

**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

RELY BRIEF OF PUBLIC COUNSEL

OCTOBER 11, 2013

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I. INTRODUCTION

1. Public Counsel submits this Reply Brief to address select issues raised by the other parties in their Initial Briefs filed on October 1, 2013. Public Counsel continues to advocate for the arguments and recommendations set out in its initial post-hearing brief. To avoid repetition, Public Counsel does not address all of its arguments again in this Reply Brief.
2. Rates charged by utilities regulated by the Washington Utilities and Transportation Commission (UTC) must be fair, just, reasonable, and sufficient.¹ The UTC has the authority and duty to set rates meeting that standard after hearing and consideration of the evidence.² Rates must be “fair” to both ratepayers and the utilities’ shareholders, “just” by being based solely on the evidentiary record developed in the general rate case proceeding, “reasonable” by being within the range of possible outcomes supported by credible evidence, and “sufficient” to meet the needs of the Company to pay its expenses and attract capital on reasonable terms.³
3. PacifiCorp holds the burden of proving that a rate increase is necessary at the level requested. Because the weight of the evidence demonstrates that the requested increase is excessive, and that the resulting rates would be unfair, unjust, unreasonable, and overly sufficient, the Commission should reject PacifiCorp’s rate request and set rates that are fair, just, reasonable, and sufficient.

¹ RCW 80.28.010(1).

² RCW 80.28.020.

³ *WUTC v. Puget Sound Energy, Inc.*, Dockets UE-111048/UG-111049 (consolidated), Order 08, ¶ 21 (May 7, 2012).

II. REGULATORY LAG

A. PacifiCorp Overstates the Commission's Duty to Mitigate Regulatory Lag.

4. PacifiCorp overstates the Commission's duty to mitigate regulatory lag when it argues that the Commission has a responsibility to reduce regulatory lag to the extent possible. PacifiCorp points to the Commission's recent decision in the Puget Sound Energy ERF/Decoupling proceeding and the authority cited in that order as support for its argument.⁴ However, neither the recent Puget Sound Energy ERF/Decoupling proceeding, nor the 1981 Washington Natural Gas case stand for the proposition that regulators must mitigate all lag experienced by regulated utilities. Indeed, regulatory lag plays an important function in regulation, as discussed by Boise White Paper in its Initial Brief,⁵ and regulatory lag is necessary when one considers the used and useful standard for allowing capital additions into rate base.
5. In the Washington Natural Gas case, the Commission recognized that inflation was negatively impacting the economy generally and utilities with large amount of new capital projects specifically.⁶ More recently in the Puget Sound Energy ERF/Decoupling case, the Commission noted that Puget Sound Energy had been in a period of replacing "substantial amounts of aging infrastructure."⁷ Large amounts of new capital expenditures necessary to meet

⁴ PacifiCorp's Initial Brief at ¶¶ 5, 115 (citing *WUTC v. Puget Sound Energy, Inc.*, Docket UE-121697 et al., Order 07, ¶ 46 (June 25, 2013)(quoting *WUTC v. Washington Natural Gas Co.*, 44 P.U.R.4th 435, 438 (September 24, 1981)).

⁵ Boise White Paper's Initial Brief at ¶¶ 6-9.

⁶ *WUTC v. Washington Natural Gas Co.*, 44 P.U.R.4th 435, 438 (September 24, 1981).

⁷ *WUTC v. Puget Sound Energy, Inc.*, Docket UE-121697 et al., Order 07, ¶ 46 (June 25, 2013).

the demands of a utility's service area can impact a utility's earnings. If this lag has a deleterious effect, regulators have "the responsibility to mitigate that effect to the extent possible."⁸

Regulators do not have a responsibility to mitigate all effects of regulatory lag.

6. The Commission is not required to, and should not, eliminate all regulatory lag. To do so would eliminate very important incentives for utilities to efficiently manage their operations to achieve dual goals of providing safe and dependable service while also realizing the opportunity to earn a reasonable return. In this case, as noted in our Initial Brief, PacifiCorp has described its whole case as its answer to "attrition,"⁹ but it has not demonstrated that all of the regulatory lag it experiences is improper. Public Counsel's recommendations in this case carefully balance reducing certain regulatory lag while still preserving the incentives created by the existence of regulatory lag. The Commission should adopt Public Counsel's recommendations and reject PacifiCorp's unsupported arguments that its entire rate case is an "attrition study."

III. MAJOR CAPITAL ADDITIONS

A. **Commission Precedent Requires that PacifiCorp's Projected Plant Additions be Excluded from Rates Because they are Premature.**

7. PacifiCorp cites to two Commission orders involving plant additions that went into service after the test period as support for the pro forma adjustments it proposes for its Jim Bridger upgrade and Merwin Fish Collector.¹⁰ Neither order supports the adjustments offered by PacifiCorp.

⁸ *WUTC v. Washington Natural Gas Co.*, 44 P.U.R.4th 435, 438 (September 24, 1981).

⁹ Public Counsel's Initial Brief at ¶ 38.

¹⁰ PacifiCorp's Initial Brief at ¶ 117.

8. In Avista's 2009 rate case, the Commission allowed an adjustment for the "Noxon No. 3 upgrade."¹¹ PacifiCorp states that the Commission found that the project's costs were "sufficiently well established."¹² This mischaracterizes the Commission's order. The Commission's order at Paragraph 81 actually reads as follows: "*All parties also agree that the project costs can be included in rates in this proceeding because they are sufficiently well established and certain that the project can be included in the power cost model that yields net power costs for the rate year.*"¹³ Moreover, the Commission limited the precedential value of its decision in the Avista 2009 rate case:

By approving the Staff's recommendation, we are knowingly making an exception to strict application of the principles guiding pro forma adjustments. The Noxon No. 3 upgrade is not yet in service. The agreement among all parties that the Noxon No. 3 costs are appropriate to include, together with the importance of the project and Staff's testimony that the plant will be completed on time and is a prudent project, allows us to make an exception in this limited case and in these circumstances. *Our decision here should not be taken as precedent for other capital additions that present different facts and circumstances.*¹⁴

9. In this case, we have the Company's statements that its capital projects will be completed on time and within budget. These bald statements alone are not sufficient, and are significantly less than what existed in the Avista case. In the Avista case, Staff supported the adjustment and provided additional evidence on the reliability of the projections. Moreover, all parties in the Avista case agreed that the costs were appropriate to include in rates. We do not have a similar

¹¹ *WUTC v. Avista Corp.*, Dockets UE-090134/UG-090135 (consolidated), Order 10, ¶¶ 80-81 (December 22, 2009).

¹² PacifiCorp's Initial Brief at ¶ 117 (quotation marks in original; citing *WUTC v. Avista Corp.*, Dockets UE-090134/UG-090135 (consolidated), Order 10, ¶ 81 (December 22, 2009).

¹³ *WUTC v. Avista Corp.*, Dockets UE-090134/UG-090135 (consolidated), Order 10, ¶ 81 (December 22, 2009)(emphasis added).

¹⁴ *Id.* (emphasis added).

agreement or evidence in the current case. Staff also conducted a prudence review of the project in the Avista case, whereas Staff did not conduct full prudence reviews of PacifiCorp's capital projects. Specifically, the Jim Bridger upgrade and the Merwin Fish Collector were not ripe for a prudence review in this case. While the Commission found that it was able to make an exception in the Avista case, it can not make a similar exception here.

10. In Puget Sound Energy's 2009 rate case, the Commission included PSE's Wild Horse Expansion project in rate base.¹⁵ The Wild Horse Expansion project went into service 10 months after the end of the test period. PSE presented the adjustment using estimated costs, but Commission Staff presented a superior adjustment based on actual costs. The Commission expressly rejected PSE's use of estimates and accepted Staff's adjustment based on actual costs. The Commission compared the two approaches, finding PSE's approach deficient:

Staff's adjustment, based on actual data, meets the requirements of a pro forma adjustment used in historic test year ratemaking in terms of being known and measurable. *PSE's approach, using estimates, does not meet these requirements.*¹⁶

11. PacifiCorp's adjustments for its Jim Bridger upgrade and Merwin Fish Collector are based on projected costs and should be rejected.

IV. EXECUTIVE COMPENSATION

A. **PacifiCorp's Criticism of Using the Market Average for Compensation is Incorrect.**

12. Public Counsel based its adjustment to PacifiCorp's executive compensation and labor expense on the Commission's well-established standard of using the market average to set the

¹⁵ *WUTC v. Puget Sound Energy, Inc.*, Dockets UE-090704/UG-090705 (consolidated), Order 11, ¶ 232 (April 2, 2010).

¹⁶ *Id.* (emphasis added).

amount of compensation that should be included in rates.¹⁷ The undisputed evidence in this case demonstrates that, in aggregate, PacifiCorp pays its 25 highest paid employees above the market average.¹⁸ Despite this, PacifiCorp continues to argue that its compensation is commensurate with market rates and bases its argument on an intangible and subjective analysis that the Commission has previously rejected. PacifiCorp's argument that Public Counsel "failed to consider the specific value provided by the particular employee" misses the mark.¹⁹

13. In Docket UE-100749, the Commission stated that it only inquires into whether the compensation exceeds the market average, is unreasonable, and offers benefits to ratepayers. The Commission does not consider the specific value provided by any employee. The Commission expressly stated that it did not "wish to delve too deeply in to the Company's management of its human resources and the manner in which it determines overall compensation policy."²⁰ Evaluating a particular employee's worth to a utility is simply not relevant in determining whether that person's wages exceed the market average.

14. PacifiCorp further criticizes Public Counsel's analysis based on the market survey data used in developing its adjustment.²¹ This argument is interesting since Public Counsel used MarketPay.com, the market survey tool provided by the Company in discovery. PacifiCorp uses

¹⁷ *WUTC v. PacifiCorp, d/b/a Pacific Power & Light Co.*, Docket UE-100749, Order 06, ¶ 250 (March 25, 2011). See also, *WUTC v. Puget Sound Energy, Inc.*, Dockets UE-111048 and UG-111049 (consolidated), Order 08, ¶ 122 (May 7, 2012) (noting no dispute over the fact that PSE's compensation is consistent with the market average and citing Docket UE-100749, Order 06, ¶ 250).

¹⁸ Exh. No. EDW-5C CX at Column H (\$22,764). The calculation in Exh. No. EDW-5C CX is based on PacifiCorp's preferred comparison methodology. The Company agreed with this conclusion at the evidentiary hearing, as Public Counsel noted in its Initial Brief at ¶ 75.

¹⁹ PacifiCorp's Initial Brief at ¶ 141.

²⁰ *WUTC v. PacifiCorp, d/b/a Pacific Power & Light Co.*, Docket UE-100749, Order 06, ¶ 250 (March 25, 2011).

²¹ PacifiCorp's Initial Brief at ¶ 141.

MarketPay.com in setting the compensation for all employees other than its Named Executive Officers.²²

15. Public Counsel's adjustment conforms to the Commission's past rulings on compensation levels to be included in rates. As a result, the Commission should adopt Public Counsel's adjustment to reduce PacifiCorp's compensation to a level consistent with the market average.

V. INVESTOR SUPPLIED WORKING CAPITAL

A. The Commission Should Reject PacifiCorp's So-Called Refinements to the Investor Supplied Working Capital Method of Calculating its Working Capital.

16. In describing the Investor Supplied Working Capital (ISWC) method in Docket UE-100749, the Commission stated, "The ISWC method is a balance sheet approach of computing working capital; it is the net difference between current assets and current liabilities."²³ The Commission further noted that the method proposed by Staff involved a detailed analysis of PacifiCorp's assets and liabilities to determine the amount of working capital necessary.²⁴ In addition, the method also determines the source of the capital.²⁵ The Commission stated, "In operation, ISWC limits working capital to the amount provided solely by investors by systematically removing any non-investor provided working capital."²⁶ The Commission adopted the ISWC method proposed by Staff in Docket UE-100749.²⁷

17. Public Counsel's recommendation with respect to the Company's proposed changes to the ISWC calculation is consistent with Docket UE-100749. PacifiCorp argues that Public

²² Exh. No. EDW-3T at 8:10-12.

²³ *WUTC v. PacifiCorp d/b/a Pacific Power & Light Company*, Docket UE-100749, Order 06, ¶ 285 (March 25, 2011).

²⁴ *Id.*

²⁵ *Id.*

²⁶ *Id.*

²⁷ *Id.* at ¶ 296; Zawislak, TR. 467:21 – 468:2.

Counsel takes an overly simplistic view and that Public Counsel failed to analyze the primary accounting categories to properly determine what amounts constitute invested capital and what amounts constitute investments.²⁸ Contrary to the Company's assertions, Mr. Coppola did perform such an analysis when he evaluated the 45 general ledger accounts PacifiCorp proposes to either include or exclude from the working capital calculation. Mr. Coppola determined that many of the accounts at issue were long-term in nature, that most of them pertain exclusively to jurisdictions other than Washington, and that a number of the accounts were non-cash accounts.²⁹

18. Moreover, as Public Counsel discussed in detail in its Initial Brief, PacifiCorp has a negative working capital requirement with respect to its pension and other post-retirement benefit accounts, making a positive adjustment unreasonable and unnecessary.³⁰

19. Given the detailed analysis that occurred just a short while ago in Docket UE-100749, that the accounts at issue existed at the time Docket UE-100749 was being considered, and the detailed analysis performed by Mr. Coppola in this case, Public Counsel continues to recommend that PacifiCorp's "refinements" to the ISWC calculation be rejected.

VI. POWER COST ADJUSTMENT MECHANISM

A. **PacifiCorp is Experiencing Declining Variability in Power Costs and Changes in Power Costs are not due to Unusual or Extraordinary Events.**

20. A key area of disagreement among the parties concerns whether PacifiCorp is experiencing sufficient variability to justify a Power Cost Adjustment Mechanism (PCAM).

²⁸ PacifiCorp Initial Brief at ¶ 139.

²⁹ Exh. No. SC-1CT at 29:1-5.

³⁰ Public Counsel Initial Brief at ¶¶ 84-85.

PacifiCorp and Commission Staff both state that the Company is facing sufficient variability to justify a PCAM. Public Counsel and Boise White Paper disagree.

21. Commission Staff asserts that it calculated PacifiCorp's current variability at a level of \$67 million, compared to a variability of \$26 million calculated during the Company's 2006 rate case.³¹ However, closer analysis of PacifiCorp's variability shows that it is declining, and is likely to be limited going forward.³² The litmus test for variability is not simply a dollar amount, resulting in a finding of sufficient variability if the amount of total variability exceeds a certain level. The more important and telling measurement is the percentage of difference between the actual power costs and the amount imbedded in rates. In this case, the difference between PacifiCorp's actual power costs and the amount imbedded in its rates has dramatically declined in the last three years.

22. PacifiCorp uses a number of statements made by Mr. Coppola out of context. For example, PacifiCorp points to Mr. Coppola's analysis of its hedging adjustment as support for establishing sufficient variability *vis a vis* its PCAM proposal.³³ It is true that a PCAM is designed to address short-term variability. However, the data clearly shows that PacifiCorp has experienced muted short-term variability in recent years. The variability that causes dramatic differences in calculating the *projected* cost of a hedge does not translate into variability that justifies establishment of a PCAM. This is an apples to oranges comparison.

23. In declining to adopt a PCAM for PacifiCorp in Docket UE-050684, the Commission noted that PacifiCorp's proposal in its earlier case was not tailored to address short run cost

³¹ Commission Staff Initial Brief at ¶ 97, n.160; Exh. No. DCG-6CX.

³² Public Counsel Initial Brief at ¶¶ 93-96.

³³ PacifiCorp's Initial Brief at ¶ 104.

changes due to unusual or extraordinary events. The Commission noted that mechanisms approved for Puget Sound Energy and Avista were designed, in part, to address changes in power costs due to “unprecedented volatility in the energy markets” during 2000 and 2001.³⁴

The same is true in PacifiCorp’s current case: PacifiCorp has not demonstrated that its proposed PCAM is designed to address changes in power costs due to unusual or extraordinary events.

B. Deadbands and Sharing Bands are Critical Design Components to a PCAM.

24. A power cost adjustment mechanism should “achieve an appropriate balance between risks to customers and risks to utility shareholders.”³⁵ The Commission recognizes that deadbands establish the range of power costs for which shareholders bear the risk or receive the benefit from power cost variation.³⁶ Sharing bands balance the risks to customers and the risks to shareholders by allocating a certain percentage of the risk to each group. The risk being shared is the risk of power costs deviating *significantly* from the costs that are embedded in the utility’s rates,³⁷ not the risk that power costs may differ from the embedded costs. Indeed, some deviation is anticipated and expected.

25. PacifiCorp argues that deadbands and sharing bands are “poor regulatory policy.” However, as the Commission noted, deadbands and sharing bands are “useful mechanisms, not only to allocate risk, but to motivate management to effectively manage or even reduce power

³⁴ *WUTC v. PacifiCorp d/b/a Pacific Power & Light*, Docket UE-050684, Order 04, ¶ 92 (April 17, 2006). The requirement of unusual or extraordinary events indicates that a power cost adjustment mechanism is not meant to shield a utility from all volatility.

³⁵ *WUTC v. Puget Sound Energy, Inc.* Dockets UE-011570/UG-011571, Twelfth Supplemental Order, ¶ 22 (June 20, 2002).

³⁶ *WUTC v. PacifiCorp d/b/a Pacific Power & Light Co.*, Docket UE-050684, Order 04, ¶ 74 (April 17, 2006).

³⁷ See *WUTC v. Puget Sound Energy, Inc.* Dockets UE-011570/UG-011571, Twelfth Supplemental Order, ¶ 22 (June 20, 2002).

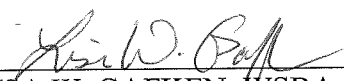
costs.”³⁸ The Commission should reject PacifiCorp’s argument and reaffirm its guidance on elements of a properly designed power cost adjustment mechanism.

VII. CONCLUSION

26. The Commission has a record before that justifies rejecting PacifiCorp’s requested rate increase. The Commission should set rates for PacifiCorp that are fair, just, reasonable, and sufficient, and in doing so, the Commission should adopt the recommendations of Public Counsel as described above and in Public Counsel’s Initial Brief.

27. DATED this 11th day of October, 2013.

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³⁸ Public Counsel’s Initial Brief at ¶ 99 (citing *WUTC v. PacifiCorp d/b/a Pacific Power & Light Co.*, Docket UE-050684, Order 04, Docket UE-050412, Order 03, ¶ 96 (April 17, 2006)).