved without a "comprehensive review" of the methodology.³⁶⁹ Staff further recommends that the Commission order the Company to file a comprehensive report on the WCA allocation factors 90 days before the Company's next rate case filing.³⁷⁰ The Commission should reject Staff's primary recommendation for several reasons.

130 First, Staff's proposal is inconsistent with Commission precedent. In PacifiCorp's 2010 rate case, the Commission approved changes to the WCA over PacifiCorp's objection. PacifiCorp argued that individual changes should not be made until after the review conducted at the end of the five-year trial period—an argument rejected by the Commission in approving the changes.³⁷¹

131 Second, contrary to Staff's assertions, a comprehensive review of the methodology has been conducted. The methodology was discussed in detail during the extensive, 11-month collaborative process in 2012,³⁷² and the Company provided a WCA report with the initial filing

³⁶⁷ Dalley, Exh. No. RBD-1T 5:15-18.

³⁶⁸ Dalley, Exh. No. RBD-3T 11:13 – 12:13.

³⁶⁹ White, Exh. No. KAW-1T 3:6-14. Boise also recommends rejection of the Company's changes because no consensus on the changes was reached during the 2012 collaborative process. But the fact that the parties to the collaborative process did not agree to these, or any, changes, is not dispositive. When agreeing to the collaborative process, the parties explicitly noted that they were not required to reach agreement, and that the Commission might be the final arbiter of any proposed changes. *WUTC v. PacifiCorp*, Docket UE-111190 Order 7 ¶ 20 (Mar. 30, 2012).

³⁷⁰ White, Exh. No. KAW-1T 3:6-18.

³⁷¹ *WUTC v. PacifiCorp*, Docket UE-100749, Order 06 ¶¶ 57-62 (Mar. 25, 2011).

³⁷² White, Exh. No. KAW-8.

in this case.³⁷³ The Company's proposed WCA changes followed the extensive, 11-month collaborative process, and the Company's filing included a detailed description of all allocation factors and detailed testimony regarding the Company's proposed modifications to the WCA.³⁷⁴ Moreover, in this case Staff conducted extensive discovery related to the WCA, conducted field visits to the Company's offices, spent significant time reviewing the WCA manual, and analyzed every factor to determine if the factor was still reasonable.³⁷⁵ Staff's request that any change to the WCA occur only after a comprehensive review is therefore unnecessary and would result in the equivalent of an unreasonable and unwarranted stay-out provision.

Third, the Company's proposals better align inter-jurisdictional allocations with the Company's cost of service study.³⁷⁶ Staff specifically acknowledged that principles underlying inter-jurisdictional allocations should be consistent with the principles underlying cost of service studies.³⁷⁷ Therefore, Staff's primary recommendation is inconsistent with the underlying principles Staff agrees should govern inter-jurisdictional allocations.

B. Staff's Proposed WCA Modifications are Unreasonable and Inconsistent with the Company's Cost of Service Study

132 Staff's primary recommendation is to maintain the status quo and reject all of the Company's proposed modifications.³⁷⁸ In the alternative, Staff requests that if the Commission adopts the Company's proposed WCA modifications it also adopt Staff's.³⁷⁹ The problem with Staff's secondary recommendation is that the PacifiCorp and Staff modifications are often contradictory and both cannot be adopted.³⁸⁰

133 Staff first proposes the use of the System Net Plant (SNP) factor, rather than the System Overhead (SO) factor, for allocating administrative and general (A&G) costs.³⁸¹ Staff claims

³⁷³ Dalley, Exh. No. RBD-2.

³⁷⁴ Dalley, Exh. No. RBD-3T 4:1-15; Dalley, Exh. No. RBD-2; McDougal, Exh. No. SRM-5.

³⁷⁵ White, Exh. No. KAW-1CT 9:1-7.

³⁷⁶ Dalley, Exh. No. RBD-3T 8:12-20.

³⁷⁷ White, TR. 431:4-14.

³⁷⁸ *Id.* 430:4-9.

³⁷⁹ White, Exh. No. KAW-1CT 4:12 – 5:10.

³⁸⁰ Dalley, TR. 283:17–284:3.

³⁸¹ While, Exh. No. KAW-1CT 18:12-18.

that the use of the SO factor is “controversial” and “has been contested on numerous occasions before the Commission.”³⁸² Staff also asserts that the SO factor disproportionately allocates costs to slower-growing jurisdictions despite the fact that increases in plant balances are driven by load growth in the faster-growing jurisdictions. Staff claims that the SNP factor better reflects the vintage of PacifiCorp’s plants by removing accumulated depreciation from the plant balances used to calculate the factor.³⁸³ Public Counsel echoes Staff’s recommendation.³⁸⁴ Even though the SO factor is based on gross plant, the vintage of the plants is accounted for because older plants have lower gross plant values.³⁸⁵ Staff and Public Counsel presented no persuasive evidentiary basis to conclude that the SNP factor is superior in this respect.³⁸⁶

134 Finally, contrary to Staff’s claims, the Company’s use of the SO factor has not been controversial—it has been used since the adoption of the WCA in 2006 without objection.³⁸⁷ Moreover, the Company uses the SO factor to allocate A&G expenses in all six jurisdictions and adoption of Staff’s recommendation will unnecessarily widen the gap between the WCA and the allocation methodology used in the Company’s other jurisdictions.³⁸⁸

135 Staff also recommends changes to the demand/energy weightings used to calculate the System Generation (SG) and Control Area Generation West (CAGW) factors.³⁸⁹ The Company proposes a modification to the weightings for the CAGW that will better align the weightings with the Company’s cost of service study.³⁹⁰ Staff recommends that both the CAGW and SG factors be modified using the “200 Coincident (CP)” methodology because Staff contends that Commission precedent supports the use of data from a longer period of time to smooth

³⁸² *Id.* 15:11-21.

³⁸³ *Id.* 17:2-13.

³⁸⁴ Coppola, Exh. No. SC-1CT 5:14-19.

³⁸⁵ Dalley, Exh. No. RBD-3T 7:13-17.

³⁸⁶ *Id.* 6:2-5.

³⁸⁷ *Id.* 6:8-16.

³⁸⁸ *Id.* 7:4-10.

³⁸⁹ White, Exh. No. KAW-1CT 24:8 – 26:5. Public Counsel opposes the Company’s changes to the demand/energy weightings and proposes maintaining the current weightings of 75 percent demand, 25 percent energy. Coppola, Exh. No. SC-1CT 5:6-13.

³⁹⁰ Dalley, Exh. No. RBD-3T 8:12-20.

variations.³⁹¹ However, Staff’s reliance on Commission precedent is misplaced because the order cited by Staff does not address the classification of costs between demand and energy.³⁹² Further, Staff’s primary and secondary recommendations are inconsistent—Staff’s primary recommendation to maintain the status quo weightings for these factors is nearly the inverse of its secondary recommendation.³⁹³ Staff also does not propose similar changes to the cost of service study in this case, so adoption of Staff’s recommended changes to the CAGW and SG factors will result in inconsistencies between the cost of service study and inter-jurisdictional allocations, which is contrary to the principle of consistency Staff expressly supports.³⁹⁴

VII. CASH WORKING CAPITAL

136 In PacifiCorp’s 2010 rate case, the Commission accepted Staff’s Investor Supplied Working Capital (ISWC) method as the most reasonable method for calculating the Company’s cash working capital balance.³⁹⁵ The ISWC method “determines the working capital by comparing the Company’s assets to its invested capital while systematically removing non-investor supplied working capital.”³⁹⁶ Thus, the definition of working capital for purposes of the ISWC is broader than the accounting definition, which is the difference between current assets and current liabilities.³⁹⁷

137 In this case, the Company accepted the use of the ISWC method and proposed several refinements to the ISWC calculation to better determine the capital supplied by investors. The ISWC determines the amount of working capital by placing the Company’s FERC Form 1 balance sheet accounts into four categories: current assets, current liabilities, investments, and invested capital. The Company’s proposed refinements reclassify derivative assets and liabilities and pensions and other post-retirement benefits for purposes of the ISWC method.³⁹⁸

³⁹¹ White, Exh. No. KAW-1CT 15:2-9.

³⁹² Steward, Exh. No. JRS-7T 5:23–6:4.

³⁹³ Dalley, Exh. No. RBD-3T 9:3-13.

³⁹⁴ *Id.* 9:12-13; White, TR. 431:4-14.

³⁹⁵ *WUTC v. PacifiCorp*, Docket No. UE-100749, Order 06 ¶ 291 (March 25, 2011).

³⁹⁶ *Id.* ¶ 293.

³⁹⁷ Stuver, Exh. No. DKS-1T 2:19 – 3:2; Stuver, TR. 340:18–341:6.

³⁹⁸ Stuver, Exh. No. DKS-1T 5:11 – 6:3; Exh. No. DKS-3T at 2:10 – 3:22.

138 Staff, who originally proposed the ISWC method,³⁹⁹ supports the Company's calculated ISWC. Staff concluded that the Company's refinements were consistent with FERC's accounting system and noted that the Company "really drill[ed] down deeper into the sub accounts and the general ledger accounts, and so was able to identify some accounts that were possibly overlooked in the past that were not earning a return, and otherwise should earn a return[.]"⁴⁰⁰ Staff concluded that the Company's treatment of pensions "achieves a proper balance of ratepayer interests and allows investors to earn a return on the net unamortized funds they have contributed to Company employees' post-retirement benefits."⁴⁰¹

139 Public Counsel opposes PacifiCorp's proposed refinements. But Public Counsel takes an overly simplistic view of the ISWC method, claiming that it is nothing more than the difference between current assets and current liabilities.⁴⁰² Based on this misunderstanding of the ISWC method, Public Counsel claims that PacifiCorp has improperly reclassified 45 different accounts and "upend[ed] the basis definition of working capital."⁴⁰³ Public Counsel is wrong—the ISWC method requires analysis beyond simply subtracting current liabilities from current assets.⁴⁰⁴ Under the ISWC method, the primary accounting categories of assets, liabilities, and owner's equity "require analysis to properly determine what amounts constitute invested capital and what amounts constitute investments."⁴⁰⁵ Contrary to Public Counsel's arguments, the Company's proposed refinements to the ISWC method are consistent with FERC accounting standards and the Commission-approved ISWC methodology and should therefore be adopted.

³⁹⁹ Stuver, TR. 340:22-24.

⁴⁰⁰ Zawislak, TR. 470 14-471:5.

⁴⁰¹ Zawislak, Exh. No. TWZ-1T 3:20-22.

⁴⁰² Coppola, Exh. No. SC-1CT 27:5-13.

⁴⁰³ *Id.* 28:17-19.

⁴⁰⁴ Stuver, Exh. No. DKS-3T 4:14 – 5:21.

⁴⁰⁵ *See* Stuver, Exh. No. DKS-3T 5:4-7 (quoting Testimony of Thomas E. Schooley, Exh. No. TES-1T at 13, Docket UE-100749 (October 5, 2010; revised October 8, 2010).

VIII. WAGES AND LABOR

A. Public Counsel's Executive Compensation Adjustments are Meritless

140 Public Counsel recommends an adjustment to the compensation levels for the top 25 highest paid positions at PacifiCorp.⁴⁰⁶ Public Counsel claims that PacifiCorp's approach "has clearly resulted in excessive compensation levels which customers pay through higher rates."⁴⁰⁷ Contrary to Public Counsel's claims, the record in this case demonstrates that the compensation paid to PacifiCorp's leadership is reasonable and consistent with the market.⁴⁰⁸ PacifiCorp uses market-based compensation to attract and retain qualified employees.⁴⁰⁹ To determine employee compensation for all levels of employees with the exception of the named executive officers, the Company analyzes extensive market data on comparable positions to determine the appropriate level of compensation for each position.⁴¹⁰ Even though compensation for the Company's four named executive officers is determined by the MEHC chair, the evidence in this case demonstrates that their compensation is nevertheless commensurate with market rates.⁴¹¹

141 Public Counsel compares PacifiCorp's compensation to a mid-point determined using limited market survey data and concludes that PacifiCorp's compensation levels are above market.⁴¹² However, market compensation encompasses a range of values, and simply because a particular employee is paid more than the market mid-point does not mean that the employee is compensated at an above-market level.⁴¹³ Further, Public Counsel's analysis was not comprehensive and failed to consider the specific value provided by the particular employee that is not directly captured in market comparisons.⁴¹⁴ In light of these deficiencies in Public Counsel's analysis and conclusions, the Commission should reject Public Counsel's adjustment.

⁴⁰⁶ Coppola, Exh. No. SC-1CT 34:8-16.

⁴⁰⁷ *Id.* 34:13-14.

⁴⁰⁸ Wilson, Exh. No. EDW-3T 7:3 – 9:20; Wilson, Exh. No. EDW-4CCX; Wilson, Exh. No. EDW-5CCX.

⁴⁰⁹ Wilson, Exh. No. EDW-3T 7:8-11.

⁴¹⁰ *Id.* 8:10-14.

⁴¹¹ Wilson, Exh. No. EDW-4CCX; Wilson, Exh. No. EDW-5CCX.

⁴¹² Coppola, Exh. No. SC-15C.

⁴¹³ Wilson, TR. 394:5-20, 381:13 – 382:4.

⁴¹⁴ Wilson, Exh. No. EDW-3T 8:16 – 9:7; Wilson, TR. 381:13–382:4, 383:12-20.

142 Public Counsel also proposes an adjustment to remove from rates the Washington-allocated portion of the MEHC officers' compensation.⁴¹⁵ Contrary to Public Counsel's claims, the MEHC officers provide value to Washington customers by allowing PacifiCorp leadership to leverage the expertise of the MEHC officers at a significantly lower expense than would be incurred were PacifiCorp to revert to having a stand-alone Chief Executive Officer like it had before the MEHC acquisition.⁴¹⁶ Thus, the MEHC officer expenses are reasonable and should continue to be included in rates.

B. Staff's Annual Incentive Plan Adjustment Should be Rejected

143 Staff proposed an adjustment to the Company's Annual Incentive Plan (AIP) that would remove the wage increase associated with the AIP, while retaining the base wage increase.⁴¹⁷ Staff argues that increasing the AIP portion of the total compensation removes the incentive aspect of the program and makes the AIP no more than another form of base salary.⁴¹⁸ Staff, however, ignores the fact that AIP is an integral part of an employee's market compensation—an employee's total compensation would not be commensurate with the market without AIP.⁴¹⁹ It is unreasonable to allow an increase to base wages but not the AIP because an employee's base wage and AIP are both an essential piece of the employee's total compensation. An increase in one must be paired with an increase in the other or the total compensation package will no longer reflect a competitive market level.⁴²⁰

IX. END OF PERIOD RATE BASE

A. The Use of End-of-Period Rate Base Provides Needed Regulatory Support

144 The Company's filing in this case reflects the use of electric plant in service balances at end-of-test-year levels, rather than the average of monthly averages (AMA) levels used in

⁴¹⁵ Coppola, Exh. No. SC-1CT 35:19-22.

⁴¹⁶ Wilson, Exh. No. EDW-3T 6:1-18.

⁴¹⁷ Huang, Exh. No. JH-1T 10:1-4.

⁴¹⁸ *Id.* 10: 8-15.

⁴¹⁹ Wilson, Exh. No. EDW-3T 4:16-20; *WUTC v. PacifiCorp*, Docket UE-100749, Order 06 ¶ 248 (Mar. 25, 2011).

⁴²⁰ Wilson, Exh. No. EDW-3T 4:16-20.

previous cases.⁴²¹ The Company proposed using end-of-period rate base to minimize regulatory lag by reflecting rate base balances that are likely to exist during the rate year and to address the Company's persistent under-earning.⁴²² Staff opposes the Company's request, claiming that the use of end-of-period rate base violates the matching principle.⁴²³ Public Counsel, on the other hand, supports the use of end-of-period rate base as an "equitable and reasonable approach to addressing 'regulatory lag.'"⁴²⁴

145 In previous cases, Staff supported the use of end-of-period rate base to address under-earning.⁴²⁵ In PSE's 2011 rate case, the Commission observed that it has approved end-of-period rate base to address regulatory lag and persistent under-earning.⁴²⁶ Then, in PSE's ERF case, the Commission approved the use of end-of-period rate base.⁴²⁷ In that case, the Commission observed that end-of-period rate base is an "appropriate regulatory tool under one or more of the following conditions: (a) abnormal growth in plant; (b) inflation and/or attrition; (c) as a means to reduce regulatory lag; (d) failure of a utility to earn its authorized rate of return over an historical period."⁴²⁸ Here, nearly every condition is present. The Company is engaged in a period of significant capital expenditures that has resulted in regulatory lag.⁴²⁹ In addition, the Company has been historically under-earning at a level worse than PSE's.⁴³⁰ Because "one or more" of the Commission's conditions has been clearly satisfied in this case, the Commission should approve the use of end-of-period rate base.

⁴²¹ McDougal, Exh. No. SRM-6T 26:10-11.

⁴²² *Id.* 26:13-17.

⁴²³ Erdahl, Exh. No. BAE-1T 6:21 – 7:2.

⁴²⁴ Dittmer, Exh. No. JRD-1T 2:16-19.

⁴²⁵ McDougal, Exh. No. SRM-6T 26:22 – 27:14; Griffith, Exh. No. WRG-1T at 11, lines 2-10.

⁴²⁶ *WUTC v. Puget Sound Energy*, Docket UE-111048 et al., Order 08 ¶ 97, (May 7, 2012)

⁴²⁷ *WUTC v. Puget Sound Energy*, Docket UE-121697 et al., Order 07 ¶ 48 (June 25, 2013).

⁴²⁸ *Id.* ¶ 45 (quoting *WUTC v. Wash. Nat. Gas Co.*, 44 P.U.R.4th 435, 438 (Sept. 24, 1981)); *see also* Erdahl, Exh. No. BAE-1T 7:6-16.

⁴²⁹ Williams, Exh. No. BNW-1T 3:9-14, 13:7-13.

⁴³⁰ Reiten, Exh. No. RPR-1T 2:22-23 (ROE of 3.9% for test period); Griffith, Exh. No. WRG-1T 3 Table 1 (per books ROE has been on average 6.04 percent less than its authorized ROE over the last 7 years); *WUTC v. Puget Sound Energy*, Docket UE-121697 et al., Order 07 ¶ 47, n. 59 (June 25, 2013) (PSE not earned authorized ROR since 2006 and ROR for 2012 was 70 basis points below authorized level).

B. The Commission Should Reject Public Counsel's Revenue Normalization Adjustment

146 Although the Company appreciates Public Counsel's support of the use of end-of-period rate base balances, the Company disagrees with Public Counsel's proposal to annualize revenues based on the number of customers at the end of the test period.⁴³¹ The Commission can and should approve the use of end-of-period rate base without also adopting Public Counsel's revenue normalization adjustment. It is important to note that the Company did annualize revenues in this case,⁴³² so the question is not *whether* to annualize revenues, but rather *how* to annualize revenues. The Company calculates revenues using historical revenues from the base year normalized to reflect rate changes during the base year.⁴³³ This method is consistent with the Commission's long-established and well-understood ratemaking practices.⁴³⁴

147 Further, Public Counsel's proposal to calculate revenues based on the customer count at the end of the test period fails to account for all the factors that are used to normalize revenues, namely loads, including seasonal loads, that are associated with changes in customer counts.⁴³⁵ Failing to account for load changes results in a mismatch between customer counts and customer usage and has complicated, and potentially controversial, consequences for setting rates.⁴³⁶

X. CONCLUSION

It is undisputed that PacifiCorp needs a substantial rate increase in this case, notwithstanding significant efficiency savings reflected in test period costs. The amount of that rate increase is contested, however, with parties differing over the major issues of cost of capital, net power costs, and capital additions. For each of these issues, the Company demonstrated that it is actually incurring the costs it is seeking to recover in this case. For example, there is no dispute that the Company's actual capital structure is comprised of 52.2 percent equity, that PacifiCorp's QF contracts in Oregon and California are part of its NPC in the west control area,

⁴³¹ Dittmer, Exh. No. JRD-1T at 2, lines 22-23.

⁴³² McDougal, Exh. No. SRM-1T 6:22 – 7:1; McDougal, Exh. No. SRM-3

⁴³³ Steward, Exh. No. JRS-7T 22:6-9.

⁴³⁴ *Id.*

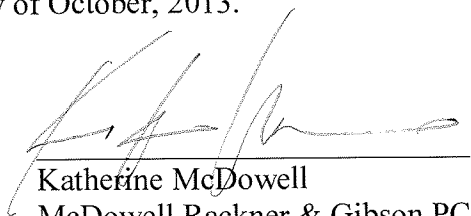
⁴³⁵ *Id.* 22:14-19; Steward, TR. 398:19–399:2.

⁴³⁶ Steward, TR. 399:20–400:16.

and that the Company has already incurred the vast majority of the costs of the new resources it is seeking to add to rate base and that all but one of these resources is already serving Washington customers. And Staff agrees that the Company's NPC variability has increased and that the Company needs a PCAM.

The real issues in controversy are around how much flexibility the Commission should exercise in its traditional ratemaking conventions to allow PacifiCorp a better opportunity to recover its costs to serve Washington customers. The Company's requests in this respect, including recognition of the Company's actual capital structure, allocation to Washington of a share of all PPAs with QFs located in the west control area, allowance of new resources that will serve customers in the rate effective period, and approval of its proposed PCAM, are limited and consistent with the flexibility the Commission has exhibited in previous cases. While the Company appreciates Staff's proposed ERF and looks forward to participating in the Commission's rulemaking on this issue, it is important that the Commission first establish reasonable baseline rates for PacifiCorp before relying on ERF proceedings to address regulatory lag. That reasonable baseline, as established in the record in this proceeding, is a revenue requirement increase of \$36.9 million to be effective December 11, 2013, along with adoption of a PCAM.

Respectfully submitted this 1st day of October, 2013.



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