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

REPLY BRIEF ON BEHALF OF COMMISSION STAFF

October 11, 2013

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I. INTRODUCTION

1 Staff's Reply Brief responds only to Company arguments that misstate or mischaracterize the Staff position on an issue, or that divert the Commission's attention from the essential issue. Our silence on any argument presented by PacifiCorp should not be construed as agreement with the Company on that issue or any related issue.

II. ARGUMENT

A. Cost of Capital

1. Return on Equity

2 The main issue presented by the initial briefs is whether the Commission should abandon the Discounted Cash Flow ("DCF") approach to determining the cost of equity because of an increase in interest rates occurring only this past summer with unknown duration and consequences. Staff recommends that the Commission not go down that road. As Mr. Elgin stated, the price of common stock is set in highly competitive capital markets that reflect investor expectations based on all relevant information.[1] The DCF model relies on the price of common stock. Therefore, the DCF model is a reliable indicator of the cost of equity. Boise White Paper agrees with Staff that the DCF model produces "reliable results that correctly gauge the appetite of the market for utility stocks . . ."[2]

3 The Company argues that rising interest rates just before hearings have increased its cost of equity, which can now be measured only by Dr. Hadaway's updated Risk Premium analyses.[3] PacifiCorp, therefore, asks the Commission to ignore all DCF results, including not only Mr. Elgin's that supports a 9.00 percent return on equity, but also the three studies submitted by Dr.

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[1] Elgin, Tr. 234:13-20. See also Staff Initial Br. at ¶55, citing, Elgin, Exh. No. KLE-1T at 5:21-6:3.
[2] Boise White Paper Post Hearing Br. at page 13 (Note: the paragraph on page 13 is not numbered).
[3] PacifiCorp Opening Br. at ¶¶13-20.

Hadaway that all produce a return on equity no more than 9 percent,[4] and the three studies presented by Mr. Gorman that produce an average return on equity of 8.83 percent.[5]

4 In support of this position, the Company claims Mr. Elgin admitted his return on equity range should be increased 25 basis points to account for changes in market conditions since he filed his written testimony.[6] PacifiCorp's characterization of Mr. Elgin's testimony is misleading because it is taken completely out of context. Mr. Elgin did *not* state that his equity range *should* be increased as a result of recent increases in interest rates. Very much to the contrary, he stated that "equity costs change slowly over time, and how they change is again reflected in the price investors are willing to pay for common equities." [7] Thus, he testified there is:

> [W]ay too much quibbling about, well, interest rates went this way and interest rates went up and down and what do you actually use for – in a risk premium study. Look at equity prices, look at how the market is reacting in relationship to what's happening in long-term interest rate, and then make a judgment. But if you look at today's dividend yields, they're still lower than when Dr. Hadaway and I filed our initial testimony.[8]

It was only in this context that Mr. Elgin stated he would update the range of his equity cost. An update, however, was not his recommendation nor did he concede that an update was necessary.

5 Even with an update, his return on equity range would be 8.75 percent to 9.25 percent.[9] His 9.0 percent return on equity is still within that range. As the midpoint, a 9.0 percent equity return still accounts for pressure due to volatility in interest rates, if the Commission's judgment is to rest its cost of equity determination on extremely recent interest rate changes.

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[4] See Hadaway, Exh. No. SCH-15 at 2. Dr. Hadaway's constant growth DCF result was 9 percent. His two other DCF studies produced a return on equity no more than 9 percent, when adjusted for a more recent GDP historical growth rate of 4.3 to 4.5 percent, rather than the 5.6 percent rate used by Dr. Hadaway. Staff Initial Br. at ¶49. Both the Commission and Staff have rejected the use of historical GDP growth in a DCF analysis. Staff Initial Br. at ¶50.
[5] Boise White Paper Post Hearing Br. ¶¶19-21.
[6] PacifiCorp Opening Br. at ¶14.
[7] Elgin, Tr. 234:17-19.
[8] Elgin, Tr. 234:21-235:4.
[9] Elgin, Tr. 268:9.

6 PacifiCorp's characterization of Mr. Elgin's testimony does a disservice to the cost of equity debate before the Commission. But, it does reveal a significant contradiction in the Company's position on the impact of interest rates on the cost of equity. When the Commission established PacifiCorp's 9.8 percent cost of equity in March 2011,[10] long-term interest rates were 5.56 percent (Single-A Utility Rate) and 4.51 percent (30-Year Treasury Rate).[11] When the Company filed its case in the current docket in January 2013, long-term interest rates were much lower: 4.15 percent (Single-A Utility Rate) and 3.08 percent (30-Year Treasury Rate).

7 Therefore, if, as PacifiCorp contends, the cost of equity should track interest rates, the Company should have requested a lower cost of equity than 9.8 percent. Instead, it requested a higher return of 10 percent. Apparently, the Company would have the Commission only *increase* the cost of equity when interest rates go up, but not *decrease* the cost of equity when interest rates go down. The only explanation for this contradiction is that PacifiCorp wants all DCF results ignored, including even its own, when the DCF model does not produce the results the Company desires. The Commission should reject the Company's strategy.

2. Capital Structure

8 Staff's proposal to impute 4 percent short-term debt in the capital structure ensures ratepayers will achieve the lowest overall cost of capital consistent with the Commission's decision that a balanced capital structure should consider "all sources of capital available to a company."[12] When combined with a 46 percent equity ratio, Staff's capital structure restores a balance of safety and economy that protects ratepayers from the decisions of MEHC, while still allowing PacifiCorp to obtain capital on reasonable terms and conditions because it supports a BBB corporate credit rating and an A- secured bond rating consistent with industry standards.

[10] *WUTC v. PacifiCorp,* Docket UE-100749, Order 06 (March 25, 2011).
[11] Hadaway, Exh. No. SCH-10T at 5, Table 1.
[12] *WUTC v. PacifiCorp,* Docket UE-050684, Order 04 at ¶224 (April 17, 2006).

9 The Company disputes Staff's proposed capital structure, alleging Mr. Elgin admitted his proposed equity ratio of 46 percent would "support" a three-step credit rating downgrade for PacifiCorp.[13] This alleged downgrade would then likely result in increased borrowing costs and potential limitation on access to capital.[14]

10 Again, the Company mischaracterizes Mr. Elgin's testimony and misleads the Commission by doing so. Mr. Elgin did not state that his capital structure recommendation would support a three-notch credit downgrade. Rather, he accepted Mr. William's theory that a 46 percent equity ratio could lower the Company's secured debt credit rating *one* notch from "A" to "A-" and increase its cost of debt.[15] Therefore, he calculated a hypothetical cost of debt of 5.34 percent using the debt cost of Avista because Avista is an investment grade utility with an equity ratio of 46 percent and a secured bond rating of A-.[16]

11 It appears that the Company reached its allegation of a three-step credit downgrade under the Staff proposal by comparing PacifiCorp's current secured debt rating of "A" with a possible reduction in its unsecured debt rating to "BBB". That is an "apples to oranges" comparison that Mr. Elgin never adopted nor admitted could or would occur.

3. Overall Cost of Capital

12 PacifiCorp attempts to gloss over the magnitude of its cost of capital proposal by stating that its recommended overall rate of return of 7.75 percent is virtually the same as the currently authorized overall return 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."[17]

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[13] PacifiCorp Opening Br. at ¶¶35 and 50. We assume the Company used the term "support" to acknowledge that it cannot know with certainty how credit rating agencies will or will not react to decisions of regulatory commissions.
[14] PacifiCorp Opening Br. at ¶35.
[15] Elgin, Exh. No. KLE-1T at 37:1-13, citing, Williams, Exh. No. BNW-1T at 15:19-16:4.
[16] Elgin, Exh. No. KLE-3.
[17] PacifiCorp Opening Br. at ¶11.

13 The Company ignores the very real and significant impacts of its proposal. As Mr. Elgin showed, the Company's proposal to increase its equity ratio to over 52 percent and ignore short-term debt comes at a heavy cost to ratepayers of $7 million to $8 million per year.[18] PacifiCorp never disputed Mr. Elgin's demonstration. It also never presented substantiated evidence that these un-rebutted costs are outweighed by any real benefits for ratepayers. Staff is the only party whose overall cost of capital recommendation restores balance to the financing decisions imposed on the Company by MEHC and the costs of those decisions for customers.

B. QF Purchased Power Costs

14 Under the current WCA cost allocation methodology, the cost of purchased power contracts with QFs located in Oregon and California are not included in Washington rates. PacifiCorp proposes to revise that method by including the cost of power purchased from Oregon and California QFs and allocating a portion of that cost to Washington. Staff, Boise White Paper, and Public Counsel all oppose the Company's proposal.

15 The fundamental argument presented by the Company is that these QF contracts benefit Washington customers.[19] The Company refers to Commission precedent under the "used and useful" standard of RCW 80.04.250 for its focus on customer benefits. That precedent does not apply here since "used and useful" is a rate base standard and the Oregon and California QF costs are not rate base items. They are purchased power contracts.

16 More important, the Company's argument entirely misses the point. The issue is not whether Washington customers benefit from the contracts with the Oregon and California QFs. The issue is whether the Company should be allowed to shift any of the costs of those contracts

[18] Elgin, Exh. No. KLE-1T at 45:24-46:5. These costs are not offset by the lower actual cost of debt of 5.29 percent that PacifiCorp now proposes, given the actual capital structure that PacifiCorp also proposes with no short-term debt and over 52 percent equity.

[19] PacifiCorp Opening Br. at ¶¶55-60.

to Washington when those costs are the direct result of the PURPA policy decisions of those other states. While PURPA allows Oregon and California to decide their own policies and methodologies, there is nothing in PURPA that compels this Commission to abdicate its duty to protect Washington ratepayers by accepting the cost consequences of those decisions.

17 Indeed, those consequences are significant and would cause substantial ratepayer impacts if the Commission does not act to protect Washington ratepayers. As Staff pointed out, if just three Oregon QF contracts had durations of five years as restricted by this Commission's rules, they would have been renewed recently at much lower rates, which would have reduced power costs for the WCA by about $6.6 million.[20]

18 The Company argues that its proposal is consistent with Commission treatment of other out-of-state QF contracts, citing the inclusion in Washington rates of the cost of an Avista contract with an Idaho QF.[21] However, the Company never showed that the PURPA policies of Washington and Idaho are dissimilar and that Washington ratepayers would be adversely affected by Idaho's approach. The Commission has the authority to protect Washington ratepayers from any such adverse consequences, if and when they are shown to exist.

19 Finally, the Company argues that the energy policies of Oregon and Washington are substantially aligned.[22] These vague references to broad energy policies and their goals are beside the point. As Staff demonstrated, the PURPA policies of Washington and Oregon are materially different. Those differences have cost consequences. Directly assigning the cost of QF power to the state where the resource is located and the cost is determined ensures that the ratepayers of each state are not affected adversely by the PURPA policies of another state.

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[20] Gomez, Exh. No. DCG-1CT at 13, n29. See also Staff Initial Br. at ¶81, citing, Exh. No. B-4, Attachment 293-2,CONF.xlxs.
[21] PacifiCorp Opening Br. at ¶57.
[22] PacifiCorp Opening Br. at ¶¶63-67.

20 In short, the Company's remedy is to ask Oregon and California to pay the entire cost of QF contracts that is the result of their commission's decisions for implementing PURPA. The remedy is not to ask Washington customers to pay those costs. Otherwise, and contrary to PacifiCorp's claim,[23] Washington ratepayers will be harmed.

C. Non-Power Cost Allocations

21 The Company proposes several modifications to the approved West Control Area cost allocation method. However, PacifiCorp did not comprehensively review the WCA method, as evidenced both by inconsistencies in its proposed Control Area Generation West ("CAGW") and System Generation ("SG") allocation factors and its failure to address the System Overhead allocation factor. Thus, Staff's primary recommendation is that the Commission should reject the revisions and set rates based upon the approved WCA method since there is no basis to conclude that the Company's selective proposals fairly allocate total system costs to Washington.

22 Staff also recommends that the Commission order the Company to provide a Report and other calculations for use in its next general rate case that will allow the WCA method to be evaluated in a comprehensive manner and any necessary revisions adopted. Should the Commission nevertheless accept any of the Company's cost allocation revisions, Staff offers a secondary recommendation for allocation factor revisions the Commission should adopt entirely in an effort to anticipate issues that the Report may reveal.

23 None of the Company's arguments should dissuade the Commission from accepting Staff's primary or, if necessary, secondary recommendation. First, PacifiCorp argues Staff's position is inconsistent with Commission precedent that, over the objection of the Company, accepted individual changes to the WCA method without first completing the initial five-year

[23] PacifiCorp Opening Br. at ¶¶61-62.

review.[24] However, PacifiCorp was overruled in that case because the Company's argument was "contrary to the principles underlying the WCA methodology: that is, those burdens align with benefits."[25] In contrast, Staff's position in this case is that the Commission needs additional narrow and specific information in order to develop a sufficient record to ensure consistency between the allocation of burdens and benefits within the WCA.[26]

24 PacifiCorp states that its proposals are designed to create greater consistency between inter-jurisdictional allocations and its cost of service study ("COSS"), which is a principle Staff supports but is not embodied in Staff's primary recommendation.[27] However, while greater consistency between inter-jurisdictional allocations and a COSS is a principle Staff supports, it is subordinate to the importance of internal consistency within the WCA method. The Company's proposals sacrifice internal consistency within the WCA method. That inconsistency is significant, as Staff explained and the Company did not refute.[28]

25 Regarding Staff's secondary recommendation to revise the demand/energy weightings in the SG and CAGW allocation factors, PacifiCorp alleges that Staff did not propose similar changes to the COSS.[29] The Company's argument is disingenuous. As the Commission is well aware, the parties settled the COSS in this case, but only as support for the rate spread and rate design they also settled. The Company should not be allowed to criticize Staff for allegedly not proposing changes to the COSS when Staff agreed to set aside COSS issues in this case in an effort to collaboratively resolve issues.

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[24] PacifiCorp Opening Br. at ¶130.
[25] *WUTC v. PacifiCorp*, Docket UE-100749, Order 06 at ¶172 (March 25, 2011).
[26] Staff Initial Br. at ¶104.
[27] PacifiCorp Opening Br. at ¶131.
[28] Staff Initial Br. at ¶¶116-117.
[29] PacifiCorp Opening Br. at ¶135.

26 Moreover, the Company's argument mischaracterizes the Staff litigation position on the COSS. Before the settlement was reached, Staff actually did propose to use 200 Coincident Peak ("CP") data, which is consistent with Staff's secondary recommendation.[30] Staff also explained that its primary recommendation is even more important due to the settlement in this case and the likelihood of litigation of the COSS in the next general rate case.[31]

27 PacifiCorp argues that an Order relied upon by Staff does not address the classification of costs between demand and energy.[32] The Company is wrong. The cited precedent relates to the apportionment of costs using usage-based data and states that the Commission prefers an average peak calculation that best reflects "actual peak *usage*."[33] Therefore, it is the distinction between cost-based data and usage-based data that is important, not the distinction between classification and allocation. The Company has switched from using cost-based data to usage-based data in this case.[34] Therefore, the precedent cited by Staff is clearly relevant.

28 Finally, the Company argues that PacifiCorp and Staff's secondary recommendation are often contradictory and both cannot be adopted.[35] However, Staff was clear that if the Commission were to accept *any* of the Company's modification, it should accept *all* of Staff's.[36] Staff clearly laid out all of its revisions, as compared to the Company's:[37]

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[30] Mickelson, Exh. No. CTM-1T at 14:15-15:20.
[31] Staff Initial Br. at ¶108. All parties reserved the right to contest the facts, principles and methodology underlying the COSS in the next general rate case. The "No Precedent" clause of the settlement is clear on that point.
[32] PacifiCorp Opening Br. at ¶135.
[33] *WUTC v. Washington Natural Gas Company,* Dockets UG-940034/UG-940814, Supplemental Order 05 at 8 (April 11, 1995). (Emphasis added.)
[34] Steward, Exh. No. JRS-7T at 5:8-11 states that the BPA agreement, which provided cost data, expired in 2011 so the Company began using a load factor, which is based on customer usage. See Exhibit No. CCP-4 at 1.
[35] PacifiCorp Opening Br. at ¶132.
[36] Staff Initial Br. at ¶109.
[37] White, Exh. No. KAW-1CT at 24, Table 1.

Allocation Factor	WCA: Original	WCA: Company	WCA: Staff
System Generation:			
Base Component	12 CP – TS	12 CP – TS	200 CP – TS
Weighting	Stipulated	Stipulated	200 CP – TS
Control Area Generation West:			
Base Component	12 CP – WCA	200 CP – WCA	200 CP – WCA
Weighting	Stipulated	Load Factor – WCA	200 CP – WCA

29 The Company's proposal is to use a load factor (1CP) for the CAGW weighting, while Staff would use 200CP. That is the only place where PacifiCorp can claim any incompatibility between its proposed modifications and Staff's secondary recommendations. Thus, the Company's accusation is a gross overstatement at best that should not be the determining factor.

D. Major Plant Additions and the Expedited Rate Filing

30 Staff recommends a "bright line" standard that would include only major plant additions that were in service on January 11, 2013, the date the Company filed this general rate case, followed by a timely expedited rate filing ("ERF") to recover plant additions completed after that date. Therefore, Staff includes the Soda Springs Fish Passage, Swift Fish Collector and Prospect In-Stream Flow/Automation system because they were in service on January 11, 2013. Using that same in-service cut-off date, Staff excludes the Merwin Fish Collector and the Jim Bridger turbine upgrade. Staff also corrects depreciation expense and accumulated reserve, and removes projected O&M expenses for Merwin and Swift that are not known and measurable.

31 The Company complains that the Staff ERF proposal will not address regulatory lag, alleging, in particular, that the ERF will not provide timely recovery of the Jim Bridger turbine upgrade.[38] Staff has explained previously that any delay in the recovery of the Jim Bridger upgrade does not contribute to any under-earning associated with regulatory lag, provided that the Company's compliance filing removes the upgrade from the calculation of net power costs.[39]

Moreover, as Ms. Reynolds explained: "I also think that the company would be able to file an alternative expedited rate filing that might depend on the July [2012] to June [2013] period, file that in January [2014], and have rates maybe four months later."[40] Thus, the ERF can accommodate earlier recovery of the Jim Bridger upgrade than feared by PacifiCorp.

32 PacifiCorp proposes a separate tariff rider for the Merwin Fish Collector once it is in service (projected for February 2014). That alternative is unnecessary given the ERF proposed by Staff that would consider timely rate recovery for both Merwin and the Jim Bridger upgrade.

33 Moreover, the Company's proposal would set precedent for an individual tariff rider for each plant addition scheduled to go into service after the cut-off date set in a rate proceeding. Staff submits this would be poor ratemaking policy, administratively burdensome to the Commission, and confusing to customers, particularly if a separate line item on a bill is required.

34 Finally, Public Counsel argues against any ERF that would exceed a three percent increase in annual revenues.[41] Staff opposes that restriction given that plant additions typically comprise a major portion of a utility's rate increase request and should be recognized for ratemaking purposes if they are shown to be prudent.

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[38] PacifiCorp Opening Br. at ¶125.
[39] Staff Initial Br. at ¶¶152-153.
[40] Reynolds, Tr. 410:16-20.
[41] Public Counsel Br. at ¶¶34-36.

35 Public Counsel's reliance on WAC 480-07-510 that defines a "general rate case" as a filing that exceeds 3 percent is also misplaced. The ERF Staff proposes excludes review of the Company's cost of capital and avoids other controversial items typically addressed in a general rate case. Thus, there is no reason to require all of the documentation required by the rule for a general rate case. Nor should that rule be used as a barrier to an ERF that exceeds three percent.

E. End-of-Period versus Average-of-Monthly Average Rate Base

36 The Company included restating adjustments to reflect electricity plant at EOP balances rather than AMA balances. The Commission should reject this proposal and maintain AMA rate base balances, consistent with its favored approach and in light of PacifiCorp's failure to prove that an EOP approach is warranted in this case.

37 Staff is willing to accept, and has accepted, EOP rate base balances in appropriate circumstances, but it is not Staff's burden to make the Company's case here. Moreover, while Public Counsel advocates for an EOP rate base with corresponding adjustments to revenues and expenses,[42] the Company disputes Public Counsel's revenue normalization adjustment.[43] That dispute highlights the insufficient record in this case upon which the Commission could adopt an EOP rate base even if PacifiCorp had carried its burden to prove a need for EOP treatment.

38 In contrast, Staff's AMA balances maintain the standard treatment that matches rate base over the course of the test year with revenue and expenses over that same period. The Commission should adopt this approach until PacifiCorp meets its responsibility to explain fully its rationale for EOP rate base either in an appropriately filed ERF or its next general rate case.[44]

[42] Public Counsel Br. at ¶25.
[43] PacifiCorp Opening Br. at ¶¶146-147.
[44] Adoption of AMA rate base balances in this case does not preclude consideration of an ERF based on EOP accounts.

F. Working Capital

39 PacifiCorp proposes refinements to the calculation of investor-supplied working capital ("ISWC") for post-retirement pension benefits and derivatives. Staff supports the proposals.[45] Public Counsel opposes them.

40 The basis for Public Counsel's challenge are factual allegations that: 1) pension and other post retirement assets do not exceed liabilities and, therefore, investor funds have not been used to fund working capital; and 2) there was a deferred tax impact from derivative assets.[46]

41 Public Counsel relies on PacifiCorp's 2012 Form 10-K for these allegations. That document is not an exhibit even though Public Counsel had ample opportunity to introduce the document at hearing. Public Counsel's arguments should, therefore, be rejected since they are not based on the record and do not provide other parties a meaningful opportunity to respond.

42 Moreover, the test period for this case, including the working capital adjustment, is the twelve-months ending June 30, 2012, not the calendar year 2012 used in the Form 10-K. Public Counsel's reliance on the 2012 Form 10-K is, therefore, misplaced in any event.

43 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."[47] That is exactly what is accomplished by the proposed refinements for derivatives and post-retirement pension benefits. Public Counsel states nothing to detract from that conclusion. Staff encourages the Commission to embrace this

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[45] Staff Initial Br. at ¶¶183-186.

[46] Public Counsel Br. at ¶¶84-86. All of Public Counsel's remaining arguments have been previously addressed and disproven. Staff Initial Br. at ¶¶187-190.

[47] Stuver, Exh. No. DKS-3T at 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).]

opportunity to improve the working capital calculation by accepting the Company's proposals for derivatives and post-retirement pension benefits.

DATED this 11th day of October 2013.

Respectfully submitted,

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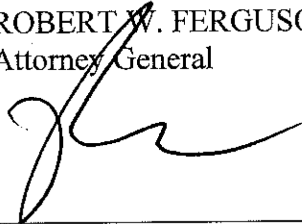

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