BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Petition of PacifiCorp dba PACIFIC POWER & LIGHT COMPANY For an Accounting Order Authorizing Deferral of Excess Net Power Costs	Docket No. UE-020417

PACIFICORP'S POST-HEARING BRIEF

CONFIDENTIAL PER PROTECTIVE ORDER IN WUTC DOCKET NO. UE-020417

April 11, 2003

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I. INTRODUCTION

This proceeding involves a modest request for rate relief by PacifiCorp within the context of a 5-year Rate Plan agreed upon in June 2000 and adopted by the Commission in August 2000. The Rate Plan was intended to produce relatively stable rates for the Company's Washington customers through 2005, with the Company limited to rate increases of 3% in 2001, 3% in 2002 and 1% in 2003. At the time the Rate Plan was entered into and approved, it was anticipated that the Rate Plan would achieve just and reasonable rates for the Company over the term of the Rate Plan.

In fact, however, the Rate Plan has resulted in dismal financial statistics for the Company's Washington operations. The Western energy crisis of 2000-2001 was the single largest cause of the deterioration in the Company's financial position—the Company's actual power costs during the crisis were $1 billion higher than the level recovered in rates, resulting in credit downgrades for the Company and significant requests for rate relief in the other jurisdictions. Larsen, Ex. 1C at 14-17; Tr. 159. As the Commission itself has recognized, the energy crisis resulted in electric utilities throughout the West facing unprecedented volatility and high prices in the wholesale markets.[1] In Washington, the Company lived up to the terms of the Rate Plan and bore the consequences, incurring power costs that were $98 million higher than the level reflected in rates.[2] Larsen, Ex. 1C at 9. While prices more recently have returned to more normal levels, as measured by historical standards, the lingering effects of the Western

[1] In *Avista Utilities*, Docket No. UE-011595, the Commission described the "extraordinary circumstances" due to the "[h]ighly perturbed conditions in Western wholesale power markets during 2000 and 2001" (Fifth Supplemental Order at ¶ 28) In a previous *Avista* decision, the Commission observed that "western wholesale power markets have exhibited, over the past eighteen months, prices and price volatility that are unprecedented in anyone's experience." (Docket No. UE-010395, Sixth Supplemental Order at ¶ 5).

[2] Assuming a baseline level of power costs of $486 million from Docket No. UE-991832 which, as discussed below, is a conservative starting point for purposes of measuring "excess" net power costs.

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energy crisis continued into the Deferral Period proposed by the Company in this case.[3] More important, the Western energy crisis stripped the Company of its ability to absorb the normal, more routine cost increases in the months and years remaining in the Rate Plan Period. As a result, the Company's current rates in Washington are clearly inadequate and non-compensatory, and will continue to worsen through the end of the Rate Plan Period.

In response, the Company is proposing very limited relief in this proceeding. Rather than filing a full general rate case to re-open the Rate Plan and reset rates at a level that achieves a reasonable return, the Company is seeking to defer about $15.9 million in excess net power costs and recover them by offsets against existing credits on customers' bills over the next two years. The result is a modest increase of 4.6% in customers' bills, which would be achieved without changing base rates. With this limited relief requested by the Company, the ROE for Washington operations would still fall far short of reasonable levels through the end of the Rate Plan Period. But the proposal would preserve for customers the primary benefit of the Rate Plan—relative rate stability—even in the face of the most tumultuous period in the electric utility industry in the Western United States, when other utilities in Washington and throughout the West were forced to impose double-digit percentage increases.

The opposing testimony in this case fails to offer any basis—factual, legal or policy—that provides a sound rationale for rejecting the Company's proposal. None of the parties offers any evidentiary presentation to refute the Company's financial testimony. Rather, the opposing testimony raises the following points (to which the Company responds as follows):

[3] June 1, 2002 through May 31, 2003.

Argument	Company Response
A "deal is a deal" and the Company must comply with the Rate Plan.	The Commission has a statutory responsibility to set rates that are fair, just, reasonable and sufficient, and has the authority to re-open the Rate Plan on its own motion, if necessary.
PacifiCorp's Washington-only results are irrelevant, because financing is obtained on a Total Company basis.	Each state in which the Company operates sets rates on the basis of that state's operating results. Washington customers should not be subsidized by the substantial rate relief the Company has obtained in other jurisdictions.
PacifiCorp's Washington-only results are unreliable because they are based upon an un-approved cost allocation methodology.	Issues surrounding cost allocation methods do not prevent an evaluation of the Company's Washington financial results. The Modified Accord approach used in the Company's filing has been used in recent Commission decisions, and other reasonable allocation methods do not have any material effect on the Company's financial results.
Power costs can't be measured against a "baseline" that was not approved by the Commission.	The baseline proposed to be used by the Company for measuring power cost deferrals is very conservative, as it assumes the Company was granted ***all*** the relief requested in the 1999 Rate Case. A *lower* baseline, which would reflect the more reasonable assumption that some of the power costs were disallowed, would result in *higher* deferrals.
PacifiCorp failed to make "simultaneous" filings for relief in Oregon and Utah.	The Company has received substantial relief in Oregon and Utah in connection with the impacts of the Western energy crisis, and the Company should not be penalized for 'missing the opportunity" to seek what would likely have been a substantial interim rate increase under Section 11 of the Rate Plan.
PacifiCorp failed to file for interim relief in the context of a general rate filing, which is required by Section 11 of the Rate Plan.	The relief sought by PacifiCorp in this filing is much more limited than what it is authorized to seek under Section 11. The Company should not be punished for (1) substantially paring its request, and (2) fulfilling the purpose of the Rate Plan by avoiding a general rate filing.

As discussed further below, these opposing arguments avoid, rather than address, the Company's undeniable and compelling testimony regarding its poor Washington financial results. The Company has made the necessary showing in this proceeding to justify granting the limited relief it is requesting. On the other hand, in the event the Commission determines that relief cannot be granted without a more thorough examination of the Company's Washington

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results, an alternative remedy would be to authorize the Company to file a general rate case later this year.

II. PROCEDURAL BACKGROUND

On April 5, 2002, PacifiCorp filed its petition for an order authorizing deferral of excess net power costs incurred by the Company in serving its Washington customers as a result of the Western energy crisis. The Company proposed to defer excess net power costs beginning two months after the filing, beginning June 1, 2002, and to continue the deferrals through May 31, 2003 or until such time as the Commission approved some form of rate recovery for the deferrals.

On May 13, 2002, Commission Staff ("Staff"), Industrial Customers of Northwest Utilities ("ICNU"), Public Counsel, Northwest Energy Coalition ("NWEC") and the Energy Project filed a Motion to Consolidate and Petition to Rehear or Reopen Docket No. UE-991832, the Company's last general rate case.[4] On August 21, 2002, the Commission denied the motion to reopen as untimely and denied the motion to rehear because it was premature to determine whether sufficient circumstances exist to justify rehearing the general rate proceeding.

At the prehearing conference on August 6, 2002, parties questioned the Commission's authority to establish a deferred account effective as of June 1, 2002 and presented differing views on the scope of the proceeding. Administrative Law Judge Dennis J. Moss requested briefing on those issues.

On September 27, 2002, the Commission issued its Third Supplemental Order Regarding Scope of Proceeding and Threshold Legal Issues. The Order indicated that the scope of the proceeding would be limited to the deferral request and directed PacifiCorp to file its proposal to recover the deferred power costs "in the very near future." The order also established that the

[4] NWEC and the Energy Project did not intervene in this docket and are not formally parties to this case.

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Commission had the legal authority to commence deferrals as of June 1, 2002, upon a showing by the Company that such deferrals were warranted.

On October 18, 2002, PacifiCorp filed its direct case, including testimony and exhibits of Jeffrey K. Larsen, Mark T. Widmer, Steven R. McDougal and William R. Griffith. The Company included tariff sheet revisions that reflect the Company's proposal for cost recovery of any excess net power costs authorized for deferral in this proceeding. This tariff filing was suspended in the Commission's Fifth Supplemental Order issued December 9, 2002.

On February 5, 2003, Staff and ICNU prefiled direct testimony and exhibits. Public Counsel did not file any testimony or exhibits. PacifiCorp filed the rebuttal testimony and exhibits of Jeffrey K. Larsen and Mark T. Widmer on February 26, 2003.

Hearings on this matter were conducted on March 20, 21, and 24, 2003 before Judge Moss and Chairwoman Showalter, Commissioner Hemstad and Commissioner Oshie.

III. ARGUMENT

A. The Company Has Established A Need for Rate Relief in Accordance with the Provisions of the Rate Plan.

1. The Rate Plan Allows the Company to Obtain Rate Relief Upon a Showing of Financial Distress.

In PacifiCorp's most recent general rate case in Washington (Docket No. UE-991832) (the "1999 Rate Case"), the Company requested a rate increase of $25.8 million (approximately 15 percent) and proposed $486 million for its level of annual net power costs. Widmer, Ex. 57C at 2-3. The Company used the Modified Accord allocation method as the basis for its case. Larsen, Ex. 8 at 12. The issues in the 1999 Rate Case were settled pursuant to a Stipulation among the parties executed on June 16, 2000 (the "Rate Plan"). Among other issues, the Rate Plan permitted incremental changes in the Company's base rates during a rate plan period beginning on the date the Commission approved the Rate Plan through December 31, 2005 (the "Rate Plan Period"). Ex. 2 at 2-3. In accordance with the Rate Plan, the Company's base rates increased by 3.0 percent effective as of September 1, 2000, by 3.0 percent on January 1, 2002,

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and by 1.0 percent on January 1, 2003. Larsen, Ex. 1C at 4. Except for the enumerated rate changes, the Rate Plan generally precluded other changes to the Company's base rates until the end of the Rate Plan Period. Ex. 2 at 3.

The Rate Plan allows the Company to make certain filings during the Rate Plan Period. Relevant to this proceeding, Section 9 of the Rate Plan permits the Company to submit "petitions for accounting orders, as appropriate, for treatment of … expenditures during the Rate Plan Period." Ex. 2 at 7. In addition, Section 11 of the Rate Plan allows the Company to obtain interim rate relief, upon meeting the following conditions:

> A general rate case filing during the Rate Plan Period may be made by the Company (or on the motion of the Company or any Party), in the event of the following:
>
> a. Interim rate relief is warranted under the six-part standard adopted by the Commission in *WUTC v. Pacific Northwest Bell Telephone Company*, Cause No. U-72-30 (October 1972), and the Company is requesting similar rate relief in its two largest retail jurisdictions … .

Ex. 2 at 7. On August 9, 2000, the Commission issued the Third Supplemental Order Approving and Adopting Settlement Agreements; Rejecting Tariff Sheets; Authorizing and Requiring Compliance Filing in that case. The Commission approved the Rate Plan.

2. The Rate Plan Has Failed to Produce Acceptable Financial Results for the Company's Washington Operations.

The Rate Plan was expected to produce rates over its term that are fair, just, reasonable and sufficient. Ex. 2, Section 1.b at 2. In fact, however, the Company's Washington earnings are severely depressed. The two years following adoption of the Rate Plan were probably the most tumultuous in the history of utility ratemaking in the western United States. Beginning in May 2000, wholesale power prices dramatically spiked and displayed unprecedented volatility and unpredictability. The energy crisis "drastically disrupted" the power markets throughout the western United States during this time. As a result, the risks to utilities and their customers

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"increased beyond anyone's expectation." *Re Avista Corporation dba Avista Utilities*, Docket No. UE-010395, Sixth Supplemental Order (Sept. 24, 2001) at ¶ 5.

Abnormally poor hydro conditions combined with the extended outage at the Company's Hunter No. 1 generating unit exacerbated the crisis for PacifiCorp. Larsen, Ex. 1C at 5. Unanticipated rule changes adopted by the Federal Energy Regulatory Commission ("FERC") in June 2001 and the resulting market price decreases further compounded the Company's losses. *Id.* Because of forward purchases prior to the FERC price cap order, the Company's net power costs did not decline after the 2001 FERC order to levels experienced prior to the power crisis. Widmer, Ex. 57C at 5. These effects continue to be felt by the Company, along with the impacts of other cost increases, and are reflected in the Company's costs during the Deferral Period. *Id.*

In the past two and one half years, PacifiCorp fulfilled its commitments under the Rate Plan despite these skyrocketing power costs, as mentioned above in the Introduction. Of the $1 billion in higher power costs incurred on a Total Company basis, the Company received approval to recover roughly one quarter of that amount from its other jurisdictions. *Id.* As Mr. Widmer testified, the Company's projected power costs are vastly different than the $486 million of annual net power costs included in the Company's 1999 Rate Case. Larsen, Ex. 1C at 3; Widmer, Ex. 57C at 2. As a result of these dramatically higher power costs, the Company's expected financial returns for the remainder of the Rate Plan Period are grossly inadequate. These unexpected expenditures have stripped the Company of its ability to absorb additional cost increases.

Moreover, the Transition Plan savings contemplated to occur as a result of the Company's merger with ScottishPower have been insufficient to offset the additional cost increases faced by the Company. The Rate Plan contemplated that the savings to be produced by implementing the Transition Plan during the Rate Plan Period would offset increases in other areas, thereby allowing the Company to achieve reasonable financial results during the Rate Plan Period. Larsen, Ex. 1C at 6. Thus, the following language was included in the Rate Plan:

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> The rate plan covers a period of significant transition for the Company. The rate plan recognizes the difficulty of setting rates during this transitional period, and provides the Company with an opportunity to earn reasonable returns, on balance, over the Rate Plan Period. At the same time, customers are provided predictable and relatively stable rates for the Rate Plan Period.

Ex. 2 at 2. As Mr. Larsen testified, however, although the Company achieved savings at the level anticipated in the Transition Plan, unanticipated increases in costs in other areas offset the transition savings.[5] Ex. 1C at 6; tr. 265-66. These increased costs therefore thwarted an essential purpose of the Rate Plan to allow the Company to earn a reasonable return. *Id.* The Transition Plan savings are insufficient to offset the additional cost increases, as earnings continue to deteriorate.

3. The Company Has Demonstrated Gross Inequity, as Required by the *PNB* Interim Rate Standards.

In its direct testimony, the Company made the necessary showing to address the *PNB* interim rate standards, as required by Section 11 of the Rate Plan. The six-part standard consists of the following considerations:

> 1. This Commission has the authority, in proper circumstances, to grant interim relief to a regulated utility; this should be done only after an opportunity for an adequate hearing.
>
> 2. An interim increase is an extraordinary remedy, and should be granted only where an actual emergency exists or where relief is necessary to prevent gross hardship or gross inequity.
>
> 3. The mere failure of a utility's currently-realized rate of return to equal the rate of return previously authorized to the utility by this Commission as adequate is not sufficient, standing alone, to justify a grant of interim relief.
>
> 4. The Commission should review all financial indices as they concern the applicant, including the rate of return, interest coverage, earnings coverage, and the growth, stability, or deterioration of each, together with the immediate and short-term

[5] The transition plan savings actually achieved by the Company are reflected in Mr. McDougal's exhibits. Tr. 295.

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> demands for new financing and whether the grant or denial of interim relief will have such an adverse effect on financing demands as to substantially affect the public interest.
>
> 5. In the current economic climate the financial health of a utility may decline very swiftly, and interim relief stands as a useful tool in an appropriate case to stave off impending disaster. This tool, however, must be used with caution, and it must be applied only in cases where the denial of interim relief would cause clear jeopardy and detriment to its ratepayers and its stockholders. This is not to say that interim relief should be granted only after disaster has struck or is imminent, but neither should interim relief be granted in any case where full hearing can be accomplished and the case in chief resolved without clear jeopardy to the utility.
>
> 6. As in all matters before this Commission, we must reach our conclusion while keeping in mind the statutory charge to this Commission that we must "regulate in the public interest." This is our ultimate responsibility and a reasoned judgment must give appropriate weight to all relevant factors.

WUTC v. Pacific Northwest Bell Telephone Co., Cause No. U-72-30, Second Supplemental Order Denying Petition for Emergency Rate Relief (Oct. 10, 1972) at 13.

As Mr. Larsen testified, the Company is not claiming an "actual emergency" with respect to its Washington operations, but that "gross inequity" exists given the Company's existing and projected financial condition in Washington. Tr. 157. To address the *PNB* interim rate standards, the Company's direct testimony included the following financial data:

Return on Equity: The most recent actual results of operation show a return on equity of 1.31%, after normalizing and restating adjustments.[6] Ex. 46 After annualizing and pro forma adjustments, this figure rises to 6.9%, which reflects the support provided by the 3%, 3% and 1% increases through the first three years of the Rate Plan. This figure also excludes the impact of the excess power costs for which shareholders have borne the full burden. Without annual

[6] Identified as "Type 1 Adjustments" on Exhibit 46, and explained in note (1) on that exhibit.

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ongoing increases in the later years of the Rate Plan, however, "the returns deteriorate significantly." Larsen, Ex. 1C at 10. [REDACTED]

Pre-tax Interest Coverage: Pre-tax interest coverage levels based on Washington operations also show a steady rate of decline throughout the Rate Plan Period. Coverage starts out at an unacceptably low level—Larsen, Ex. 1C at 12-13; Ex. 4C.

Cash Flows: The Company's cash flows on a Washington basis also diminish over time. While cash flows are slightly positive in fiscal year 2003 [REDACTED], they drop precipitously into negative results during the remaining years of the Rate Plan Period, with the [REDACTED]. Larsen, Ex. 1C at 13; Ex. 5C.

Capital Expenditure Requirements: The Company's capital expenditure requirements for the duration of the Rate Plan Period are significant. Exhibit 55C shows the forecasted capital expenditures for fiscal years 2003 through 2006, [REDACTED]. Larsen, Ex. 1C at 14; Ex. 55C As a result of increasing load, new generation facilities are being added to the Company's system. During the same time period, the Company will need to spend an average of $7.3 million per year to meet federal Clean Air Act requirements. McDougal, Ex. 50C at 7. Hydro licensing capital expenditures associated with the Lewis River projects in Washington are expected to be between $4 million to $5 million each year from fiscal year 2003 through 2006. Id. at 8.

Access to Capital: With such results and anticipated costs, the Company would not be able to access credit on reasonable terms if it relied solely on the Company's Washington results of operations. Larsen, Ex. 1C at 15. The benchmarks used by Standard & Poor's suggest that

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the Company's credit rating based on these figures is "BB" or below investment grade. *Id.* at 13. With such junk bond status, the Company would be hard-pressed to obtain credit on reasonable terms, if at all. *Id.* at 15. Even on a total Company basis PacifiCorp's ratings have declined. The Company is rated Baa1 by Moody's Investor's Service. *Id.* at 14. In November 2001, Moody's lowered the debt rating on PacifiCorp's senior secured debt from A2 to A3, citing the "weaker financial condition at PacifiCorp, caused, in large part, by above market purchase power costs incurred by PacifiCorp which surfaced from a very volatile wholesale power market in the west." Standard & Poor's, for its part, downgraded the Company's ratings to A- (long-term) and A-2 (short-term) because of the uncertainty surrounding the amount of refunds for excess power costs that may be allowed by various regulators in the United States and the potential for continued volatility in the Company's service area. *Id.* at 15.

The Company's case satisfies the *PNB* interim rate standard. First, the parties have had an adequate opportunity for hearing during this proceeding. Second, the Company has described the gross inequity that it is experiencing as a result of the effects of the Western energy crisis and the constraints of the Rate Plan. Third, the Company's case is based on more than a mere inability to achieve its authorized rate of return, but addresses pre-tax interest coverage issues and the impact on credit rating which, in turn, affects the Company's ability to access capital on reasonable terms. Fourth, as described above, the Company presented its case regarding its financial condition. Fifth, the Company has shown that without relief, its results of operations in Washington would continue deteriorating, with cash flow becoming increasingly negative for the remainder of the Rate Plan Period. Larsen, Ex. 8 at 4. Last, the requirement to "regulate in the public interest" is served by preserving the financial stability of electric utilities providing essential services in the state of Washington, as the Commission stated in its *Avista* order:

> The Company's obligation is to provide an essential service—electricity—to customers in its service territory. We regulate the Company to ensure that rates charged to customers are fair, just, and reasonable, and that those rates are sufficient for the

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utility to maintain financial viability and the capability to fulfill its obligation. *The public interest is served when the interests of the utility and the interests of the utility's customers are kept in careful balance.* We cannot, and we will not, ignore *the importance for customers of maintaining the financial stability of the Company.*

Avista Corp. d/b/a Avista Utilities, Docket No. UE-010395, Sixth Supplemental Order (Sept. 24, 2001) at ¶ 7. In PacifiCorp's case, the interests of the Company and its Washington customers are seriously out of balance, and it threatens the financial integrity of the Company's Washington operations. This filing is intended to make modest movement toward restoring that balance.

4. The Commission Should Grant the Limited Relief Requested by the Company in this Proceeding.

The Company asks the Commission to authorize the Company to establish a deferral account to track its excess net power costs over a defined period. The Commission considers applications for deferred accounting pursuant to its general ratemaking authority, and has allowed deferral accounts to be created in instances where extraordinary events arise such that costs are greater than originally anticipated when rates last were set.[7] In addition, Section 9 of the Rate Plan explicitly recognizes that the Company may file petitions to establish deferral accounts.[8] Ex. 2 at 7. The deferral account would measure the difference between actual net power costs and the level included in rates for a one year period from June 1, 2002 through May 31, 2003.[9] The Deferral Period captures, among other things, the effects of the forward

[7] For example, the Commission approved Avista Utilities' request for a deferred accounting mechanism that allowed Avista to defer certain increased costs related to its power supply in Docket No. UE-000972. The Commission also authorized Puget Sound Energy's request to defer a portion of its electric energy supply costs. *Re Puget Sound Energy*, Docket No. UE-011600, Order Granting Accounting Petition (WUTC Dec. 28, 2001).

[8] Staff's contention that this deferred accounting request is not permitted by Section 9 of the Rate Plan is without merit. Staff is connecting two unrelated sentences in Section 9 in order to achieve its interpretation. As discussed in Mr. Larsen's rebuttal testimony (Ex. 8 at 20), Staff's restrictive interpretation of Section 9 is incorrect.

[9] Excess net power costs are determined monthly and are derived by subtracting the Company's base net power costs ("BNPC") from actual net power costs ("ANPC"), multiplied

(continued…)

purchases for Summer 2002 made by the Company in Spring 2001 before the FERC price cap order took effect.[10] Larsen, Ex. 1C at 20.

With respect to rate recovery of deferred amounts, the Company proposes to recover deferrals by netting them against the balances in the Centralia and Merger credit accounts.[11] The Company proposes to modify Schedule 97, Adjustment Associated with the Sale of Centralia ("Centralia Credit"), and Schedule 99, Credit from ScottishPower ("Merger Credit"), to suspend the amounts currently being credited on customer bills. Griffith, Ex. 90 at 2. Any excess amounts would be retained in the deferred account and addressed in the Company's next general rate filing in Washington if small in amount or recovered through a surcharge that would continue until the deferral account balance reached zero. *Id.* at 3. A surcharge equal in amount to the credits would achieve the same result. As discussed more fully in Section III.D below, there are other options as well for addressing the Company's current financial situation in Washington.

In the Company's view, it is seeking a more limited form of rate relief than it is authorized to seek under Section 11 of the Rate Plan. Under that provision, the Company *could* have filed a full general rate case that would reset rates to achieve a full return on equity. The relief requested here is more narrow and provides a minimum amount of relief needed for the

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(…continued)
by the Washington load deemed in rates. Widmer, Ex. 57C at 2. Base net power costs are the costs currently reflected in rates, and are equal to the monthly net power cost, consisting of purchased power, wheeling and fuel expenses less special sales revenue, divided by the monthly net system load in rates. *Id.*

[10] The Company is not proposing a sharing mechanism with respect to deferred amounts given (1) the limited amount of deferrals ($15.9 million), (2) that the Company has already borne $98 million of excess power costs allocable to Washington (Tr. 144), and (3) no incentive is necessary given that most of the Deferral Period has already passed. (Tr. 226)

[11] The Commission established the Centralia credit in Docket No. UE-991262 for customers to receive a portion of the gain from the sale of the Centralia plant. As a condition to the merger of PacifiCorp with ScottishPower in Docket No. UE-981627, the Commission
(continued…)

Company to get through the end of the Rate Plan Period, while still preserving the basic feature of the Rate Plan to avoid a general rate increase. The Rate Plan may continue otherwise unchanged for the duration of the Rate Plan Period for the benefit of the Company's Washington customers. Mr. Larsen stated the Company's request succinctly, as follows:

> "[W]e're trying to find an easy mechanism to deal with the financial hardship and the gross inequity that the company has suffered as a result of the rate plan and putting forward a deferred accounting mechanism to seek limited relief on an interim basis through the use of the merger credits, the Centralia credit, to offset the cost. If the Commission finds that that isn't appropriate, then we have proposed as an alternative that we reopen the rate plan, that we would file a general rate case and establish new rates. And whether the Commission deems that those go in as an interim basis from this hearing until the general rate case is filed and the full costs are reviewed, the company is just looking for some mechanism and level of relief."

Tr. 137-38. Whether this relief is characterized as "interim" should not be determinative of the treatment accorded. In the Commission's September 2001 *Avista* order granting temporary rate relief, for example, the Commission indicated some flexibility was appropriate in addressing a utility's financial needs:

> "Were we to concern ourselves unduly with form, we would hamper our flexibility and our ability to address the very real substance of the problem before us.
>
> This is not to say that we should ignore the well-established principles that are a familiar part of the ratemaking process. Rather, we should look to these principles for guidance, while being sufficiently flexible, adaptive, and creative to meet the financial crisis Avista faces while protecting the Company's ratepayers, to the extent possible, from severe rate shock.
>
> . . . .

(…continued)
required the Company to provide a merger credit of $3 million per year for four years commencing January 1, 2001. Larsen, Ex. 1C at 20.

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> We agree that form should follow function, not the reverse. Our function here is to determine whether Avista has sufficiently supported its claim for immediate relief. We do not regard this case as a request for interim relief as that term traditionally is used in utility ratemaking. . . . Under the extraordinary circumstances of this case, the usual labels that describe various forms of rate relief, and the constraints the use of such labels might imply, are more of an impediment than an aid to reasoned decision making."

Docket No. UE-010395, Sixth Supplemental Order, ¶¶ 21, 22, 26. While the Company in this case is not claiming the sort of financial emergency that faced Avista at that time, the Company is in a similar situation to the extent its proposal in this case is being criticized for not strictly falling within one category or another. The Company is hopeful that the Commission will exercise similar flexibility and creativity in evaluating the Company's proposal in this case.

B. The Barriers Raised by Other Parties Do Not Provide a Basis for Denying Rate Relief.

As noted above in the Introduction, in response to the Company's thorough presentation regarding its financial condition in Washington, Staff and ICNU have raised a number of issues which they claim preclude the Commission's consideration of rate relief to the Company. These issues include: (1) interjurisdictional cost allocations, (2) the use of Washington-only financial data, (3) the absence of an adopted "baseline" level of power costs in the 1999 Rate Case, and (4) the requirement under Section 11 of the Rate Plan for "simultaneous" requests for similar relief in Utah and Oregon. As discussed below, these "barriers" do not provide a basis for denying rate relief in this proceeding.

1. Interjurisdictional Cost Allocation Issues Do Not Provide a Basis for Denying Rate Relief.

Staff uses the absence of an "approved" cost allocation methodology in Washington as the basis to deny relief to the Company in this proceeding. According to Staff, the Company's Washington costs cannot be reasonably determined unless and until the Commission approves an allocation methodology that is agreed upon by the states in which PacifiCorp operates. Martin, Ex. 125 at 14. Staff states that "there is no allocation methodology that Staff would support at

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this time" although it is potentially amenable to alternative allocation methodologies being considered in the Company's Multi-State Process ("MSP"). Ex. 118. Thus, Staff concludes that it is impossible to evaluate the Company's financial condition in this case.

The "controversy" regarding cost allocation methodologies does not provide a basis for denying rate relief in this proceeding. As discussed below, Staff has been able to process the Company's filings in the past, even in the absence of an "approved" cost allocation methodology. Second, Staff exaggerates the "problems" associated with the Modified Accord methodology used by the Company in this filing. Third, using other reasonable allocation methods does not materially affect the Company's financial picture, which under any scenario shows a compelling need for rate relief.

a. Using Allocation Methods as a "Barrier" is Inconsistent with Prior Proceedings.

The absence of an "approved" cost allocation methodology in Washington has not previously prevented the evaluation of the Company's financial results, nor has it prevented the processing of the Company's filings in Washington. The Company consistently uses Modified Accord in five of the six states in which it operates, including Washington.[12] Indeed, the Company's Washington results of operations that it periodically files with the Commission are based on Modified Accord. The Commission never rejected any of those filings. Tr. 595. And Staff never complained that the results of operations should be rejected due to the use of the Modified Accord methodology.[13] Tr. 596-597.

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[12] Utah adopted a "rolled in" approach. But the Utah "rolled in" approach has no impact on this filing because the Company used the Modified Accord allocation method to compute the Washington results and assumed all jurisdictions use the same allocation method No costs are shifted to other jurisdictions as a result of Utah using a different allocation method. Rather, the Company's shareholders sustain the burden of all costs that are not fully allocated. Larsen, Ex. 8 at 16.

[13] Mr. Larsen also discussed a December 1996 letter from Staff regarding the Company's results of operations filing in which a number of issues are identified, none of which related to the Company's used of the Modified Accord methodology. Tr. 281.

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Importantly, Staff faced the same issue of unresolved allocation methodologies in the 1999 Rate Case. Larsen, Ex. 8 at 9. There, Commission Staff admitted that it never supported or opposed the Modified Accord allocation method in the 1999 Rate Case.[14] Martin, Ex. 125 at 7. Yet Staff concedes that Modified Accord was the "foundation of [Staff's] analysis on a preliminary basis" in that case. Tr. 455. In any event, even in the absence of an approved allocation methodology, Commission Staff determined that it had a basis for determining that the Rate Plan would result in "rates for the Company that are fair, just, reasonable and sufficient throughout the Rate Plan Period." Ex. 2, Section 1.b; Tr. 454, 600. There is no cognizable distinction between the Company's presentation of its financial condition in the 1999 Rate Case and the instant proceeding. If Staff could reach a finding in the 1999 Rate Case regarding the justness and reasonableness of the Company's rates without an approved cost allocation methodology, there is nothing preventing Staff from following the same approach and reaching *some* determination on the adequacy of the Company's rates in this filing.

As Mr. Martin conceded, Modified Accord was used in Docket No. UE-000969 to determine Washington's allocation of costs associated with the Company's Voluntary Enhanced Early Retirement Program and Employee Severance Program. Tr. 615. There, Commission Staff recommended that the Commission grant the deferred accounting petition without

[14] It is curious that Staff takes the position in this proceeding that the Rate Plan was intended to give the Company an opportunity to solve the cost allocation problem, and thus cost allocations were an issue that needed to be resolved during the Rate Plan Period. Elgin, Ex. 101 at 11. There was no mention of this issue either in the Rate Plan Stipulation (Ex. 2), the Staff testimony to the Commission when the Stipulation was presented (Ex. 44, tr. 453), or in the Commission's Order approving the Stipulation. (Third Supplemental Order, Docket No. UE-991832) It is even more confounding to take this position when it is considered that Staff initially frustrated the Company's attempts *since* the 1999 Rate Case to solve the cost allocation "problem," including moving to dismiss the Company's Structural Realignment Proposal, or SRP, filing (tr. 464) and opposing the Commission's participation in the Multi-State Process (tr. 466). Staff admits that had its recommendation been followed with respect to dismissing SRP and not participating in MSP, the Company would have been unable to solve the cost allocation problem during the Rate Plan Period. (Tr. 470)

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challenging the allocation methodology. Ex. 111 at 2. In fact, the Staff memo at page 1 refers to a "Washington allocation" of approximately 8.7%, which is based on the Modified Accord. Tr. 615. Mr. Martin acknowledged that there is no alternative allocation method because the last filing that used an accepted allocation methodology was the Company's general rate case in 1986, before the merger between PacifiCorp and Utah Power. Tr. 619-620.

Therefore, Staff's claim in this proceeding that this issue prevents an analysis of the Company's financial situation in Washington is clearly contradicted by Staff's previous practices, as well as Commission decisions. The lengthy and consistent track record in Washington is that cost allocation issues have not prevented the analyses and processing of the Company's previous filings.

b. The Modified Accord Method Provides a Reasonable Basis for Proceeding in this Case, Until Another Method is Adopted.

The use of Modified Accord is appropriate for purposes of this proceeding, and should be used as the basis to evaluate the Company's filing. Staff's complaints regarding the allocation methodology are exaggerated and, in many cases, are just plain incorrect. Staff identified three so-called "flaws" in the Modified Accord methodology: (1) cost allocation related to load growth; (2) system-wide allocation of special contracts; and (3) allocation of taxes. Martin, Ex. 125 at 8-9.

As to the first, Staff states that the "key flaw" of the Modified Accord methodology is that the methodology fails to recognize costs caused by "consistently disparate load growth in jurisdictions the Company serves." *Id.* at 8. Staff inflates this issue. In fact, the allocation factors change over the period shown in the Company's analysis to reflect changes in each jurisdiction's allocation percentage over time. Tr. 306. Staff, in contrast, assumed that the allocation factors did *not* change over time as each state's share of the Total Company load changes. Tr. 543. Furthermore, Washington's load growth has contributed to the Company's

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total system needs, in most years outpacing other jurisdictions and growing faster than the total Company's system. Tr. 606; Ex. 9 at 1.

Staff's second concern relating to system-wide allocation of special contracts also is a non-issue. As Mr. McDougal testified, all special contracts have been allocated to their home states. Ex. 50C at 5. Staff acknowledged its error in this regard because it was unaware that the Company policy changed to no longer enter into special contracts. Tr. 608. None of the costs or revenues associated with special contracts in other states were assigned to Washington, and the Company adjusted the allocation factors accordingly. Larsen, Ex. 8 at 15. Because the results presented in this case exclude the impact of special contracts on this basis, Staff's concern about the Company's results must be disregarded.

Staff's third concern relating to allocation of taxes is misplaced. PacifiCorp pays the Washington Public Utility Tax and allocates this tax pursuant to Modified Accord. For the fiscal year ended March 31, 2002, the Company paid $6.7 million in Public Utility Tax to Washington and allocated the amount to all jurisdictions. Larsen, Ex. 8 at 16. If this amount were not allocated on a system-wide basis, then the full amount would be included in the Washington results of operations. Tr. 610-611. In contrast, under Modified Accord only about $2.7 million is included in Washington results of operations. Larsen, Ex. 8 at 16. Modified Accord allocation actually produces a *benefit* for Washington customers because it allocates approximately $4 million *less* in taxes to Washington than if the taxes were situs-assigned. *Id.* at 15.

c. The Particular Allocation Methodology Chosen Does Not Have any Material Effect on the Company's Financial Showing in this Case.

Using other cost allocation methods to determine the Company's Washington costs results in no material variation in the financial results. For example, the PITA Accord method shows that the returns on equity are slightly higher, but the Company's earnings through the

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remainder of the Rate Plan Period fall far short of the allowed returns.[15] Larsen, Ex. 8 at 9-10. As an additional exercise, the Company modeled the "Idaho approach" – a cost allocation method being considered in MSP that Staff "believes to be potentially acceptable." Martin, Ex. 125 at 13. The Idaho approach divides the Company according to the eastern and western control areas. Preliminary analysis of this cost allocation approach suggests a slight revenue requirement increase for Washington – about 0.3 percent – as compared to the Modified Accord methodology. Thus, under this potentially acceptable approach, the indicated financial performance for the Company would be essentially the same as that suggested under the Modified Accord method.[16] Larsen, Ex. 8 at 10.

This case is not about allocation methodologies. Nor should it be. The Company has used Modified Accord in all its recent filings with the Commission. In addition, the MSP process, with Staff input and the participation of representatives from all of the Company's jurisdictional state commissions, is developing a new allocation scheme that represents a durable solution to the allocation methodology issue. Until that process produces a suitable replacement for Modified Accord, this allocation method continues to be a reasonable basis for purposes of evaluating the Company's filing in this proceeding.

[15] As discussed by Mr. Larsen, the PITA Accord method contains a "fatal flaw" in that the mechanism "grows" the hydro endowment for the Pacific states, even though that growth was not in fact occurring. Tr. 260.

[16] Mr. Larsen examined "reasonable" cost allocation methodologies for purposes of his discussion, which considered approaches that have the likelihood of being accepted by the states in the Multi-State Process. Tr. 263. Mr. Elgin points to one scenario in Exhibit 29 that suggests a lower revenue requirement for Washington than is produced by Modified Accord. Mr. Elgin conceded, however, that no other jurisdiction would likely agree to such an allocation method. Tr. 544. Nor is it the approach that Staff finds "potentially acceptable" in the Multi-State Process. Martin, Ex. 125 at 13. Thus it is not a reasonable scenario to consider for purposes of examining the impact on the Company's filing in this case.

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2. Issues Regarding Washington-Only Versus Total Company Financial Data Do Not Provide a Basis for Denying Rate Relief.

The other parties took the position in their Motion to Dismiss that the Company's Washington-only financial data were meaningless given that the Company's credit ratings and financings are based upon Total Company data. Tr. 363. As stated by Staff witness Elgin, there is "no such thing as PacifiCorp's Washington stand-alone bond rating." Tr. 488. Thus, these parties would deny the Company any rate relief in this proceeding given that the Company cannot demonstrate a financial emergency on a Total Company basis. Tr. 362. As noted above, the Company's credit rating on a Total Company basis is "A-" and, while the Company has experienced a downgrade, is still capable of accessing capital.[17] It is indefensible to suggest that the Company should be denied rate relief in Washington—upon a demonstrated need for such relief on a Washington-only basis—because of the adequacy of the Company's financial condition on a Total Company basis. Such an approach is contrary to both sound regulatory policy and law.

With respect to regulatory policy, the Company was faced with a similar argument in its recent interim rate proceeding in California. The Office of Ratepayer Advocate ("ORA") argued that the Company should be denied rate relief in California because a financial emergency could not be shown on a Company-wide basis. This position was rejected by the California Public Utilities Commission ("CPUC"):

> "Historically, we have set rates based on California jurisdictional operations. If we were to do as ORA and the other parties suggest, we would base a determination of whether an

[17] With respect to the Total Company financial picture, there was some discussion during the hearings of the Company being "on track" to double its profits to $1 billion over the next three years. Tr. 158. As discussed by Mr. Larsen, this "doubling" of profits reflects as a starting point a very low level of profitability--returns of 3% to 4%--given the level of power costs absorbed by the Company the last two years. Tr. 159. Achieving the $1 billion "target" requires the Company to obtain considerable rate relief in all the states to earn 11%, to resolve the MSP issue and fill the allocation hole, and to address regulatory lag issues. Tr. 267-68.

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> interim increase is necessary on total company operations. In other words, if the total company is financially healthy, California rates need not be increased regardless of whether the results of operations for California demonstrate that California ratepayers are paying the full costs of the service they receive, including a reasonable return. Logically, however, this would mean that if the total company results of operations are poor, California rates should be increased regardless of whether California ratepayers are already paying their share. This is not reasonable. California rates should be based on California operations. California ratepayers should not subsidize other states, nor should they be subsidized by them. Therefore, we will base our decision on California jurisdictional operations."

Re PacifiCorp, Application 01-03-026, Decision 02-06-071 (CPUC June 27, 2002) at 4-5. Similarly, Washington rates should be based upon Washington operations.

It is particularly bad regulatory policy when it is not proposed to be applied even-handedly. From the parties' testimony in this case, it seems that the refusal to look at Washington on a stand-alone basis does not apply in all situations. Specifically, when Washington appears to be subsidized by other states, Washington apparently cannot be examined on a stand-alone basis. But if the perception is that other states are not carrying their fair share, a Washington-only approach suddenly becomes acceptable. This is clear from the following exchange between Chairwoman Showalter and Staff witness Elgin:

> Q. "[I]f you have a company that's in many states, it's not going to be surprising if some states look at the company in a different way than the other states do. And to a degree, you could say that's the company's problem, but at some point, isn't it everybody's problem if the company can't make ends meet because of another state, it affects us?
>
> A. Yes, but ultimately you're the arbiter of what's the final rates for Washington, and part of that is--on an allocated result, once you have the evidence in front of you, you will make a reasonable determination regarding the assignment of and the allocation of common costs. *And in Washington, if it turns out that Utah and Oregon provide--do not provide sufficient rates, at some point what we would do in Washington is regulate this company truly on a stand-alone basis, and that's at the point where we would be.*"

Tr. 508-09 (emphasis added). In other words, once Washington ceases to be cross-subsidized and the cross-subsidization starts to go the other way, a stand-alone approach "is the point at where we would be." For purposes of this case, however, where the substantial rate relief in the other states points to cross-subsidization to Washington's benefit, "there's no basis for saying that Washington is a stand-alone company."[18] Tr. 488.

The suggestion that Washington rates should be subsidized by the Company's operations in other states is contrary to law. The Commission sets rates that are fair, just, reasonable and sufficient by "determining the Washington intrastate adjusted results of operations during the test year, establishing the fair value of the company's property-in-service for intrastate service in the state of Washington (rate base), determining the proper rate of return permitted of the Company on that property, and then ascertaining the appropriate spread of rates charged various customers to recover that return." *Re Avista Corporation*, Docket No. UE-991606, Third Supp. Order (WUTC Sept. 29, 2000) at ¶ 14. The Commission must endeavor to not only assure fair prices and service to customers, but also "to assure that regulated utilities earn enough to remain in

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[18] Ratemaking has long recognized the importance of avoiding cross-subsidization between jurisdictional and non-jurisdictional activities. The Alaska Public Utilities Commission ("APUC"), for example, refrained from computing a company's revenue requirements on a total company basis because of the risk that a company would seek to subsidize its deficient interstate operations with its intrastate operations. Glacier State Telephone Company ("GSTC") requested interim and permanent rate increases, and claimed that its rate of return was so low as to be confiscatory. GSTC filed its rate case on a total company basis, combining its interstate and intrastate toll and local exchange components. The APUC adopted a separate company approach and required that the revenue requirement of local exchange carriers be based on their local exchange operations only. The APUC's separate company approach was appropriate to avoid subsidization. *Glacier State Telephone Co. v. Alaska Public Utilities Comm'n*, 724 P.2d 1187 (Ala. Sup. Ct. 1986). *See also, Re Carolina Power & Light Co.*, Docket No. 17,134, Order 18,100, 9 P.U.R.4th 129 (S.C.P.S.C. Jan 15, 1975)("Rates will not and cannot be granted which have the effect of subsidizing nonjurisdictional operations through earnings derived from company operations within the commission's jurisdiction"); *Re Hoosier Energy Rural Electric Coop.*, Cause No. 37294, 62 P.U.R.4th 134 (Ind. P.S.C. June 29, 1984) (commission's duties are to establish reasonable and just charges for service to member systems based on the costs incurred in providing service to them, regardless of revenue deficiencies in non-member sales).

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business—each of which functions is as important in the eyes of the law as the other." *People's Org. for Wash. Energy Resources (POWER) v. Utilities & Transp. Comm'n*, 104 Wn.2d 798, 808, 711 P.2d 319 (1985).

For a utility such as PacifiCorp that provides retail services in several jurisdictions, the property upon which a return is to be allowed includes "situs" property, generally distribution facilities located in Washington, and an appropriate allocated share of other balance sheet items like transmission and generation assets. With respect to the return to be allowed on assets dedicated to serve Washington customers, the principles of *Bluefield Waterworks & Improvement Co. v. Public Service Comm'n of West Virginia*, 262 U.S. 679 (1923) ("*Bluefield*") and *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944) ("*Hope*") apply. Without regard to the activities of a utility's non-jurisdictional operations, the Commission's duties in setting an appropriate return are to permit the utility to earn a return:

> On the value of the property which it employs for the convenience of the public 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; … *Bluefield*, at 692-693.
>
> … [T]he return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and attract capital. *Hope*, at 603.

Because the Commission's jurisdiction does not extend to PacifiCorp assets that are not dedicated to the public service in Washington, it should not consider the results of operation that reflect the California, Oregon, Idaho, Utah or Wyoming retail operations of PacifiCorp. Those results of operations reflect, among other things, the assets dedicated to the public in those respective retail jurisdictions and this information should be of no consequence in setting Washington rates. To consider the financial condition of operations of PacifiCorp that do not involve assets dedicated to the Washington public is inconsistent with the requirements of *Hope* and *Bluefield*.

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It should be noted as well that the *PNB* decision does not require such a Total Company showing. Notably, Pacific Northwest Bell in that case did not attempt to make a showing that its Washington financial data were different than its Total Company data. According to that decision:

> "While the rate of return figures on common equity of necessity are for the company as a whole, there is no demonstration in the record that Washington intrastate operations are failing to contribute their proportionate share to overall earnings."

PNB, Cause No. U-72-30, p. 4. The Company is clearly making such a demonstration in this case. Moreover, this demonstration is unrefuted by either Staff or the other parties.

A Total Company analysis would result in improper subsidization by one state of another state's costs. In contrast, a Washington-only analysis, as presented by the Company, ensures that Washington rates cover Washington costs. Larsen, Ex. 1C at 10. The Commission should consider financial indicators for Washington-only. The Company's request for relief does not ask for Washington customers to pay for cash flow demands from other jurisdictions. It is just the opposite. The Company requests relief to ensure that Washington customers sufficiently fund the needs imposed on the Company as a result of Washington's demands. Larsen, Ex. 8 at 8. Rate relief should not be denied in Washington as the consequence of the Company's ability to obtain significant relief in its other jurisdictions in response to the Western energy crisis.

3. The Absence of an Approved Power Cost "Baseline" Does Not Provide a Basis for Denying Rate Relief.

The Company uses the $486 million of net power costs as filed by the Company in the 1999 Rate Case for its baseline. Widmer, Ex. 57C at 2. This $486 million figure is the Company's highest threshold of base power costs assuming that no adjustments or additional changes were made on a total company basis. This proposed baseline is conservative because it does not reflect the fact that the Company received substantially less than the level of rate relief requested in the 1999 Rate Case. It assumes the Company received 100 percent of the costs

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requested, despite the fact that the Rate Plan adopted by the Commission allowed the Company to recover only 50 percent of the original request. Widmer, Ex. 62 at 4. The staggered recovery of rate relief and the time value of money further suggests that the percentage recovery is even smaller. *Id.* If the Company had assumed a lower baseline for power costs, then the deferred amounts requested in this filing would be higher.

Staff claims that this baseline is inappropriate because the Commission has not approved the Modified Accord allocation methodology. Buckley, Ex. 115 at 10-11. But allocation issues have no impact on Total Company net power costs, which are calculated systemwide. Widmer, Ex. 62 at 3. Moreover, Mr. Buckley claims that many of the power costs included in the Company's proposal should not be allocated to Washington. Buckley, Ex. 115 at 4. This would include Gadsby and West Valley, for example, even though they have been demonstrated to provide benefits on a system-wide basis and would be allocable, in part, to Washington under the Modified Accord method. Widmer, Ex. 62 at 7-9. Mr. Buckley claims that in disputing the allocation of such costs to Washington, he is "totally get[ting] away from allocation issues" and applying a test of "reasonableness." Tr. 576. In fact, however, Mr. Buckley is simply proposing a *different* allocation method--one that assigns costs based on perceived "direct benefits" to a particular state versus a systemwide approach. Tr. 583-84. Applying this "different" allocation approach, he is challenging various components of the Company's power supply costs. Thus, many of his adjustments presume use of an allocation method different than Modified Accord, and should be rejected for the same reasons as discussed above with respect to the cost allocation issue generally.

Staff also claims the Company's proposed baseline is inappropriate because not all power supply issues were resolved in the 1999 Rate Case. Mr. Buckley lists a number of such power supply issues that were unresolved, including power supply model, number of water years used in calculating normalized power costs, wholesale contract prices, thermal outage rates, fuel price issues, and short-term sales and purchase prices. Ex. 115 at 9. In order for Staff's position

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regarding the baseline to have any validity, one would have to conclude that Staff's position on these issues would have resulted in a recommendation that the Commission adopt a level of power costs *higher* than requested by the Company. That seems highly unlikely, at best. As stated by Mr. Widmer, even if all outstanding power supply issues were settled in the Company's favor, in a fully litigated case the Company would at most have recovered the amount requested in its initial filing. Widmer, Ex. 62 at 5. Thus, Staff's assertion that the Company's baseline is inappropriate lacks merit.

a. Staff's and ICNU's Criticisms Regarding the Scope of the Proposed Deferrals Are Misplaced.

Staff and ICNU also criticize the simplicity of the Company's proposal and claim that it is too broad. Admittedly, if the Company sought to implement a permanent recovery mechanism along the lines of the proposed deferral, the Company's approach might indeed be too broad. Staff and ICNU's criticism of the broadness of the deferral petition misses the point. The Company does not propose to implement a permanent power cost recovery mechanism based on this calculation. Widmer, Ex. 62 at 5-6. Rather, the Company seeks additional cost recovery under the terms of the Rate Plan to ameliorate the Company's poor Washington jurisdictional earnings. *Id.* at 6. The net power cost deferral mechanism is simply designed to quantify and support recovery of the additional costs to help soften the impact of poor Washington earnings. *Id.* For this discrete purpose to track costs for a limited deferral period, the Company's proposal is entirely appropriate.

b. Many of the Issues Raised by Staff and ICNU Could Be Addressed in a Subsequent Review Proceeding Once the Deferred Amounts are Known.

Staff and ICNU attempt to raise a number of additional issues as the basis to reject outright the Company's request for deferral. In fact, these issues would more properly be addressed in a subsequent review of the deferred amounts. Once the deferral period ends on May 31, 2003 and the actual deferred amounts are known, the Commission could review the

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prudency and accuracy of the calculations. In such a review, the parties would have an opportunity to review the prudence of costs included in the deferred balance and to propose adjustments as necessary. After such a review, the Commission could decide whether adjustments should be made.

If the Commission accepts this proposal, however, the Commission should include certain parameters in order to avoid rehearing issues that are resolved in this proceeding. For example, the Commission should decide that the issue of proper allocation methodology is not a basis upon which the parties may recommend adjustments. Otherwise, the review proceeding would merely be a rehash of this proceeding and Staff again would argue that no costs are allocable to Washington. The proceeding should be limited to a review of the prudence of the costs and to determine the accuracy of the calculations, and should not be expanded beyond those considerations.

c. ICNU Witness Falkenberg's Own Power Cost Numbers Demonstrate that the Level of Power Costs in Washington Is Substantially Lower Than in Other States.

ICNU witness Falkenberg states a number of criticisms with respect to the Company's testimony regarding power costs and, among other things, suggests that the level of power costs being recovered in Washington is not much different from that being allowed in other states, even after the rate relief granted in those states. Ex. 140C at 18. Mr. Falkenberg prepared an exhibit which purports to adjust for the changes in load levels reflected in the various rate proceedings. Ex. 145. However, the same numbers as Mr. Falkenberg relies upon for his "analysis" show that, in fact, the level of net power costs recovered by the Company in Washington is ***about 14-20% less on a per MWh basis than net power costs in the other states where rate relief has been granted***. Table 1 below shows the calculation, on a $/MWh basis, of

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the Company's net power costs in Washington as compared with the annual net power costs allowed in Utah, Wyoming and Oregon, using the numbers from Mr. Falkenberg's Exhibit 145.[19]

TABLE 1

	Annual Net Power Costs ($)	Loads (MWh)	Power Cost $/MWh	% Difference Washington
Washington	486.8	50277816	9.68	
Wyoming	626.4	53312632	11.75	**21.35%**
Oregon	589*	53143690	11.08	**14.47%**
Utah	589	52876916	11.14	**15.05%**

*Excluding one-time recovery of 2002 summer forward purchases.

Notwithstanding Mr. Falkenberg's claims about differences in load growth and rate relief in the various states, the relatively straightforward analysis in Table 1 above demonstrates that the level of power cost recovery in Washington is substantially below that in other states where rate relief has been granted in base rates, and not even considering additional recoveries of excess deferred power costs recovered through other mechanisms.

4. The Company Has Obtained Relief in Oregon and Utah with Respect to the Issues Raised in this Proceeding, and Satisfies the Requirements of Section 11 of the Rate Plan.

With respect to the requirement under Section 11 of the Rate Plan regarding similar rate relief in the Company's two largest jurisdictions, the Company sought and obtained similar rate relief in its two largest jurisdictions, Oregon and Utah. Widmer, Ex. 57C at 6. Indeed, the Company sought deferral and recovery in most of its jurisdictions to recover the higher power costs arising from the dramatic increases in wholesale electric industry prices. *Id.* In Oregon, the Oregon Public Utilities Commission authorized the Company to recover approximately $130

[19] For Wyoming, Mr. Falkenberg accepted the figures subject to check. Tr. 434-35. The (continued…)

million in excess net power costs plus carrying charges over the amortization period. This amounts to $22.8 million annual recovery in Oregon for the Company since February 2001. In August 2002, this amount increased to $45 million, or six percent. *Id.* The Utah Public Service Commission authorized the Company to recover excess net power costs incurred during the deferral period of May 2001 through September 30, 2001 and to recover replacement power costs for the Hunter 1 outage. *Id.* at 6-7. The Company was authorized to recover approximately $147 million of excess net power costs through a combination of recovery mechanisms, including a surcharge and offsets to the Centralia credit and Merger credit. *Id.* at 7.

Although Staff and ICNU claim that the filings in Oregon and Utah had to be "contemporaneous" with the Company's request in this case (Elgin, Ex. 101 at 14; Falkenberg, Ex. 140C at 5), that requirement does not appear in the terms of Section 11 of the Rate Plan. This Section 11 provision recognizes that rate relief in Washington, standing alone, cannot redress any financial difficulty the Company may be facing, and the Utah and Oregon jurisdictions must be expected to provide relief as well. This requirement has been satisfied by the Company's seeking, and subsequently obtaining, rate relief in Utah and Oregon with respect to power costs arising during and since the Western energy crisis. Thus, the Company's Washington customers will not be making up for an absence of rate relief in the Company's two largest jurisdictions; rather, with the rate relief already granted in these jurisdictions, it is the Company's Washington customers who are being subsidized. This filing seeks to reduce that cross-subsidization. The Section 11 requirement should not be used to bar this filing, since it is consistent with the underlying purpose of that requirement.

Similarly, the Company should not be penalized for *not* taking *full* advantage of the remedy available under Section 11 through an earlier filing for an interim increase. In this regard, Mr. Falkenberg states that the Company "missed the opportunity to re-open the Rate

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(…continued)
Wyoming Order is also included as Exhibit 17.

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Plan" by not filing an interim case in Washington in early 2001, when it filed for emergency relief in Utah and for an interim increase in Oregon. Ex. 140C at 4. It is clear that the Company would have been able to demonstrate a need for interim relief in Washington at the time, given the substantially higher power costs that the Company was incurring during 2000 and 2001. Mr. Falkenberg's contention ignores the practicalities, however, of needing to seek relief *first* in the Company's largest states, where the magnitude of the rate relief would have the greatest impact in preserving Total Company financial integrity.[20] Tr. 275. For Washington, the Company honored the commitment of the Rate Plan by avoiding such a filing. That the Company did not make such a filing represents a significant benefit to customers provided by the Rate Plan—they were shielded from the impact of the $98 million in higher power costs borne by the Company to serve Washington customers. Mr. Falkenberg admits that "clearly the customers have benefited from the rate plan, because they have avoided up to this point some share of those costs." Tr. 416. It is punitive to suggest, as Mr. Falkenberg does, that the Company should be denied a modest amount of relief now as a consequence of passing up the substantial relief it could have obtained if it hadn't "missed the opportunity."

C. The Other Parties Have Utterly Failed to Rebut or Respond to the Company's Financial Testimony.

Although they dispute the Company's claim that its financial condition in Washington creates a gross inequity, neither Staff or ICNU offer any competing analysis to rebut the Company's case on return on equity, pre-tax interest coverage, cash and capital requirements, or the Company's bond rating. Instead, both Staff and ICNU propose to deny any relief based on misplaced procedural or technical arguments.

No party presents:

- Any analysis of return on equity for Washington operations to compare against the Company's presentation included at Exhibit 3C. Tr. 486 (Staff). Moreover, although

[20] In other words, "it seems rational for a company to go to the big states first for some kind of economic relief, since that's going to make the most difference." Tr. 414.

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Staff claims the analysis should be performed on a Total Company basis, Staff fails to present any return on equity information on that basis, either. Tr. 487. ICNU witness Falkenberg, for his part, conducted some simple mathematical calculations regarding ROE, as discussed below, but these were not based on any actual post-1999 Rate Case data. Tr. 388.

- Any analysis of pre-tax interest coverage for Washington operations to compare against the Company's presentation included as Exhibit 4C. Tr. 487 (Staff); tr. 398 (ICNU) Moreover, although Staff claims the analysis should be performed on a Total Company basis, Staff fails to present any pre-tax interest coverage information on that basis, either. Tr. 488.
- Any analysis of capital requirements or cash flows related to Washington operations to compare against the Company's presentation included at Exhibit 5C.[21] Tr. 490, 492 (Staff); tr. 399 (ICNU).
- Any analysis of the Company's bond ratings on a Washington-only basis to discuss or refute the Company's statement that it would be rated "BB", or junk-bond status. Nor has any party claimed that the Company's claims with respect to credit ratings on a Washington-only basis are incorrect. Tr. 488 (Staff); tr. 400 (ICNU).

Thus, the Company's testimony regarding its financial situation in Washington is unchallenged. Rather than address the merits of the Company's financial presentation or offer any competing analysis, the parties oppose rate relief on unrelated grounds. As discussed elsewhere in this Brief, these grounds are without merit.

1. ICNU Witness Falkenberg Relies Upon a Simplistic Mathematical Exercise to Support His Claim that the Company is Only "Slightly Under-Earning" in Washington.

ICNU witness Falkenberg takes the position the Company failed to show a financial emergency exists or that relief is needed to prevent a gross inequity. Ex. 140C at 7; Tr. 373. The support for this position is based solely on Table 1 in Mr. Falkenberg's testimony, which purports to calculate the Company's return on equity during the Rate Plan Period. Ex. 140C at 8. Mr. Falkenberg's Table 1 is nothing more than what he describes as a "very simple analysis" (tr. 374) that, in fact, illustrates nothing. The only variables Mr. Falkenberg changed in his

[21] Mr. Elgin takes issue with some capital requirements as being unrelated to Washington load, but does not quantify these items in a manner that allows comparison with the Company's presentation. Ex. 101C at 15-16; tr. 492.

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Table 1 were the percentage increases to the Company's revenues under the Rate Plan. His Table 1 incorrectly assumes that the Company's expenses remained *entirely unchanged* in 2001 through 2003. Tr. 379. In making his calculations, Mr. Falkenberg failed to consider any of the Company's actual expenses during that timeframe. He also failed to take into account actual load changes since the Rate Plan. Tr. 380-381. It is simply wrong to calculate an expected return on equity without considering the Company's expenses or changes in loads. Moreover, although Mr. Falkenberg claims that his calculation presents what the Company "should have expected to earn" (Ex. 140C at 8), the response to Bench Request 11 in the 1999 Rate Case (Ex. 154) indicates that the Company's stated expectation was that expenses would be *higher* in the early years of the Rate Plan given the expenditures associated with the "cost to achieve" the Transition Plan savings. Thus, ICNU's analysis is inherently flawed and provides no guidance on the issues in this proceeding.

2. The "Total Financial Profile" Approach Suggested by Staff Witness Elgin is Not a Credible Solution.

Staff witness Elgin, for his part, argues that the Company must be required to submit a "total financial profile" before it can seek rate relief under Section 11 of the Rate Plan. Tr. 481. This contention is without merit. First, the requirement of a "total financial profile" is not imposed by Section 11, as the document makes no mention of such a requirement. Rather, filings in both Utah and Oregon are required, which the Company has satisfied in this case. Nor has a "total financial profile" been required under the *PNB* standards, as they have been implemented by the Commission over the years. Tr. 480. Second, Mr. Elgin claims that the filing of a "total financial profile" will enable the Company to obtain interim rate relief, even in the absence of an approved cost allocation methodology, because "some amount of relief would be apportioned to Washington." Ex. 101 at 11; Ex. 36. Yet it is apparent from Staff's view of things that no agreement is likely to be reached on the "amount of relief" that should be "apportioned to Washington." Staff has taken the position that the Company's allocation

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"problem" stems from Utah's adoption of the "rolled-in" cost allocation methodology, for which Staff claims the Company's shareholders should bear the consequences.[22] Ex. 110. Thus, in apportioning "some amount of relief" to Washington, Staff can be expected to take the position, as it did in Exhibit 110, that Washington should not bear any consequences associated with the cost allocation "problem." Moreover, depending upon the cause of the financial distress, Staff would oppose Washington bearing any portion whatsoever of any Total Company need for interim relief. Tr. 485. Thus, the "total financial profile" requirement offers no solution at all—the same allocation issues used by Staff as the basis for refusing to analyze the Company's financial data in this case would presumably be used to allocate an "amount of relief" of ***zero*** as the share of relief that should be "apportioned to Washington."

D. The Company Has Presented a Number of Options for Addressing Its Current Financial Distress in Washington.

As discussed in the Company's direct testimony and by the Company's witnesses during the hearings, a number of options are available to the Commission to address the Company's financial circumstances in Washington. These include the following:

1. The Commission Could Grant the Deferral, with Recovery Using the Existing Credits.

The proposal as set forth in the Company's direct testimony is to recover the deferred amounts by netting them against the balances in the Centralia and Merger credit accounts, as discussed above. (Alternatively, the Commission could impose a surcharge designed to recover the deferred amounts, which would have the same effect on the customers' bills.) As of October

[22] Exhibit 110 is Staff's memorandum to the Commission opposing Washington's participation in the Multi-State Process. In that memo, Staff stated that the "responsibility for the Company's substantial under-recovery of its costs lies with its Utah operations" (p. 6) and thus "[t]he Company's ability to recover its costs is not related to anything this Commission can do other than increase rates to Washington ratepayers in order to pick up the costs Utah no longer supports in rates." (pp. 7-8) Rather, the Company's shareholders should bear this under-recovery as "the Company and its shareholders accepted the risk that a 'regulatory gap' would exist when they proposed to acquire Utah." (p. 8)

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2002, the Centralia Credit account contained $10.2 million and the Merger Credit account contained $6.8 million.[23] Griffith, Ex. 90 at 2. The effect of removing these two credits will increase customer bills by an average of 4.6 percent. *Id.* at 3. Any deferred amounts in excess of the remaining credit balances would be retained in the deferred account and addressed in the Company's next general rate filing in Washington if small in amount, or could be recovered through a surcharge that would continue until the deferral account balance reached zero. *Id.* By applying the deferred amounts against the Centralia and Merger credits, no change in rates would occur and the essential feature of the Rate Plan would remain intact. This approach provides the minimum amount of relief that the Company needs without disturbing the essential feature of the Rate Plan and allows the Company to achieve a more reasonable, albeit far insufficient, return on equity through the end of the Rate Plan Period.

2. The Commission Could Authorize a General Rate Filing.

If the Commission finds that review of the Company's financial performance cannot adequately be evaluated without a general rate filing and a more complete development of the cost allocation issues, the Commission could authorize the Company to submit a general rate filing. Larsen, Ex. 8 at 2. Under this option, the Commission could grant the deferral request, and address the recovery of deferred amounts in the general rate case proceeding. Alternatively, the Commission could deny the deferral request, and determine that the Company's sole means of obtaining rate relief is through the general rate filing. The Company committed to file such a general rate case by the end of 2003, if the Commission deemed it necessary in order to adequately review the Company's financial performance. Larsen, Ex. 8 at 2. This would allow the filing to reflect the outcome of the Multi-State Process, and thus present a cost allocation proposal for the Commission's consideration.

[23] These accounts continue to diminish as time passes. By the end of April 2003, the amount remaining to be distributed to customers from both accounts would be approximately $15.3 million total.

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3. The Commission Could Allow Application of Existing Credits Toward Power Costs, without the Interim Step of Creating Deferrals.

The Commission could also determine that while some form of limited rate relief may be warranted, the deferral proposed by the Company is not a proper means of quantifying the amount or not a proper circumstance for allowing deferrals. Rather than going through the deferral and review process, the Commission could authorize the Company to apply the Centralia and Merger credits in the manner proposed. This option provides a limited and certain amount of rate relief without the complexities and controversy associated with adopting a deferral mechanism and conducting a review of the amounts once deferred. Moreover, there is a record basis to support granting rate relief in this amount, as the evidence shows that even with the relief requested, the Company's earned return on equity in Washington would fall far short of a reasonable level.[24] With this limited relief, the Rate Plan could remain in full force and effect through the end of the Rate Plan Period.

4. Deferral Without Prompt Recovery Would Provide No Relief.

Each of the above options would address the immediate cash flow needs of the Company because the Company would receive some form of relief prior to the end of the Rate Plan. It should be noted that an option which does not provide any relief to the Company is carrying the deferral through the end of the Rate Plan Period. Determination of a recovery method for deferred amounts now rather than at the end of the Rate Plan Period is necessary to address the Company's need for immediate cash flow. Granting the deferral without also authorizing any recovery mechanism prior to the end of the Rate Plan Period does not address the Company's financial predicament. As Mr. Larsen testified:

> The real issue is the need for immediate cash flow, and to defer something on the books until 2006 really doesn't help the financial situation. Had all of [the Company's] states followed that

[24] According to Mr. Larsen's calculations, granting the full request would add about 200 basis points to the Company's earned returns. Given the equity figures shown in Exhibit 3C, there is no risk that the relief would result in the Company approaching a reasonable return.

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> route, said, yeah, you can defer the power costs that you have experienced and you can come back after 2006, by then the Company would have probably gone through bankruptcy and not have been able to deal with the financial crisis that it actually went through. By Utah providing an interim increase of $70 million initially, and they're 40% of our jurisdiction or of our business, that helped us stave off some of that, from which Washington is benefiting. But we still have that need for all of our states to contribute, and so the real issue is addressing that cash flow situation and getting recovery started today.

Tr. 216-17. Therefore, it is essential that some relief be provided before the end of the Rate Plan period.

E. The Commission Has Sufficient Authority to Grant Various Forms of Relief in this Case.

Given the Commission's broad ratemaking authority, the Commission has a number of options for granting relief in this case. These include the following:

1. The Commission Could Allow Recovery Pursuant to Section 11 of the Rate Plan.

The Commission has a basis for finding that the Company's evidence in this case satisfies the requirements of Section 11 of the Rate Plan, and thus that the Company is entitled to some form of additional rate relief during the Rate Plan Period without re-opening the Rate Plan. The Commission could determine that the limited form of relief proposed in the Company's filing is an acceptable, and perhaps preferable, alternative to the full general rate filing allowed by Section 11 of the Rate Plan.

2. The Commission Could Allow Recovery Pursuant to Section 9 of the Rate Plan.

Section 9 of the Rate Plan clearly allows the Company to submit an accounting petition seeking the deferral of expenditures or revenues during the Rate Plan Period. With respect to rate recovery of deferred amounts, the Commission arguably also has the authority under Section 9 to grant an exception to allow rate recovery of extraordinary or unusual amounts that are deferred in accordance with Section 9.

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3. The Commission Could "Re-Open" the Rate Plan on Its Own Motion.

Given that the evidence demonstrates that the Company's existing rates in Washington are not fair, just, reasonable or sufficient, the Commission may re-open the Rate Plan under its own motion and allow the Company to file a general rate case. Even though the Rate Plan generally does not specify a means to modify or re-open its terms, the Commission has the authority under state law to reopen any part of it. RCW 80.04.210 provides:

> The commission may at any time, upon notice to the public service company affected, and after opportunity to be heard as provided in the case of complaints rescind, alter or amend any order or rule made, issued or promulgated by it, and any order or rule rescinding, altering or amending any prior order or rule shall, when served upon the public service company affected, have the same effect as herein provided for original orders and rules.[25]

There is no dispute that the Commission possesses the ability to exercise this authority. In Docket Nos. UE-001952 and UE-001959, for example, the Commission stated as follows:

> "PSE's arguments that 'a deal is a deal' and that Schedule 48 and the Special Contract should be left untouched by Commission action must be subordinate to our continuing statutory duty to ensure that all rates, terms, and conditions of service provided to all customers of jurisdictional utilities remain fair, just, and reasonable at all times."

Air Liquide America Corporation, et. al. v. Puget Sound Energy, Inc., Sixth Supplemental Order, p. 38.[26]

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[25] This authority is re-emphasized in WAC 480-09-815.

[26] When necessary, the Commission has reopened matters in order to address problems with prior orders. For example, in *WUTC v. Puget Sound Power & Light Co.*, Docket No. U-81-41, the Commission on its own motion reopened a deferred accounting proceeding to determine if it was necessary to continue, modify or rescind the utility's energy cost adjustment clause ("ECAC") which was used to help track power supply cost variations. The proceeding was reopened six years after the Commission adopted the ECAC to clarify the policy regarding the ECAC and to make procedural modifications. The Commission ultimately ordered that the prior order adopting the ECAC should be modified. *WUTC v. Puget Sound Power & Light Co.*, Docket No. U-81-41 (Reopened), Sixth Supplemental Order (Dec. 19, 1988). Here, too, the Commission can find that the Rate Plan should be reopened and modified because the

(continued…)

4. The Commission Could Re-Open the Rate Plan Based on the Unavailability of Relief under Section 11, as Implemented by the Parties.

The Commission could also find that a re-opening is warranted given that the remedy seemingly available to the Company under Section 11 of the Rate Plan is, in fact, unavailable. Staff's position in this case is that (1) there is no "approved" cost allocation methodology in Washington, (2) cost allocation methodology was an issue identified in the 1999 Rate Case as requiring resolution during the Rate Plan Period (Elgin, Ex. 101 at 18), (3) although interim relief is technically available under Section 11 of the Rate Plan, the Company cannot "make any assertions regarding its financial results in Washington . . . until the cost allocation problem is solved" (Elgin, Ex. 101 at 23), and (4) the cost allocation problem is not solved, and the Company's Washington costs cannot be determined, until "a more equitable allocation plan . . . is agreed upon by PacifiCorp states and approved by the Washington Commission." (Martin, Ex. 125 at 14). Given this interpretation by Staff, the limited relief available to the Company under Section 11 of the Rate Plan is not actually available, and Section 11 of the Rate Plan is rendered meaningless. Indeed, there seems to be no scenario under which a request for

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(…continued)
Company's existing rates in Washington are not just and reasonable and cannot be reset based upon the existing record.

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rate relief from the Company would be processed by Staff.[27] Staff's position frustrates the letter and intent of the Rate Plan.[28]

In the Company's view, Staff's reading of Section 11 contradicts the letter and intent of the Rate Plan and well-established rules of contract interpretation. In the event Staff's interpretation is found reasonable, however, its effect is to strip away the availability of Section 11 as a remedy to the Company during the Rate Plan Period. This, too, provides a basis for the Commission to re-open the Rate Plan.

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[27] Although Mr. Elgin explains in Exhibit 36 (Staff's response to PacifiCorp Data Request No. 1.12) that relief is in fact available to the Company through an interim filing followed by a general rate case that would solve the allocation issue, this scenario is inconsistent with the statement in Mr. Martin's testimony that agreement by all PacifiCorp states ***and*** approval by the Washington Commission is required before the Company's Washington costs can be determined. Moreover, the interim relief presumably available under the scenario described in Exhibit 36 presumably requires "some amount of relief" to be "apportioned to Washington" once the Company's "total financial profile" is presented. (Elgin, Ex. 101 at 11) As discussed earlier, there is unlikely to be any scenario under which any portion of any emergency relief would be "apportioned to Washington" given Staff's position regarding a "more equitable allocation plan."

[28] Denying the Company the ability to obtain interim relief violates law, specifically the Commission's obligation to ensure fair, just, reasonable and sufficient rates under RCW 80.28.020. Regardless of what the Rate Plan says, the parties cannot waive this statutory obligation. "[A] contract that is contrary to the terms and policy of an express legislative enactment is illegal and unenforceable." *Tanner Elec. Coop. v. Puget Sound Power & Light Co.*, 128 Wn.2d 656, 669, 911 P.2d 1301 (1996) *citing to Vedder v. Spellman*, 78 Wn.2d 834,837, 480 P.2d 207 (1971); *Waring v. Lobdell*, 63 Wn.2d 532, 533, 387 P.2d 979 (1964).

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IV. CONCLUSION

For the reasons set forth in this Brief, in the Company's prefiled testimony and exhibits, and in the Company's testimony during the hearings, the Company respectfully requests that the Commission grant the relief requested in the manner proposed herein.

DATED: April 11, 2003.

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