BEFORE THE

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, v. PACIFICORP D/B/A PACIFIC POWER & LIGHT COMPANY, Respondent.	)	DOCKET NO. UE-130043 POST-HEARING REPLY BRIEF OF BOISE WHITE PAPER, L.L.C.

POST-HEARING REPLY BRIEF

OF BOISE WHITE PAPER, LLC

October 11, 2013

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I. INTRODUCTION

1 Pursuant to WAC § 480-07-390 and Prehearing Conference Order 03, Boise White Paper, LLC ("Boise") hereby submits this reply brief in response to PacifiCorp's (or the "Company") opening brief.

2 The theme of PacifiCorp's brief is that the Company has allegedly under-earned for years, and therefore, it should be permitted to adopt new accounting measures designed to raise customer rates. As "support," PacifiCorp argues that Puget Sound Energy ("PSE") and Avista Corp. ("Avista") received rate plans due to alleged under-earning. What PacifiCorp fails to acknowledge is that the Company itself agreed to its current rates, and agreed that they were fair, just, reasonable and sufficient.[1/] Any alleged under-earning since that time is the fault of the Company and its management, not the rates. The failure of PacifiCorp's arguments regarding PSE or Avista is obvious: each utility has its own costs, capital projects, and growth rates. What is appropriate for the Seattle metro area has no relevance to customers in the Walla Walla area. In other words, PSE is experiencing growth while rural Eastern Washington is not.

3 Further, PacifiCorp likens itself to PSE and Avista, which have accepted rate plans, but it apparently wants the rates without the trade-offs involved. Boise understands that in return for increases largely based on extraordinary capital expenditures and other factors, PSE agreed, through an expedited rate filing, to a rate increase of approximately 1.6% with a similar escalator tied to a rate case stay-out of approximately four years.[2/] Avista also agreed to a rate

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1/ WUTC v. PacifiCorp, Docket No. UE-111190, Order 07 (March 30, 2012) (adopting the Stipulation in the case).

2/ WUTC v. PSE, Docket Nos. UE-121697 et al., Order 07 (June 25, 2013).

DAVISON VAN CLEVE, P.C.
333 SW Taylor, Suite 400
Portland, OR 97204
Telephone (503) 241-7242

plan that minimized rate increases through a settlement agreement.[3/] These preset "rate plan" increases were intended to incentivize increased managerial efficiency, and to encourage those utilities to cut costs.[4/] PacifiCorp wants no such constraints; rather, it asks the Washington Utilities and Transportation Commission (the "Commission") to hand it a double-digit rate increase to compensate for its own alleged earnings failures, but agrees to no incentives to improve its efficiency or cut costs, and it reserves the right to re-file for new rates the day the present rate case is concluded. The three investor-owned utilities are not similarly situated and PacifiCorp's arguments for "similar treatment" fall flat.

4 Throughout its brief, PacifiCorp stridently maintains that "no party . . . disputes" any number of "facts."[5/] Like other intervening parties, Boise is limited by resource constraints and cannot submit testimony regarding every assertion the Company makes. The Commission should assume that each time such a statement is made in the Company's opening brief, Boise does, in fact, dispute the assertion. These "undisputed" claims are based upon quotes taken out of context, massaged facts, and split hairs. Assertions supported by no more than a claim that other parties have not disputed them should be found to have no support at all.

II. ARGUMENT

A. PacifiCorp's Cost of Capital Arguments are Unsupported and Misleading

5 PacifiCorp attempts to discredit Mr. Gorman's careful analyses of the Company's cost of equity and capital structure, but its claims are inaccurate and ignore the evidence presented by Mr. Gorman.

3/ WUTC v. Avista, Docket Nos. UE-120436 et al., Order 09 (Dec. 26, 2012).
4/ Id. at P. 76; Docket Nos. UE-121697 et al., Order 07 at P. 172.
5/ See, e.g., Brief of PacifiCorp at PP. 4; 61; 76.

DAVISON VAN CLEVE, P.C.
333 SW Taylor, Suite 400
Portland, OR 97204
Telephone (503) 241-7242

1. PacifiCorp's Cost of Equity is Far Lower Than the Company Claims

6 PacifiCorp argues that interest rates increased between the filing of Boise and Staff testimony and the hearing, and that the increases were largely due to the Federal Reserve's announcement on June 13, 2013, that it would end its bond purchasing policy once the economy showed sufficient improvement.[6/] As noted in Boise's opening brief, this "taper" did not occur, and interest rates have again fallen. Contrary to Dr. Hadaway's predictions, events since the hearing leave the economy on perilous footing and utility investments are increasingly popular.

7 In support of its argument that its cost of equity is increasing, PacifiCorp makes a number of inaccurate claims. First, it notes that the 4.87% yield of "A" utility bonds had increased over the course of this year. However, these yields were still over 100 basis points lower than the "A" bond yield that prevailed at the time PacifiCorp originally was awarded a 9.8% return on equity.[7/] The 9.8% Return on Equity ("ROE") was originally awarded two rate cases ago when prevailing interest rates were much higher. Thus, PacifiCorp would have the Commission look only at a very short-term trend in a highly unpredictable market and ignore the fact that much higher bond yields were required to support the current 9.8% ROE than exist in the market today. This means that, even considering the run up in interest rates that occurred prior to the hearing,[8/] PacifiCorp's last authorized return on equity of 9.8% is significantly in excess of current capital market costs.[9/] Thus, short-term interest rate fluctuations do not justify a significant change in Boise's recommended return on equity.

6/ Brief of PacifiCorp at P. 13.
7/ Gorman, TR. at 185:3-11.
8/ Notably, interest rates since the hearing have declined.
9/ Gorman, TR. at 185:19-25.

DAVISON VAN CLEVE, P.C.
333 SW Taylor, Suite 400
Portland, OR 97204
Telephone (503) 241-7242

8 Nonetheless, even minor adjustments are not necessary because Mr. Gorman already recognized the risk of fluctuation in the interest rate markets when developing his recommended return on equity for PacifiCorp. Specifically, Mr. Gorman placed 75% weight on the high-end of his risk premium results and only 25% weight on the low-end of his results.[10/] This weighting was designed to recognize government influence in interest rate markets and the risk of changes in cost of capital going forward. Also, Mr. Gorman placed minimal weight on the results of his Capital Asset Pricing Model ("CAPM"), because he found those results to be low in the current market.[11/] This means that if he had not already accounted for the possibility of a run up in interest rates, such as occurred prior to the hearing, a recommendation significantly lower than 9.2% would have been justified.

9 PacifiCorp's case for an increase in ROE despite the current low cost of capital rests primarily on the argument that the Commission should abandon its long-standing use of the DCF model because only the risk premium model can produce PacifiCorp's desired outcome. The Company is so results-oriented that it described capital markets as "rapidly changing" when dismissing the DCF model generally, but when defending Dr. Hadaway's DCF, it claims that there is no longer "uncertainty in capital markets."[12/] The Company cannot have it both ways.

10 Yet, even if the Commission were to ignore the broad range of evidence presented by Mr. Gorman (and, indeed, supported by the balance of Dr. Hadaway's studies as well as those of Mr. Elgin), Dr. Hadaway's risk premium model does not support his ROE recommendation without the application of a regression-based adjustment that the Commission considered and rejected in PacifiCorp's last contested rate case.[13/] PacifiCorp claims that Mr. Gorman

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[10/] Gorman, Exh. No. MPG-1T at 33:1-14.
[11/] Id. at 39.
[12/] C.f. Brief of PacifiCorp at P. 18 with P. 26.
[13/] WUTC v. PacifiCorp, Docket UE-100749, Order 06 at P. 86 (March 25, 2011).

DAVISON VAN CLEVE, P.C.
333 SW Taylor, Suite 400
Portland, OR 97204
Telephone (503) 241-7242

"altogether ignored" a "thorough and complete regression analysis" that allegedly supports Dr. Hadaway's regression-based adjustment to his risk premium model.[14/] This could not be further from the truth. Mr. Gorman addresses Dr. Hadaway's simplistic model by demonstrating that the academic literature does not support the application of a simple regression analysis because multiple other factors, which are not accounted for by Dr. Hadaway, affect the relationship between interest rates and risk premiums.

11 In fact, Mr. Gorman points out that only during the high volatility interest rate environment of the 1980s did a simple regression analysis accurately model risk premiums.[15/] Importantly, Mr. Gorman notes that these relationships have changed over time in response to changes in perception of bond risk relative to equity risk, which are related to inflation outlooks.[16/] Dr. Hadaway ignores the literature and relies on a simple scatterplot based on nominal interest rates that allegedly demonstrates this inverse relationship.[17/] This scatterplot is unreliable because of its simplistic reliance on nominal interest rates. Further, it does not even identify the vintage of its data points, meaning that the factors identified in the academic literature and in Mr. Gorman's testimony are completely erased from the study. As it did in 2006, the Commission should reject Dr. Hadaway's simplistic regression analysis.

12 Properly corrected, Dr. Hadaway's risk premium model would suggest an ROE even lower than Mr. Gorman's recommended figure of 9.2%.[18/] Nonetheless, Boise recommends that the Commission continue to rely on the less volatile, more reliable combination of DCF, risk premium, and CAPM analyses, as it has in the past.

14/ Brief of PacifiCorp at P. 20.
15/ Gorman, Exh. No. MPG-1T at 50:13-21.
16/ Id. at 50:19-51:16.
17/ Hadaway, Exh. No. SCH-8 at 3.
18/ Gorman, Exh. No. MPG-1T at 52:2-5.

DAVISON VAN CLEVE, P.C.
333 SW Taylor, Suite 400
Portland, OR 97204
Telephone (503) 241-7242

13 Finally, PacifiCorp cites to other utilities' rate settlements or expedited rate filings, ostensibly to support its assessment of the current market cost of equity.[19/] As a threshold matter, PSE and Avista are different utilities with different ownership structures, different service territories and different risk profiles. PacifiCorp's apparent argument that 'one size fits all' is simply not true for the market cost of equity. Further, the Commission explicitly stated that it believed that there was insufficient record evidence in the PSE expedited rate filing to make a cost of equity determination in that case.[20/] PacifiCorp cannot rely on the fact that the Commission declined to adjust PSE's cost of equity in an expedited rate filing as proof that the Commission should now increase PacifiCorp's ROE in the face of ample evidence that it should be lowered. Likewise, Avista's ROE was adopted as part of the give and take process reached in a settlement. The Commission, while skeptical that 9.8% was within the upper end of the range of reasonableness at that time, determined that it would rely on the consensus of the parties that had negotiated the settlement and who had sponsored cost of capital studies.[21/] There is no such negotiated settlement nor consensus in this case, and the settlement terms reached by parties to a different company's rate case in different market conditions have no bearing on PacifiCorp's cost of equity today.

2. A Washington Jurisdictional ROR of 7.25% Adequately Supports PacifiCorp's Investment Bond Rating

14 Mr. Gorman demonstrates that a Rate of Return ("ROR") of approximately 7.25% will support PacifiCorp's credit rating and ensure continued access to low cost capital.[22/] PacifiCorp argues that Mr. Gorman's recommendation is based on a flawed analysis. However,

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19/ Brief of PacifiCorp at 21.
20/ Docket Nos. UE-121697 et al., Order 07 at P. 58.
21/ Docket Nos. UE-120436 et al., Order 09, P. 74.

DAVISON VAN CLEVE, P.C.
333 SW Taylor, Suite 400
Portland, OR 97204
Telephone (503) 241-7242

the "flaw" PacifiCorp asserts exists in his testimony is no flaw at all. Rather, Mr. Gorman analyzes credit metrics on a jurisdictional cost of service basis, rather than on a consolidated PacifiCorp basis.[23/] Mr. Gorman developed the credit metrics in this way to show that his recommended ROR will support PacifiCorp's financial obligations for Washington utility operations. To any extent that PacifiCorp alleges it may under-recover because of its operations in multiple jurisdictions, the Company accepted this risk when it chose to merge its operations 20 years ago.[24/]

15 Modifying the Standard and Poor's ("S&P") credit metrics to focus only on Washington jurisdictional cost of service prevents an increase in Washington retail rates to subsidize financial obligations PacifiCorp has taken on for businesses outside of the Washington retail utility. Mr. Gorman did not represent that his credit metrics were a duplication of S&P's methodology. S&P is concerned with total company operations, while the Commission's responsibility is to ensure that Washington rates are fair, just, reasonable, and sufficient. Thus, Mr. Gorman designed a methodology consistent with S&P's credit metric methodology to assess whether or not the ROR and other cost of service components will support credit metrics that contribute to PacifiCorp's ability to maintain its investment grade bond rating.[25/] While PacifiCorp frames its objection as a challenge to the accuracy of the analysis, it is in fact challenging the assumption that regulated Washington operations should not subsidize the company's other operations.

22/ Gorman, Exh. No. MPG-1T at 40:4-6 et. seq.
23/ Id. at 41:10-11.
24/ WUTC v. PacifiCorp, Docket No. UE 050684 et al., Order 04 at P. 56 (April 17, 2006).
25/ Gorman, Exh. No. MPG-1T at 41:10-18.

DAVISON VAN CLEVE, P.C.
333 SW Taylor, Suite 400
Portland, OR 97204
Telephone (503) 241-7242

16 PacifiCorp also alleges that Mr. Gorman ignored entirely the Funds from Operations ("FFO") to interest coverage ratio.[26/] Again, PacifiCorp tries to modify Mr. Gorman's study, but does not identify errors in it. Mr. Gorman makes clear that he relied on S&P's credit metric methodology for assigning credit metrics based on assessment of utilities' business and financial risk.[27/] While it is true that the FFO to interest is a ratio noted by S&P in its reports on PacifiCorp, it is not a ratio that is included in the standard credit metric business and financial risk matrix methodology published by S&P, upon which Mr. Gorman relied.[28/]

17 The Company also argues that Mr. Gorman ignored the expiration of bonus depreciation. However, PacifiCorp fails to provide any kind of credible explanation of how Mr. Gorman failed to include this in his analysis. To the extent bonus depreciation expense was included in the PacifiCorp Washington cost of service in this proceeding, then it was properly included in Mr. Gorman's credit metrics analysis. If PacifiCorp did not want bonus depreciation considered in rates, it could have removed it, but it did not.[29/]

18 Finally, PacifiCorp seeks through briefing to revive its unsuccessful attempt to discredit Mr. Gorman at hearing. The Company makes an egregiously erroneous argument that Mr. Gorman represents that his analysis will support an "A-" bond rating, even though the Company's current rating is "A."[30/] This blatant misrepresentation of the facts in the record demonstrates how thin and fabricated the Company's request for an inflated ROR is. Mr.

26/ Brief of PacifiCorp at P. 51 (citing Williams, Exh. No. BNW-14T at 16:7-11).
27/ Gorman, Exh. No. MPG-1T at 41:3-7.
28/ Id. at 41:10-18.
29/ See Williams, Exh. No. BNW-14T at 16:18-23.
30/ Brief of PacifiCorp at P. 51.

DAVISON VAN CLEVE, P.C.
333 SW Taylor, Suite 400
Portland, OR 97204
Telephone (503) 241-7242

Williams' testimony unambiguously identifies S&P's corporate bond rating for PacifiCorp as "A-" and its senior secured bond rating is "A."[31/]

19 Mr. Gorman testified that he reviewed the credit metrics' ability to support the corporate credit rating or senior unsecured credit rating and refuted PacifiCorp's misinformation during cross examination.[32/] Mr. Gorman's reliance on the "A-" bond rating tied his analysis to the senior unsecured credit rating. PacifiCorp's argument is both false and misleading.

B. The Commission Should Adopt Boise's Recommended Adjustments to Net Power Costs and the Washington Control Area Methodology

1. PacifiCorp's Misleading Arguments Do Not Justify Inclusion of the Full Costs of Oregon and California QFs in Washington Rates

20 PacifiCorp never meets its burden of proof to justify why the Commission should depart from previous practice on QF allocation and burden Washington customers with the incremental costs created by the regulatory decisions of other state commissions. Rather, the Company makes vague arguments about how these costs are "consistent" with PURPA and Washington state policy, and that the prices are reasonable and do not "harm" customers.[33/] Contrary to PacifiCorp's strange assertion, Boise believes it self-evident that a $10.7 million dollar rate increase without incremental benefit will harm customers. Further, as well explained by Messrs. Gomez and Deen, an arguably "reasonable" average price for California or Oregon QF power hides significant policy choices that have been made in those states and that drastically increase the actual costs to Washington ratepayers.[34/] It appears to be PacifiCorp's position that the Commission should simply accept the decisions made by other Commissions

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31/ Gorman, TR. at 196:10-14; Williams, Exh. No. BNW-1T at 4.
32/ Gorman, TR. at 196:12-24.
33/ Brief of PacifiCorp at PP. 55, 61, 63, and 68.
34/ Deen, Exh. No. MCD-1T at 6:18-23; Gomez, Exh. No. DCG-1T at 10:6-14.

DAVISON VAN CLEVE, P.C.
333 SW Taylor, Suite 400
Portland, OR 97204
Telephone (503) 241-7242

regarding PURPA implementation. PacifiCorp further asserts that if the Commission does not wish to abdicate its responsibility to protect Washington ratepayers and allow only prudently incurred costs, it must conduct prudence reviews of every QF contract entered into by the Company in other states.[35/] The absurdity of this argument is obvious.

21 Additionally, the Company takes the position that renewable energy credits ("REC") from Oregon QF contracts are eligible to satisfy PacifiCorp's obligations under the Energy Independence Act ("EIA").[36/] The Company fails to inform the Commission that in Oregon, "contracts to purchase renewable electricity do not transfer the green tags associated with the purchased electricity."[37/] Thus, unless PacifiCorp separately purchases RECs from the QFs, it does not acquire and cannot use them. PacifiCorp's statement that Oregon and California QF contracts are "eligible" to satisfy PacifiCorp's EIA obligations is patently false, and no more than a smokescreen designed to justify a rate increase that is not based on the Company's costs. Some contracts may qualify, but most will not. This further demonstrates the significant differences between Oregon and Washington policy, and the potential for PacifiCorp to game the system and over-recover its costs by exploiting the differences between state regulatory methodologies.

2. PacifiCorp's Attempts at Distraction Do Not Invalidate Boise's Conservative Power Cost Adjustments

22 Mr. Deen recommended a conservative adjustment to reflect the known and measurable improvement to the Jim Bridger coal plant's heat rate. This adjustment will appropriately match the benefits of the Bridger upgrade to the costs of the improvement, which

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35/ Brief of PacifiCorp at P. 61, 62.

36/ Id. at 67.

37/ Re Public Utilities Commission of Oregon, OPUC Docket No. AR495, Order 05-1229 at 8 (Nov. 28, 2005).

DAVISON VAN CLEVE, P.C.
333 SW Taylor, Suite 400
Portland, OR 97204
Telephone (503) 241-7242

PacifiCorp wishes to begin recovering from ratepayers in this case.[38/] PacifiCorp asks the Commission to ignore this correction to its power costs on the basis that it is unnecessary and "entirely speculative."[39/] Neither assertion is supported by the record in this case.

23 PacifiCorp claims that the adjustment is unnecessary because "customers receive the benefits of the efficiency gains as the actual unit heat rates are incorporated into the historical average used to calculate the normalized heat rate."[40/] As Boise stated in its opening brief, without Mr. Deen's adjustment, customers do not enjoy this benefit because it is not included in rates now, and it will not be fully included for at least four more years using the Company's methodology.[41/] All the while, customers will be paying the full price of the upgrade, and the Company will be collecting additional profits from this regulatory lag.

24 PacifiCorp's argument that Mr. Deen's adjustment is "entirely speculative" is simply false. As noted in Boise's initial brief, the heat rate improvement at the Bridger plant is so reliable that the contractor has been willing to guarantee an increase of 417 btu/kWh, and to be liable for damages if this level is not reached.[42/] Mr. Deen's adjustment has been made using the same rationale that induced PacifiCorp to deem the upgrade prudent – it is verifiable by reference to similar, though not identical, improvements to other units – and given the minimum, base level guaranteed by the contractor, Mr. Deen's adjustment will not capture incremental improvements attributable to normal maintenance.

25 Similarly, PacifiCorp attempts to invalidate Mr. Deen's recommendation that the Commission require the Company to remove its artificial, one-sided market caps in GRID by

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38/ Deen, Exh. No. MCD-1T at 18:14-16.
39/ Brief of PacifiCorp at PP. 89, 90.
40/ Id. at P. 89.
41/ Deen, Exh. No. MCD-1T at 20:9-15.
42/ Exh. No. B-5 at Project Proposal, 8.

DAVISON VAN CLEVE, P.C.
333 SW Taylor, Suite 400
Portland, OR 97204
Telephone (503) 241-7242

focusing only on the incremental effects of the adjustment at the California Oregon Border ("COB") market hub, and repeatedly calling this hub "illiquid."[43/] As Mr. Deen repeatedly demonstrated, this hub is not illiquid, and PacifiCorp's transactions make up a small percentage of that market's activity, meaning counterparties are readily available.[44/] The Company has presented no evidence contravening these facts. Rather, the Company myopically focuses on the increased transactions at COB in the absence of market caps, while asking the Commission to ignore the fact that the overall effect of the adjustment is to bring the level of simulated, beneficial transactions closer to, but still below, historic actuals. While the market caps may approximate current activity at COB, they drastically under-represent the Company's total level of sales.[45/] The Commission does not set rates based on COB transactions in isolation, but on the overall level of costs and benefits the Company experiences in a normalized test year. Mr. Deen's adjustment provides a more accurate, if still understated, level of off-system sales, and provides a far more accurate basis for setting rates in this case.

26 Finally, the Company argues that Mr. Deen's adjustment to the Bridger coal costs is inappropriate, but it does so by using the wrong legal standard. The Company cites to a general statute that permits the Commission to disallow payments to affiliates if they are not "reasonable."[46/] This argument is completely irrelevant because Boise has not recommended disallowing the costs of Jim Bridger affiliate purchases, but rather asks the Commission to hold the Company to its own Commission-approved commitment to use asymmetrical pricing for

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43/ E.g. Brief of PacifiCorp at PP. 97-98.
44/ Deen, Exh. No. MCD-1T at 14:11-18.
45/ Id. at 15:4-6.
46/ Brief of PacifiCorp at P. 74 (citing RCW § 80.16.030).

DAVISON VAN CLEVE, P.C.
333 SW Taylor, Suite 400
Portland, OR 97204
Telephone (503) 241-7242

affiliate transactions.[47/] To the extent that an alternative market source is available, the Company must use market prices for affiliate purchases.[48/]

C. PacifiCorp Continues to Disregard the Commission's Rulings Regarding a PCAM

27 PacifiCorp makes the claim that it addressed the Commission's concerns in the 2006 rate case in the design of its current power cost adjustment mechanism ("PCAM") proposal.[49/] In fact, the Company has ignored the bulk of the Commission's previous direction regarding PCAMs. Of the many infirmities the Commission identified, the use of actual rather than computer-generated data is the only shortcoming that PacifiCorp has addressed, and Boise did not challenge this facet of the mechanism.

28 The Commission's order in 2006, however, required deadbands and/or increased sharing bands to properly redistribute risk and to confine the operation of the PCAM to extraordinary events such as drought or energy market failure.[50/] As thoroughly discussed in Boise's opening brief, the Company ignored this direction by failing to include a deadband and eliminating the already insufficient sharing band it previously proposed. Now, PacifiCorp does not want to bear the risk of normal fluctuations that can be normalized, though not eliminated.[51/] The Company's brief on this subject continues its theme of shifting risk to ratepayers, including the risk of normal stream flows, market prices, fuel prices, loads, or forced outages.[52/]

29 PacifiCorp's attempt to recover, on a dollar for dollar basis, every dime of power costs is an attempt to shift to customers all possible risks, even though the Commission has

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47/ Re MEHC and PacifiCorp, Docket No. UE 051090, Order 08 at App. A, P. 16 (March 10, 2006) (Commitment WA-12).
48/ Deen, Exh. No. MCD-1T at 21:19 – 22:11.
49/ Brief of PacifiCorp at P. 112.
50/ Docket Nos. UE-050684 et al., Order 04 at PP. 91-92.
51/ Brief at PacifiCorp at P. 110.
52/ Id. at P. 102.

DAVISON VAN CLEVE, P.C.
333 SW Taylor, Suite 400
Portland, OR 97204
Telephone (503) 241-7242

stated these risks should be fairly distributed, and even though the Company is compensated for bearing such normal risks.[53/] In addition, if the Company is assured that it will receive full compensation regardless of how it responds to or manages normal variations outside of its control, the Company will have no incentive to maximize efficiency and make good decisions in meeting its power needs. PacifiCorp's PCAM is so one-sided that it should be summarily rejected.

IV. CONCLUSION

30 PacifiCorp has not demonstrated that its proposed rate increase is just or reasonable in this case. The Commission should adopt Mr. Gorman's reasonable and well-supported cost of capital and capital structure recommendations, as well as Mr. Deen's conservative measurable adjustments to net power costs. PacifiCorp's attempt to shift QF costs from Oregon and California ratepayers should also be rejected. The Commission should decline to adopt a PCAM for PacifiCorp because the Company has not demonstrated a need for such a mechanism, and refuses to propose a PCAM consistent with Commission requirements.

53/ Deen, Exh. No. MCD-1T at 24:21-25:2; 28:14-29:8.

DAVISON VAN CLEVE, P.C.
333 SW Taylor, Suite 400
Portland, OR 97204
Telephone (503) 241-7242

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Respectfully submitted,

DAVISON VAN CLEVE, P.C.

Melinda J. Davison
Joshua D. Weber
333 S.W. Taylor, Suite 400
Portland, Oregon 97204
(503) 241-7242 telephone
(503) 241-8160 facsimile
mjd@dvclaw.com
jdw@dvclaw.com
Of Attorneys for Boise White Paper, L.L.C.