BEFORE THE

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, v. PACIFICORP d/b/a PACIFIC POWER & LIGHT COMPANY Respondent.	)	**Docket No. UE-050684** **Docket No. UE-050412** *(consolidated)*

INITIAL BRIEF OF

THE INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES

February 27, 2006

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I. INTRODUCTION

1 Pursuant to WAC § 480-07-390 and the schedule adopted in Docket Nos. UE-050684 and UE-050412, the Industrial Customers of Northwest Utilities ("ICNU") submits this Initial Brief. ICNU requests that the Washington Utilities and Transportation Commission ("Commission" or "WUTC") reject PacifiCorp's proposed rate increase and order a rate reduction of approximately $14 million. ICNU further recommends that the Commission reject PacifiCorp's proposed power cost adjustment mechanism ("PCAM"), deny the proposed power cost deferral, and adopt a modified version of the Company's proposed interstate cost allocation methodology that will more fully capture the value of the lower cost resources of PacifiCorp's western system.

II. BACKGROUND

2 PacifiCorp seeks to increase its Washington rates on an annual basis despite the fact that no rate increase is justified. PacifiCorp has increased its Washington rates in four of the past five calendar years. Most recently, on November 10, 2004, the Commission allowed PacifiCorp to increase its rates by $15.5 million, an average 7.5% increase.[1/] The 2004 rate increase occurred during a two-year period in which PacifiCorp had agreed in a Rate Plan that no rate increases would occur, which followed three years of rate increases in 2001, 2002 and 2003.[2/]

3 Less than a year after its last rate increase, PacifiCorp filed this general rate case, requesting a $39.2 million rate increase, including a 20.3% increase for

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1/ WUTC v. PacifiCorp, Docket No. UE-032065, Order No. 07 (Nov. 10, 2004).

2/ PacifiCorp increased rates three times pursuant to the terms of the Rate Plan (3% on January 1, 2001, 3% on January 1, 2002, and 1% on January 1, 2003). See WUTC v. PacifiCorp, Docket No. UE-991832, Third Suppl. Order (Aug. 9, 2000).

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industrial customers.[3] In its rebuttal testimony, PacifiCorp reduced its proposal to a $32.6 million increase, which would result in a 15.6% increase for industrial customers.[4] The adjustments contained in PacifiCorp's rebuttal testimony include a $2.5 million reduction based on a net power cost stipulation between the Company and ICNU.[5] PacifiCorp apparently also has agreed that its overall proposed rate increase should be reduced by an additional $1 million to incorporate the rate credits associated with the Mid-American Energy Holdings Company ("MEHC") acquisition.[6] This would result in an approximately $31.6 million rate increase.[7]

4 The record in this proceeding demonstrates that PacifiCorp's rates should be significantly reduced beyond the amount to which PacifiCorp has agreed. PacifiCorp's rate increase request is not based on actual cost increases related to serving Washington customers, but is instead largely driven by other factors, including expensive new resources PacifiCorp has acquired to serve Utah load growth, self-serving changes in the Company's power cost methodology, and the inclusion of costs that the Company agreed to remove from rates in its last rate case. Although PacifiCorp agreed in a stipulation with Staff in the 2004 rate case that its rates were fair, just, reasonable and

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3/ Exh. No. 253 (Est. Effect of Proposed Prices on Revenues from Electric Sales to Ultimate Consumers in WA, 12 Months ended September 2004).

4/ Exh. No. 258 at 1 (Estimated Effect of Proposed Prices on Revenues from Electric Sales to Ultimate Consumers in Washington, 12 Months ended September 2004 (Revised December 2005)).

5/ Exh. No. 195T at 3 (Wrigley Rebuttal).

6/ Exh. No. 225T at 1, 3 (Wrigley Suppl.).

7/ The Company's specific overall or percentage increase is unknown. Remarkably, PacifiCorp has refused to answer ICNU's data requests asking the Company to specify the Company's overall proposed rate increase, or to identify the overall or customer specific percentage rate increase.

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sufficient, the Company is seeking additional revenue in this case based on its complaint that the $15.5 million rate increase approved by the WUTC in 2004 was insufficient.[8/]

5 The evidence in the record demonstrates that PacifiCorp should remove from its rate increase proposal the revenue requirement impacts associated with: 1) the Company's inflated return on equity ("ROE") request; 2) the production factor adjustment; 3) regional transmission organization ("RTO") costs that do not benefit Washington customers; 4) the imprudent costs associated with the Western Area Power Administration ("WAPA") contract; 5) overstated health care, pension and retirement benefit costs; and 6) and the inflated and non-beneficial costs of PacifiCorp's bonus and incentive programs. PacifiCorp's rate request also inappropriately includes costs for taxes that are never paid to any taxing authorities.

6 The Commission also should deny PacifiCorp's request that the Commission adopt the Company's interstate cost allocation methodology, the Revised Protocol, without adjustments to protect Washington customers from costs that are unrelated to providing service in Washington. The Revised Protocol would allow PacifiCorp to charge Washington ratepayers the costs associated with high cost resources in its eastern control area that do not benefit, and are not used and useful for, Washington ratepayers. ICNU has proposed a simple modification to the Revised Protocol that excludes resources not used and useful to Washington and more fully captures the lower costs of the pre-merger Pacific Power & Light ("PP&L") system. In the alternative,

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[8/] Exh. No. 386 at 8 (Settlement Agreement, Docket No. UE-032065 (Aug. 27, 2004)).

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ICNU has proposed corrections and conditions that the Commission should adopt if it intends to approve the Revised Protocol on an interim or permanent basis.

7 The Commission should also reject both PacifiCorp's request to defer alleged excess hydro costs and its proposed PCAM. PacifiCorp's power cost deferral should not be granted because the Company has failed to submit any evidence demonstrating that the deferral is warranted or that any of the costs have been prudently incurred. PacifiCorp's PCAM would unjustifiably shift the majority of the risk associated with power cost variations from the Company to ratepayers, could provide PacifiCorp with inappropriate regulatory incentives, and fails to include a reasonable mechanism for allocating the risk of net variable power costs between the Company and its customers. In addition, PacifiCorp's proposed PCAM would require Washington ratepayers to shoulder more than their fair share of costs associated with Utah load growth and hydro shortfalls.

8 ICNU's proposed adjustments would reduce PacifiCorp's request by approximately $41.9 million. ICNU supports the non-duplicative revenue requirement reductions proposed by Public Counsel and Staff. ICNU opposes, however, Staff's proposal to allow PacifiCorp to recover a portion of its hydro deferral costs. The table below provides ICNU's proposed adjustments, as well as $4.3 million in non-duplicative Staff and Public Counsel revenue requirement adjustments supported by ICNU. The adoption of these adjustments would reduce the rate increase in PacifiCorp's rebuttal case by approximately $46.3 million, and result in an overall rate <u>decrease</u> of approximately $13.7 million from current rates.

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ICNU Proposed Adjustments to PacifiCorp's Rebuttal Testimony Rate Increase on a Washington Jurisdictional Basis (000)	
Multi-State Adjustment	$8,605
WAPA Contract	$240
Production Factor Adjustment	$9,823
Return on Equity[9]	$7,900
Health Care	$435
Pension Expense and Other Retirement Benefits	$468
Incentive/Bonus Expense	$2,151
Consolidated Tax Adjustment	$7,967
Remove Hydro Deferral	$3,090
MEHC Rate Credits	$1,000
RTO Expense	$226
Total ICNU Proposed Adjustments	**$41,905**
Public Counsel Electric Plant Acq. Adj.	$473
Public Counsel Major Plant Additions	$145
Public Counsel Amortization Of Capital Stock Exp.	$171
Total Non-Duplicative Public Counsel Adjustments	**$789**
Staff Weather Normalization	$1,098
Staff DSM Amortization Removal	$2,180
Staff Property Insurance	$153
Staff Miscellaneous A&G	$137
Total Non-Duplicative Staff Adjustments	**$3,568**
Total Proposed Adjustments	**$46,262**

[9] ICNU's direct testimony supports a $7.9 million revenue requirement to reflect a reasonable ROE. Exh. No. 121T at 3: 19-21 (Gorman Direct). However, the final revenue requirement number will be lower if the Commission accepts Staff's proposed rate base adjustments.

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III. ARGUMENT

A. The Company Bears the Burden of Proof

9 As the proponent of a general rate increase, PacifiCorp has the burden of proof to demonstrate that its proposed tariffs are just and reasonable.[10] This burden includes "the burden of going forward with evidence and the burden of persuasion."[11] The Company retains this burden throughout the proceeding and must establish "by a preponderance of the evidence that the rate" change is just and reasonable.[12] PacifiCorp also retains the burden of proof to demonstrate that its proposed PCAM and power cost deferral should be adopted.[13]

10 When setting rates, a utility is allowed an opportunity to recover its operating expenses and to earn a rate of return on its property that is used to provide service.[14] The amount of a utility's operating expenses included in rates is typically "based on actual operating expenses in a recent past period referred to as the 'test period' or 'test year'."[15] However, a utility "cannot include every expense it wishes" in rates, because the Commission reviews the utility's costs "to disallow those which were not prudently incurred."[16] The Commission also removes from rate base all property not used and useful to serve Washington customers, and removes from rates all non-recurring, one-time expenses that a utility is unlikely to experience again during the term

[10] RCW § 80.04.130(4); WAC § 480-07-540; WUTC v. PacifiCorp, Docket No. UE-050684, Order No. 01 at ¶ 11 (May 24, 2005).
[11] WAC § 480-07-540.
[12] WUTC v. PP&L, Cause No. U-84-65, Fourth Suppl. Order at 17 (Aug. 2, 1985).
[13] See WUTC v. PacifiCorp, Docket No. UE-050684, Order No. 01 at ¶ 11; Re PacifiCorp, Docket Nos. UE-991832 and UE-020417, Sixth/Eighth Suppl. Order at ¶ 22 (July 15, 2003).
[14] People's Org. for Wash. Energy Resources v. WUTC, 104 Wn.2d 798, 808-11 (1985).
[15] Id. at 810.
[16] Id.; Re Puget Sound Energy, Inc., Docket No. UE-031725, Order No. 14 at ¶ 93 (May 13, 2004).

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of the proposed rates.[17] Finally, regardless of prudence, all costs and expenses that do not benefit ratepayers or were incurred to benefit shareholders must be removed from rates.[18]

B. The Commission Should Incorporate the Known and Measurable Changes Related to the MEHC Acquisition of PacifiCorp

11 The Commission should adjust PacifiCorp's revenue requirement to reflect the MEHC acquisition, which has been approved by this Commission as well as the utility commissions in California, Oregon, Utah, Wyoming, and Idaho. The Commission should not wait to make these revenue requirement adjustments until the MEHC acquisition actually closes because the acquisition is a known and measurable event that is likely to occur during the time in which rates are expected to be in effect and during the test year for certain costs.

12 ICNU agrees with PacifiCorp witness Paul Wrigley that PacifiCorp should reduce its revenue requirement request by approximately $1 million to account for cost reductions contained in the MEHC stipulation.[19] MEHC and PacifiCorp have committed to provide specific rate credits and cap other costs to demonstrate that the acquisition meets the Commission's standards regarding utility mergers and acquisitions.[20] The rate credits regarding the West Valley lease, affiliate management fees, and administrative

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[17] RCW § 80.04.250; WUTC v. Avista Corp., Docket Nos. UE-991606 and UG-991607, Third Suppl. Order at ¶¶ 205-07 (Sept. 29, 2000).

[18] U.S. West v. WUTC, 134 Wn.2d 74, 126-27 (1997); WUTC v. Avista Corp., Docket Nos. UE-991606 and UG-991607, Third Suppl. Order at ¶¶ 239-40.

[19] Exh. No. 225T at 3: 19-21 (Wrigley Suppl.). At the time of the hearing, ICNU had not received adequate information from PacifiCorp to determine if the Company's revenue requirement should be further reduced to account for additional rate credits. See Exh. No. 821T at 1: 8 – 3: 15 (Selecky Suppl.). ICNU now agrees that PacifiCorp has properly passed through the full rate credits that should be provided to Washington at this time.

[20] Exh. No. 225T at 1: 9-22 (Wrigley Suppl.).

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and general costs would reduce the Company's Washington revenue requirement by approximately $1 million.[21] These rate credits should be incorporated into the Commission's final order in this proceeding.

C. The Revised Protocol Does Not Allocate Costs Based on How PacifiCorp Serves Its Washington Customers

13 The Commission should adopt an interstate cost allocation methodology that allocates costs to Washington based on the costs PacifiCorp actually incurs to provide service to Washington customers. The Revised Protocol harms Washington customers because it charges those customers a portion of the high cost pre- and post-merger resources in the Company's eastern control area. These resources do not benefit, were not built to serve, and are not used and useful for Washington customers.

14 PacifiCorp has proposed different versions of the Revised Protocol in each of its jurisdictions. The Washington Revised Protocol does not include rate credits, does not cap rate increases, fails to adequately compensate Washington for the value of its low cost hydro resources, and has been modified by PacifiCorp to charge Washington the high costs of existing Utah Qualifying Facilities ("QFs").

15 The Commission should adopt Mr. Falkenberg's proposed modification to the Washington version of the Revised Protocol to ensure that Washington customers pay only those costs that the Company actually incurs to serve such customers. In the alternative, if the Commission elects to adopt the Revised Protocol as an interim or

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[21] Id. at 2: 1 – 3: 21.

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permanent cost allocation methodology, the Commission should adopt conditions that are consistent with the versions of the Revised Protocol adopted in other states.

1. The Revised Protocol Is a Temporary Solution

16 PacifiCorp has requested approval of the Revised Protocol in order to close an alleged gap in cost recovery and to ensure that the Company has consistent allocation methodologies in its six jurisdictions.[22] PacifiCorp ignores that its alleged cost allocation problems were caused by the merger of PP&L and Utah Power & Light Company ("UP&L") (the "Merger") without first resolving the jurisdictional allocation issue.[23] At the time of the Merger, PacifiCorp affirmatively assumed the risk of any failure of different states to resolve cost allocation issues that could result from the integration of PP&L's low cost system with UP&L's high cost system.[24] The Commission has recognized this problem and has previously sought to protect Washington customers from the higher costs of the former UP&L system.[25]

17 The Commission has historically provided PacifiCorp with more than a full and fair opportunity to recover the Company's costs, and Washington rates are not the cause of any alleged cost recovery gap. Following the Merger, this Commission has increased rates in each of the general rate cases the Company has filed. PacifiCorp

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22/ Exh. No. 1 at 26-28 (Furman Direct).

23/ Exh. No. 491TC at 18: 21 – 21: 3 (Falkenberg Direct).

24/ Id. at 20: 19-21; Re PP&L, Oregon Public Utility Commission ("OPUC") Docket No. UF 4000, Order No. 88-767 at 22 (July 15, 1988) ("Applicants have committed indefinitely that Pacific's customers will not be harmed by the merger and will not subsidize benefits to Utah Power customers. Applicants recognize that if the merger results in higher costs, those costs will be borne by the merged company's shareholders. Applicants further agree that shareholders will assume all risks that may result from less than full system cost recovery if interdivisional allocation methods differ among the various jurisdictions.").

25/ See Exh. No. 491TC at 19: 21 – 20: 15 (Falkenberg Direct); Exh. No. 461T at 6-17 (Lott Direct); Re PP&L, Docket No. U-87-1338-AT, Second Suppl. Order at 13-14 (July 15, 1988).

stipulated to the overall rate increase in each of these proceedings and agreed that the stipulated increase would result in fair, just, reasonable and sufficient rates. Thus, since the Merger, Washington's base rates have increased 16.9% for industrial customers and 6.8% for residential customers[26/] even though the state has experienced modest load growth.[27/]

18 In contrast, Utah has had significant load growth,[28/] while its overall rates have been reduced 14.2% for industrial customers and 9.4% for residential customers since the Merger.[29/] Although PacifiCorp has added new high cost resources to serve its growing Utah load, Utah rates have been reduced to capture the benefits of the low cost western system. Essentially, Washington has been paying more than its fair share of costs and should not be required to pay even higher rates to subsidize Utah's rate decreases.

19 PacifiCorp also fails to acknowledge that adopting the Washington version of the Revised Protocol will not provide the Company with consistent allocation methodologies in its six jurisdictions. The versions of the Revised Protocol adopted in Utah, Oregon, Wyoming, and Idaho include significant state-specific conditions that may prevent the Company from having a permanent system-wide allocation methodology.[30/] For example, Utah and Idaho approved the Revised Protocol subject to rate caps that will

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26/ Exh. No. 764 (Staff Response to Bench Request ("BR") No. 25).

27/ See Exh. No. 335 at 2 (Retail Load Growth (Firm & Non Firm MW)) (Washington's load grew approximately 9.8% from 1992 to 2002).

28/ See Exh. No. 335 at 2 (Retail Load Growth (Firm & Non Firm MW)) (Utah's load grew approximately 53% from 1992 to 2002).

29/ Exh. No. 764 (Staff Response to BR No. 25).

30/ Exh. No. 541TC at 41-44 (Buckley Direct).

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set the Company's rates in those states.[31] The Utah rate caps resulted in a $12.6 million revenue requirement reduction in PacifiCorp's 2004 Utah rate case, and ensure that "there is no way in which the Revised Protocol in this case for Washington will ever be comparable to Utah's modified Revised Protocol."[32]

20 The Revised Protocol also is unlikely to be a permanent, durable cost allocation methodology. The Revised Protocol recognizes that states may adopt different rates or cost allocation methodologies if those methodologies are just, reasonable and in the public interest.[33] Oregon and Utah adopted their versions of the Revised Protocol based on the condition that PacifiCorp track its costs against their own preferred cost allocation methodologies—the Rolled-in for Utah and the Hybrid for Oregon.[34] The Utah version of the Revised Protocol also specifically recognizes that a new allocation methodology may be adopted if the Revised Protocol deviates from Rolled-in by more than 1%.[35] Finally, there are other significant unresolved cost allocation issues, including the finalization of the Hybrid method, the issue of cost shifting due to Utah load growth, and the permanency of the hydro endowment. The rate caps and other unresolved issues suggest that the various state specific versions of the Revised Protocol are temporary resolutions.

31/ Exh. No. 491TC at 23, 31 (Falkenberg Direct); Exh. No. 541TC at 37-38, 44 (Buckley Direct).
32/ Exh. No. 491TC at 31: 12-18 (Falkenberg Direct).
33/ Exh. No. 362 at 1-2 (PacifiCorp Inter-Jurisdictional Cost Allocation Protocol (Revised Protocol)).
34/ Re PacifiCorp, Utah Public Service Commission ("UPSC") Docket No. 02-035-04, Order (Dec. 14, 2004); Re PacifiCorp, OPUC Docket No. UM 1050, Order No. 05-021 (Jan. 12, 2005).
35/ Re PacifiCorp, UPSC Docket No. 02-035-04, Order; Exh. No. 491T at 33: 18 – 34: 20 (Falkenberg Direct).

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2. The Washington Version of the Revised Protocol Illegally Harms Washington

21 The Commission should reject PacifiCorp's proposed Washington Revised Protocol because, without significant changes, it would include in rates high cost Utah resources that do not benefit, and are not used and useful to serve, Washington customers. In addition, the Revised Protocol inappropriately allocates the cost of the Company's western control area hydro resources and existing Utah QFs.

a. The Revised Protocol Illegally Charges Washington Ratepayers for Costs that Are Not Incurred for Washington

22 Washington law allows the Commission "to ascertain and determine the fair value for rate making purposes of" only that utility property "used and useful for service in this state…."[36/] Specifically, the Commission cannot include the costs of generation resources in rate base unless they are "employed for service in Washington *and* capable of being put to use for service in Washington."[37/] Similarly, Washington utilities cannot charge customers for costs that were not prudently incurred to benefit them.[38/]

23 The majority of PacifiCorp's generation resources in its eastern control area, including those that were part of the former UP&L system and those acquired since 1986, do not benefit and are not used or useful for Washington, thus warranting removal from rates.[39/] PacifiCorp argues that Washington should pay for these resources because

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36/ RCW § 80.04.250.

37/ People's Org. for Wash. Energy Resources v. WUTC, 101 Wn.2d 425, 430 (1984) (emphasis in original); RCW § 80.04.250.

38/ See Jewell v. WUTC, 90 Wn.2d 775 (1978).

39/ Exh. No. 491TC at 35-39 (Falkenberg Direct).

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they serve all of PacifiCorp's customers.[40] The evidence demonstrates that PacifiCorp built or acquired these resources to serve loads in the eastern control area and that these resources provide very little, if any, electricity or other benefits to Washington.[41] Indeed, only a very small amount of the energy from these resources can even theoretically be transferred to the western control area (including Washington, California and Oregon),[42] and the Company cannot even identify specific examples of any benefits to Washington of its new resources.[43] Thus, the Commission should exclude costs of these resources from rates because PacifiCorp has not met its burden to establish that any of these generation resources benefit or serve Washington.[44]

b. The Revised Protocol Fails to Compensate Washington for the Value of Its Hydro Resources or Protect Washington from Utah Load Growth

24 The Revised Protocol also has other significant problems, including inadequately compensating Washington customers for the value of the Northwest hydro resources, and the lack of a structural protection mechanism to protect Washington from the costs of Utah load growth. Since the Merger, the proposed cost allocation methodologies have considered providing the western states with a "Hydro Endowment" or some preferential allocation of the Company's owned hydro resources and Mid-C

40/ Exh. No. 356 (PacifiCorp Response to ICNU Data Request ("DR") No. 14.17).

41/ Exh. No. 541TC at 9-10, 14-15, 30, 56-127 (Buckley Direct); Exh. No. 491TC at 37-39 (Falkenberg Direct).

42/ Exh. No. 541TC at 9-10, 14-15, 30, 56-127 (Buckley Direct), Exh. No. 491TC at 37-39 (Falkenberg Direct).

43/ Exh. No. 356 (PacifiCorp Response to ICNU DR No. 14.17).

44/ See People's Org. for Wash. Energy Resources, 101 Wn.2d at 432 (the term "'service' does not include lack of service").

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contracts.[45] The Revised Protocol's Hydro Endowment provides only a minimal benefit to Washington and "ignores some of the most important benefits of hydro to the system – most noticeably load shaping and dynamic overlay."[46] In addition, the minimal Hydro Endowment benefit may be temporary, as other states may seek to capture an even larger share of the hydro resources after the Northwest bears the costs associated with hydro re-licensing.[47] Finally, despite the trend of adding new resources to serve load growth in Utah, the Revised Protocol does not adequately protect Washington ratepayers from paying the costs of those expensive new resources.[48]

c. The Washington Revised Protocol Inappropriately Charges Washington Customers the Costs of the Existing Utah QFs

25 PacifiCorp has modified the Washington version of the Revised Protocol to ensure that Washington pays for the high costs of existing Utah QFs. For "Existing QFs," the Revised Protocol allocates the costs in excess of embedded costs on a situs basis. "New QFs," on the other hand, are allocated on a system-wide basis. PacifiCorp has inappropriately proposed to allocate on a system-wide basis, rather than on a situs basis, four existing QF contracts that were acquired specifically to serve Utah.[49] The four challenged Utah QF contracts are the US Magnesium, Desert Power, Kennecott, and Tesoro contracts.

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[45] Exh. No. 491TC at 23:30 – 24:3 (Falkenberg Direct); Exh. No. 461T at 10: 13-15, 11: 12-14, 13: 9-15, 15:1-3 (Lott Direct).
[46] Exh. No. 491TC at 26:6-8 (Falkenberg Direct).
[47] Id. at 27.
[48] Id. at 2: 29 – 3: 2, 23: 8-11, 28-30.
[49] Exh. No. 541TC at 173-74 (Buckley Direct).

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26 The terms of the Revised Protocol in other states define the difference between New and Existing QFs as the date the Revised Protocol is effective. In Washington, the Revised Protocol has not been adopted and cannot be effective until the Commission issues its final ruling in April 2006.[50/] Each of the challenged Utah QFs took effect on or before January 1, 2005, and must be considered Existing QFs that must be allocated on a situs basis to Utah.[51/]

27 In the Washington Revised Protocol, however, PacifiCorp has altered the definition of "Existing QFs" to ensure that the high costs of these QFs are allocated to Washington. Specifically, PacifiCorp changed the definition of "Existing QFs" from QFs that were "entered into prior to the effective date of this Protocol" to all QFs entered into "prior to May 21, 2004."[52/] It is inappropriate for PacifiCorp to manipulate the Revised Protocol in this manner, while alleging that the Revised Protocol is a common allocation method for all states. Finally, these QFs should be assigned on a situs basis to Utah because PacifiCorp has not presented a legitimate basis to treat new and existing QFs differently, and these QFs were specifically acquired to serve Utah.[53/]

28 The rate caps in the Utah Revised Protocol along with PacifiCorp's manipulation of the Utah QFs demonstrates that the Company will favor Utah and is not an "honest broker" regarding disputes concerning the implementation of the Revised

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50/ Exh. No. 376 (PacifiCorp Response to ICNU DR No. 2.136); Exh. No. 541TC at 173 (Buckley Direct).
51/ Exh. No. 491TC at 45-48 (Falkenberg Direct).
52/ Id.; Exh. No. 362 at 18 (PacifiCorp Inter-Jurisdictional Cost Allocation Protocol (Revised Protocol)).
53/ Exh. No. 541TC at 173-74 (Buckley Direct).

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Protocol.[54] The Revised Protocol is purposefully vague in certain respects and has not resolved many allocation disputes, including which resources will be allocated to Utah as seasonal resources, cost shifting due to load growth and the designation of above-market special contracts.[55] Since Utah's rates are capped under the Utah Revised Protocol, PacifiCorp has a built-in incentive to ensure that all disputed Utah costs are charged on a system-wide basis. This is exactly what the Company has done with its existing Utah QFs and what the Company is likely to do in future cost allocation disputes under the Revised Protocol.

3. The Commission Should Adopt ICNU's Pre-Merger Adjustment to the Revised Protocol

29 ICNU witness Randall Falkenberg has proposed a straightforward "Pre-Merger Method" that will ensure that Washington ratepayers pay the costs of only those prudently incurred resources that are beneficial to and used and useful for serving Washington customers. The Pre-Merger Method avoids designing a complex new methodology, and instead makes a simple modification to the Revised Protocol that reflects the costs of the pre-merger resources of PP&L.[56] The Pre-Merger Method quantifies the difference in embedded costs of the pre-merger PP&L resources and other resources, and computes the difference between the average cost of energy from the pre-merger PP&L states and the system average cost.[57] The credit is multiplied by the

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[54] Exh. No. 491TC at 32-33, 45: 17-22 (Falkenberg Direct).
[55] Id. at 32-34.
[56] Id. at 40.
[57] Id. at 40-41.

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generation of these resources and allocated to Washington.[58/] The approach effectively reduces the cost impact of new resources that are added by PacifiCorp to meet load growth in Utah and ensures that Washington receives the benefits of the resources that were allocated to Washington before the merger.[59/]

30 Finally, the Pre-Merger Method is a flexible method that is capable of expanding to reflect changes in PacifiCorp's operations. For example, the Pre-Merger Method could be easily modified to insulate Washington from the costs of new transmission investments that MEHC has committed to undertake to address load growth in its eastern control area.[60/]

4. In the Alternative, the Commission Should Impose Minimum Conditions If the Revised Protocol Is Adopted

31 If the Commission does adopt the Revised Protocol, it should address specific defects applicable to Washington and condition its approval in a manner that is consistent with other states. First, the Commission should impose Mr. Falkenberg's proposed "rate caps" that guarantee the Company's claim that the Revised Protocol will result in rates lower than the Modified Accord Method.[61/] Unlike the Utah rate caps that have reduced the Company's Utah rates, Mr. Falkenberg's Washington rate caps would only impact rates if PacifiCorp's cost projections are erroneous.[62/]

58/ Id. at 41.
59/ Id.
60/ Exh. No. 522T at 5 (Falkenberg Suppl.).
61/ Exh. No. 491TC at 43 (Falkenberg Direct).
62/ Id.

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32 The Commission also should reserve the right to adopt a structural protection mechanism to shield Washington from Utah load growth.[63] PacifiCorp is currently developing such a mechanism with the Multi-State Process parties; however, PacifiCorp is unlikely to support a mechanism that actually protects the western states.

33 Finally, the Commission should adopt adjustments to PacifiCorp's proposed test period to mitigate the costs of Utah load growth imposed on Washington customers. This includes reversing the Company's production factor adjustment, requiring the use of an historic test year for power costs, removing the high costs of the existing Utah QFs from rates, and removing Currant Creek from the test year because it was not used and useful during the historic period.[64]

D. PacifiCorp's PCAM Is Unjustified and Fatally Flawed

34 PacifiCorp's PCAM should be rejected because it unnecessarily shifts risks traditionally borne by the Company to customers, when shareholders are far more capable of managing any power cost volatility risk. PacifiCorp's PCAM also suffers from numerous design flaws that will harm Washington ratepayers, including requiring customers to shoulder significant costs of Utah load growth, the lack of a reasonable sharing mechanism or deadband, and proposing too broad of a definition of eligible costs.

1. PacifiCorp Has Failed to Justify Adopting a PCAM

35 PacifiCorp's proposed PCAM unjustifiably shifts the vast majority of power cost risks to ratepayers and provides the Company with inappropriate regulatory

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[63] Id. at 44.
[64] Id. at 44-48.

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incentives. PacifiCorp has not explained why its proposal is consistent with the Commission's standards regarding PCAMs or why it is preferable for ratepayers to bear increased risk of power cost fluctuations.

36 PacifiCorp asserts that its PCAM is necessary to increase its opportunity to earn its authorized rate of return.[65] The Commission has recognized "that an allowed rate of return merely presents the utility in question an opportunity to achieve the allowed return subject to risks and exigencies which may prevent the utility from achieving the allowed return."[66] The risk that the utility may not earn its authorized rate of return forces the utility to operate efficiently, and PacifiCorp's PCAM will eliminate much of the Company's incentive to efficiently manage its power costs.[67]

37 PacifiCorp argues that the Commission should approve a PCAM to address power cost volatility.[68] The Company has not presented specific evidence, however, regarding the actual power cost fluctuations to which the Company is exposed or establishing that these fluctuations are having a significant impact. PacifiCorp has stipulated to the overall power costs in rates in this proceeding, and the evidence demonstrates that power cost volatility "has been relatively smooth since mid-2001, and does not reflect the volatility of the Energy Crisis years that provides much of the 'exposure' claimed by the Company."[69] In other words, while power cost fluctuations

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[65] Exh. No. 381T at 8: 7-9 (Omohundro Direct).

[66] WUTC v. Timberland Tel. Co. et al., Cause Nos. U-75-56, U-75-69 and U-75-74, Third Suppl. Order at 11 (Aug. 16, 1976).

[67] See Exh. No. 491TC at 65-67 (Falkenberg Direct).

[68] Exh. No. 381T at 2 (Omohundro Direct).

[69] Exh. No. 541TC at 188 (Buckley Direct).

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could theoretically affect the Company's ability to earn its authorized rate of return, PacifiCorp has not shown that such impacts are occurring.

38 Moreover, even if power cost fluctuations were harming PacifiCorp, a PCAM would not necessarily be the best means to address that issue. PacifiCorp's management makes the decisions associated with power supply options, and the risk of management practices should be placed "on those that make the business decisions—management—not customers."[70/] The Company is in a better position to mitigate its power cost risk through prudent resource acquisitions and appropriate hedging strategies.[71/]

39 Absent a PCAM, the Company will have an incentive to reduce its dependency on short-term markets and mitigate its risk, and have more financial incentive to select low-cost supply alternatives. For example, even if a transmission investment would have a lower total cost than purchasing resources, the Company would have a financial incentive to purchase power if a PCAM were in place because the costs could be directly passed through to customers.[72/] In short, with a PCAM in place, PacifiCorp might have "the incentive to continue a potentially more risky strategy of overreliance on the market" rather than developing effective long-term solutions.[73/]

40 Finally, PacifiCorp and MEHC have stated an intention to file annual rate cases in Washington, including a new general rate case in the summer of 2006. Annual

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70/ Exh. No. 499 at 14: 17-26 (Direct Testimony of Verl R. Topham (Utah, May 1990)).
71/ See Exh. No. 381T at 4: 16 – 5: 6 (Omohundro Direct); Exh. No. 385 at 2 (The Aquila hydro hedge reduced PacifiCorp's shareholders' net power cost exposure by $7.7 million in fiscal year 2005).
72/ Exh. No. 491TC at 65 (Falkenberg Direct).
73/ Id.

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rate filings that update the Company's power cost will insulate PacifiCorp from much of the power cost risk and regulatory lag that a PCAM is designed to address. Frequent rate adjustments will dramatically reduce the risk that PacifiCorp will not recover its power costs, making a PCAM unnecessary. While ICNU does not support annual rate cases, this decision rests with the Company.

2. PacifiCorp's PCAM Is Fatally Flawed

41 PacifiCorp has proposed a one-sided PCAM that is designed to harm Washington customers. Unlike the PCAMs for Puget Sound Energy ("PSE") and Avista, and the Company's proposed Wyoming PCAM, PacifiCorp has not modified its PCAM to address any of the concerns of Staff or intervenors about a reasonable deadband, a sharing mechanism, or the types of costs that should be included in the PCAM. PacifiCorp has also ignored Commission precedent by failing to include a reasonable cost of capital adjustment as part of its PCAM proposal. Finally, PacifiCorp has also specifically designed the PCAM to harm Washington by shifting the costs of Utah load growth to Washington customers and manipulating the allocation to overcharge Washington customers for costs of hydro variation.

a. PacifiCorp's PCAM Charges Washington Customers Additional Costs of Utah Load Growth

42 PacifiCorp's PCAM allocates system-wide power costs to Washington in a manner that is highly inequitable because the PCAM charges Washington the costs of Utah load growth.[74/] PacifiCorp's PCAM allocates the costs of load growth on a Rolled-

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[74/] Id. at 51.

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in basis instead of based on cost responsibility. The Company's unexpected Utah load growth is a significant cause of the Company's higher power costs, and Washington "ratepayers should not be called upon to protect the Company from volatility caused by load growth in other jurisdictions . . . ."[75/]

43 Irrespective of whether the Commission believes that ratepayers should bear the risk of power cost variations, PacifiCorp's PCAM should be rejected because it shifts the costs of Utah load growth to Washington customers. For example, between March 2000 and March 2007, Utah is projected to account for 83% of the Company's load growth while Washington will account for only 1% of load growth.[76/] However, the PCAM assigns the costs of this load growth based on historic allocation factors instead of Washington's share of load growth or Washington's actual loads. This results in the PCAM shifting, in 2007 alone, $4.9 million in costs to Washington that are directly attributable to Utah load growth.[77/]

b. PacifiCorp Manipulates the Revised Protocol to Overcharge Washington for Hydro Variations

44 PacifiCorp also appears to purposefully misapply the Revised Protocol in its PCAM in order to increase Washington revenues.[78/] PacifiCorp's misapplication of the Revised Protocol demonstrates that the Company is not concerned with obtaining a consistent, reasonable allocation methodology, but intends to manipulate the interstate allocation process to maximize Washington revenues. PacifiCorp's proposal is

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75/ Exh. No. 541TC at 188 (Buckley Direct).
76/ Exh. No. 493 at 1 (Cost Shifting Due to Production Factor and PCAM).
77/ Exh. No. 491TC at 51-52 (Falkenberg Direct); Exh. No. 493 at 1 (Cost Shifting Due to Production Factor and PCAM); Exh. No. 541TC at 194 (Buckley Direct).
78/ Exh. No. 491TC at 52 (Falkenberg Direct).

particularly egregious because it is charging Washington the costs of load growth on a Rolled-in basis, while assigning Washington a greater share of any hydro-related costs.

45 Although ICNU opposes adopting the Revised Protocol without specific modifications, the methodology should be fairly applied if adopted. PacifiCorp misapplies the Revised Protocol by using the Revised Protocol's Embedded Cost Differential ("ECD") allocators—which apply only to hydro resources, Mid-Columbia contracts, and existing QF contracts—to allocate purchased power costs in the PCAM.[79/] Furthermore, it is inappropriate to apply the ECD calculation in the context of a PCAM in any event because the ECD is based on normalized hydro levels, while a PCAM is based on actual hydro conditions.[80/]

46 PacifiCorp's proposal would assign an inordinate amount of the cost of hydro variations to Washington. Specifically, Washington would bear twice the amount of cost responsibility for a hydro shortfall than is appropriate.[81/] Essentially, the Revised Protocol itself denies Washington the benefits of the low cost hydro resources, and PacifiCorp modifies the Revised Protocol in its PCAM to charge Washington a greater share of any hydro shortfall. If the Commission approves the Revised Protocol and a PCAM, it should allocate incremental costs of power cost variations based only on the Revised Protocol's system allocators.

79/ Id. at 53-54.
80/ Id. at 55-56.
81/ Id. at 54: 11-13.

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c. PacifiCorp's PCAM Should Be Rejected Because It Does Not Include a Deadband or an Appropriate Sharing Mechanism

47 A fundamental defect in PacifiCorp's proposed PCAM is its lack of a deadband. A deadband is an essential component of any PCAM, because it ensures that the Company retains at least some of its traditional ratemaking risk of cost changes between rate cases.[82/] PacifiCorp has agreed to a deadband for its proposed Wyoming PCAM.[83/] Furthermore, the PCAMs that the Commission adopted for Avista and PSE to address financial emergencies during the wholesale energy crisis include deadbands.[84/] Any appropriate deadband for PacifiCorp should reflect the fact that the Company has significantly higher overall power costs than Avista or PSE.[85/]

48 Instead of including a deadband, PacifiCorp proposes a sharing mechanism that is far too generous to the Company. Under PacifiCorp's sharing mechanism, PacifiCorp is responsible for 10% of its power cost variance, while ratepayers are responsible for 90%.[86/] This sharing mechanism will "greatly reduce any incentives [PacifiCorp] has to minimize power costs."[87/] In addition, this sharing mechanism allocates a much greater percentage of costs to ratepayers than the sharing

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82/ Exh. No. 541TC at 194: 9-20 (Buckley Direct).

83/ Exh. No. 755 (PacifiCorp First Suppl. Response to BR No. 22) ($40 million deadband with significantly lower customer power cost exposure because the Company's Wyoming overall net power costs are $660 million compared to PacifiCorp's request for $801 million in Washington).

84/ Exh. No. 759 (PacifiCorp Response to BR No. 23).

85/ See Exh. No. 761 (Public Counsel Response to BR No. 23) (The sharing bands should be sized to company, "therefore a comparison of nominal values without comparing ratebase and revenue is not relevant.")

86/ Exh. No. 391T at 31-32 (Widmer Direct).

87/ Exh. No. 491TC at 57: 23-24 (Falkenberg Direct).

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mechanism the Company accepted in its Wyoming PCAM.[88] Any PCAM should have both an appropriate deadband and a fair sharing mechanism to ensure that management retains an incentive to minimize its power costs.

d. PacifiCorp's PCAM Has Other Significant Flaws

49 The Commission has recognized that PCAMs shift risks to customers and that such mechanisms should compensate customers for the additional risks that they will bear.[89] In rejecting a PCAM for Avista, the Commission found that "[m]echanisms that simply shift risk from shareholders to ratepayers without compensating benefits do not meet" the objective of having "an equitable balancing of risk between ratepayers and shareholders."[90] Despite this precedent, PacifiCorp has failed to propose an appropriate ROE adjustment.

50 PacifiCorp also has not defined the costs that are eligible for inclusion in its PCAM, and instead provides an illustrative example based on 2004 actual data.[91] The lack of clarity regarding the eligible costs and other potential issues related to how PacifiCorp can classify costs will provide PacifiCorp an opportunity to game the system in order to over-recover its costs.[92]

88/ Exh. No. 755 (PacifiCorp First Suppl. Response to BR No. 22) (PacifiCorp absorbs 30% of the costs between $40 million and $100 million, 15% of the costs between $100 million and $200 million, and 10% of the costs above $200 million with net power costs of $660 million).

89/ E.g., WUTC v. Avista Corp., Docket Nos. UE-991606 and UG-991607, Third Suppl. Order at ¶ 185; WUTC v. Puget Sound Power & Light Co., ("PSP&L") Docket Nos. U-89-2688-T and U-89-2955-T, Third Suppl. Order at 13-15 (Jan. 17, 1990).

90/ WUTC v. Avista Corp., Docket Nos. UE-991606 and UG-991607, Third Suppl. Order at ¶ 185.

91/ Exh. No. 491TC at 58 (Falkenberg Direct).

92/ Id. at 71-72.

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51 PacifiCorp's PCAM also will inappropriately allow the Company to recover costs related to expenses that are not volatile, significant, or beyond the Company's control. The Commission has recognized that PCAMs, if appropriate, should be established to recover short run cost changes that the utility cannot control, such as weather and hydro conditions.[93/] PacifiCorp's nebulous "definition" of allowable actual power costs, which could allow the Company to recover solid fuel costs, transmission expenses, and long-term contract costs, should be rejected.[94/] Solid fuel costs, transmission expenses, and long-term contract costs should not be recoverable through a PCAM because they are not highly volatile or significant, and are not typically beyond the Company's control.[95/]

E. The Commission Should Reject PacifiCorp's Power Cost Deferral

52 PacifiCorp's petition for a deferred account regarding its costs related to alleged declining hydro generation should be denied because PacifiCorp has failed to present any evidence that such costs are extraordinary or otherwise not included in rates. Similarly, the Commission should reject the Company and Staff's request to amortize a portion of any deferred costs because there is no evidence demonstrating that these costs were prudently incurred or would produce just and reasonable rates. In fact, the record is completely devoid of any evidence that would support the deferral of these costs or amortization in rates.

93/ WUTC v. Avista Corp., Docket Nos. UE-991606 and UG-991607, Third Suppl. Order at ¶¶ 172-73.

94/ Exh. No. 491TC at 58 (Falkenberg Direct).

95/ Id.

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53 PacifiCorp has the burden to show that it is experiencing extraordinary conditions that warrant a deferral and that the deferred costs are not included in rates.[96/] For the deferral or amortization to be granted, PacifiCorp must clearly identify the elements of why its proposal is consistent with Washington law and present evidence that meets that burden.[97/]

54 PacifiCorp has not submitted any evidence, or even clearly identified the factual or legal basis, to support its power cost deferral or the amortization of any deferred amounts. The only information the Commission has upon which to base its decision is PacifiCorp's petition. There is absolutely no basis to determine what portion of these hydro costs are above and beyond what is currently in rates. The issue of the baseline power costs in current rates may be contentious because the Commission approved the Company's last rate case based on a stipulation that the Company has treated as a "black box" settlement.[98/]

55 PacifiCorp also has not submitted any evidence regarding whether the hydro conditions the Company is currently experiencing are extraordinary or otherwise warrant the unusual remedy of a deferred account. There is no evidence to suggest that the Company's hydro generation is outside of what PacifiCorp should have expected.

96/ See Re PacifiCorp, Docket No. UE-020417, Third Suppl. Order at 1-2 (Sept. 27, 2002); Re PacifiCorp, Docket Nos. UE-991832 and UE-020417, Sixth/Eighth Suppl. Order at ¶¶ 29, 32.

97/ See GTE Northwest Inc. v. Whidbey Tel. Co., Docket No. UT-950277, Fifth Suppl. Order (Apr. 2, 1996); WUTC v. Am. Water Resources Inc., Docket No. UW-000405, Final Order (Mar. 30, 2001).

98/ See WUTC v. PacifiCorp, Docket No. UE-032065, Order No. 07 at ¶ 4; Re PacifiCorp, Docket Nos. UE-991832 and UE-020417, Sixth/Eighth Suppl. Order at ¶¶ 26-27 (The Commission found that it lacked a suitable baseline to establish normalized power costs because the prior rate case was settled).

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56 The Commission should reject Staff's proposal to allow PacifiCorp to amortize a portion of its proposed deferred power costs.[99/] PacifiCorp appears to have accepted Staff's proposal, and is requesting partial cost recovery of its deferred power costs.[100/] PacifiCorp must show that any amortization of deferred amounts produces just and reasonable rates, even for amounts for which Staff supports recovery.[101/] Allowing PacifiCorp to amortize these costs without a prudence determination would "violate the Commission's duty to ensure that rates are based on prudent costs."[102/]

57 Staff's proposal should also be rejected because it utilizes a mixture of actual and currently projected replacement hydro costs.[103/] It is inappropriate to treat projections of future hydro replacement costs as if they were actual costs in a deferred account. There is no evidence that the projections relied upon by Staff are reasonable because hydro conditions have improved. One recent report highlights the good hydro conditions with record-breaking rainfall, snow pack at or above average, and better than average water supply forecasts.[104/]

58 Finally, the record lacks any evidence regarding the portion of any deferred costs that should be allocated to Washington. There should be an accepted or approved inter-jurisdictional allocation methodology to determine the proper allocation

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99/ Exh. No. 541TC at 204-10 (Buckley Direct).

100/ Exh. No. 195T at 5 (Wrigley Rebuttal).

101/ RCW § 80.04.130(4); See WUTC v. Wash. Exch. Carrier Ass'n, Docket No. UT-971140, Fifth Suppl. Order at 21 (Oct. 30, 1998).

102/ Re PSP&L Docket Nos. UE-920433, UE-920499 and UE-921262, Eleventh Suppl. Order at 23 (Sept. 21, 1993).

103/ Exh. No. 541TC at 207: 1-10, 211: 10-13 (Buckley Direct).

104/ Alan Mountjoy-Vanning, Warm and Wet January Spawns Many Record Events, Clearing Up No. 1223, Feb. 13, 2006, at 5.

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of deferred power costs to Washington.[105] Staff's proposed amortization of a portion of the deferred account is based on Staff's Amended Revised Protocol method. PacifiCorp's original application, on the other hand, appears to utilize the hydro allocation factors in the Revised Protocol. It may be inappropriate to use these allocation proposals because current rates are not based on either of these methods.

F. PacifiCorp Has Inflated Its Cost of Capital by Ignoring Realistic Economic Forecasts and Relying Upon Unnecessary Equity Infusions

59 ICNU supports reasonable adjustments to PacifiCorp's overall capital structure and return on equity ("ROE") that would more accurately reflect the conditions that are expected to occur during PacifiCorp's test year. ICNU's proposed 9.8% ROE is reasonable, will allow PacifiCorp to attract necessary capital, and most accurately reflects the recent decline in equity market costs. In addition, PacifiCorp's proposed capital structure should be adjusted to exclude a proposed $375 million equity infusion from PacifiCorp Holdings Inc. ("PHI") because the equity infusion is not known and measurable, nor will it improve PacifiCorp's credit quality or lower its cost of capital. ICNU proposes a $7.9 million Washington revenue requirement reduction based on an overall rate of return of 8.02%, an ROE of 9.8%, and a fiscal year ("FY") 2006 capital structure that excludes the projected $375 million capital infusion.[106]

60 ICNU does not recommend that the Commission adjust PacifiCorp's capital structure or cost of capital based on the proposed MEHC acquisition. While PacifiCorp's cost of capital and capital structure may be significantly impacted by the

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[105] See Re PacifiCorp, Docket Nos. UE-991832 and UE-020417, Sixth/Eighth Suppl. Order at ¶ 30.
[106] Exh. No. 121T at 3: 19-21 (Gorman Direct).

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proposed acquisition, the record is not adequately developed to determine the exact impact on PacifiCorp's cost of capital and capital structure from the MEHC acquisition.[107/]

1. PacifiCorp's Proposed Equity Infusion Is Unlikely to Improve the Company's Credit Quality

61 ICNU supports a reasonable overall cost of capital for PacifiCorp based on PacifiCorp's projected FY 2006 capital structure, excluding a projected $375 million equity infusion from its corporate parent. This capital structure would be 47.1% common equity,[108/] 51.8% debt, and 1.2% preferred stock.[109/] In addition to being consistent with PacifiCorp's expected actual capital structure, this capital structure has been recognized by the credit rating agencies as supporting PacifiCorp's current bond rating, and is comparable to the common equity ratios of comparable utility groups. ICNU's proposed capital structure also is consistent with the Commission's requirement to consider the specific circumstances of each utility when establishing a capital structure on a case-by-case basis.[110/]

62 The primary difference between ICNU's and PacifiCorp's proposed capital structures is that the Company includes three quarterly equity infusions that could increase PacifiCorp's common equity balance by $375 million. The equity infusions

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107/ Exh. No. 142T at 1 (Gorman Suppl.).

108/ ICNU recognizes that the MEHC settlement includes a provision that requires PacifiCorp to meet a capital structure that includes 48.25% common equity capital, plus one half preferred equity to total capital. Exh. No. 11 at 24 (Oregon Stipulation). However, this does not mean that the Company must have a minimum common equity ratio of 48.25%.

109/ Exh. No. 121T at 16: 5-6 (Gorman Direct).

110/ WUTC v. PSE, Docket Nos. UG-040640, UE-040641, UE-031471 and UE-032043, Order No. 06 at ¶ 27 (Feb. 18, 2005).

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should be excluded because it is not known and measurable that they will be made during the test period.[111] Even if the planned equity infusions are made, the actual impact on PacifiCorp's common equity is not known because much of the equity infusion can be returned to its parent company.

63 More importantly, increasing PacifiCorp's reliance on higher cost common equity and reducing its reliance on debt is unlikely to improve PacifiCorp's credit quality or lower its cost of capital without comparable adjustments at ScottishPower or MEHC. The practical effect of the equity infusion may only be to increase PacifiCorp's cost of capital by including more expensive common equity capital. Increasing PacifiCorp's common equity without a comparable increase in its parent company's equity ratio and a corresponding debt leverage risk reduction is unlikely to improve PacifiCorp's credit quality or lower its cost of capital.[112] Essentially, recognizing the equity infusions "will simply increase PacifiCorp's cost of capital by overweighting the capital structure with more expensive common equity capital."[113]

64 ICNU's proposed capital structure is reasonable because it should allow PacifiCorp to maintain its credit rating, is consistent with changes at the consolidated ScottishPower companies, and is comparable to other utility groups. Ratings agency reports establish that PacifiCorp's current capital structure and financial ratios support its "A-" bond rating.[114] Utilizing PacifiCorp's FY 2006 capital structure, without the projected equity infusion, is within the reasonable range of comparable utilities and

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111/ Exh. No. 121T at 9: 19 – 10: 2 (Gorman Direct).
112/ Id. at 11: 3-12.
113/ Id. at 11: 10-12.
114/ Exh. No. 139 at 4, 16, 19 (Credit Rating Reports).

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sufficient to maintain its bond rating.[115/] Finally, ICNU's proposed capital structure is consistent with the consolidated debt ratio of ScottishPower and its consolidated companies.[116/]

2. The Commission Should Adopt ICNU's 9.8% ROE Recommendation

65 The evidence demonstrates that ICNU's proposed 9.8% ROE for PacifiCorp is reasonable and based on realistic, observable market conditions.[117/] In contrast, PacifiCorp's proposed 11.125% ROE is inconsistent with prevailing low interest rates and is based on unrealistic expectations of future economic growth. In fact, PacifiCorp's proposal also supports a 9.8% ROE, once that proposal is adjusted to include unbiased and publicly available consensus economists' predictions and more accurate, observable market interest rates. Finally, a 9.8% ROE will produce financial ratios that support PacifiCorp's unsecured BBB+ bond rating and A- secured bond ratings.

66 In setting a utility's ROE, there is no "precise science" to establishing the proper ROE, but there is "an exercise in informed judgment" in consideration of "the competing financial analysis evidence."[118/] The Commission's overall authorized ROE should attempt to: 1) be sufficient to maintain financial integrity; 2) attract capital under

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115/ Exh. No. 121T at 15: 10-25 (Gorman Direct).
116/ Id. at 16: 10-11.
117/ Id. at 1.
118/ WUTC v. PSE, Docket Nos. UG-040640, UE-040641, UE-031471 and UE-032043, Order No. 06 at ¶ 80; see also Fed. Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591 (1944); Bluefield Water Works & Improvement Co. v. Pub. Serv. Comm'n of W. Virginia, 262 U.S. 679 (1923).

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reasonable terms; and 3) be commensurate with returns investors could earn by investing in other enterprises of comparable risk.[119/]

67 While the setting of each individual utility's ROE should be grounded in sound financial evidence regarding the actual returns investors could expect from similar investments, the overall result should be unbiased and within a range of reasonable options.[120/] ICNU's 9.8% ROE is based on the average ROE of three separate methodologies: 1) the constant growth discounted cash flow ("DCF") model; 2) the bond yield plus risk premium model; and 3) the capital asset pricing model ("CAPM").[121/] These analyses produced ROE ranges from 8.9% to 10.3%, with a recommended mid-point of 9.8%.[122/] Mr. Gorman's ROE analysis relied upon the same comparable electric utility proxy group as used by PacifiCorp.[123/]

68 ICNU's proposal is also a reasonable midpoint proposal between Staff's 8.95% ROE,[124/] Public Counsel's proposed 9.125% ROE,[125/] and PacifiCorp's inflated 11.125% ROE.[126/] The ROE estimates of ICNU, Staff, and Public Counsel reasonably account for the current decline in capital costs that has persisted for some time.[127/] In contrast, PacifiCorp's ROE recommendation includes errors in financial logic, refuses to

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119/ WUTC v. Avista Corp., Docket Nos. UE-991606 and UG-991607, Third Suppl. Order at ¶ 324.
120/ WUTC v. Avista Corp., Docket Nos. UE-050482 and UG-050483, Order No. 05 at ¶¶ 45-49 (Dec. 21, 2005); WUTC v. Avista Corp., Docket Nos. UE-991606 and UG-991607, Third Suppl. Order at ¶¶ 374-78.
121/ Exh. No. 121T at 1 (Gorman Direct).
122/ Id. at 29.
123/ Id. at 18: 5-6.
124/ Exh. No. 151T at 4 (Rothschild Direct).
125/ Exh. No. 91T at 3-4 (Hill Direct).
126/ Exh. No. 21-T at 4 (Hadaway Direct).
127/ Exh. No. 121T at 4-6 (Gorman Direct); Exh. No. 91T at 4 (Hill Direct); Exh. No. 151T at 7 (Rothschild Direct).

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acknowledge current low capital market costs, and relies upon the fallacy that the Company's cost of capital should be based on the exclusive use of their own projected interest rates, which reflect dramatic increases over current observable and real interest rates.[128/] As explained by Mr. Gorman, "[d]epriving customers of today's low cost capital market environment is prejudicial and unreasonably tilts the regulatory balance in favor of investors."[129/]

69 Finally, the overall reasonableness of ICNU's recommended 9.8% cost of capital is supported by the fact that it is consistent with recent commission rulings in other jurisdictions, including Oregon's September 2005 order granting a 10% ROE to PacifiCorp.[130/] This represents corroborative evidence and provides a useful check that demonstrates that ICNU's 9.8% ROE recommendation is reasonable.[131/]

a. The DCF Model Results Support ICNU's Recommended ROE

70 The DCF model is designed "to measure what level of equity return investors will demand in the market for a particular company, thus measuring that company's cost of money in the equity market."[132/] Use of the DCF model is widely recognized for "determining the return on equity [and] is perhaps the most commonly used method for computing cost of equity among the regulatory agencies today."[133/]

128/ Exh. No. 121T at 6: 1-4 (Gorman Direct); Exh. No. 151T at 5-7 (Rothschild Direct).
129/ Exh. No. 121T at 6: 1-2 (Gorman Direct).
130/ Exh. No. 12 at 3 (Re PacifiCorp, OPUC Docket No. UE 170, Order No. 05-1050 at Appendix H (Sept. 28, 2005)); see also Exh. No. 91T at 5 (Hill Direct).
131/ WUTC v. Avista, Docket Nos. UE-050482 and UG-050483, Order No. 05 at n.45.
132/ WUTC v. PSE, Docket Nos. UG-040640, UE-040641, UE-031471 and UE-032043, Order No. 06 at ¶ 42.
133/ Leonard Saul Goodman, The Process of Ratemaking 617 (1998); Exh. No. 21T at 11: 21-22 (Hadaway Direct).

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71 The constant growth DCF model assumes that a stock price is valued by summing the present value of expected future cash flows discounted at the investors' required rate of return or cost of capital. The analysis is based on a current stock price, an expected dividend, and an expected dividend growth rate.[134/] For current stock prices and expected dividends, Mr. Gorman used the average of the weekly high and low stock prices over a 13-week period and the most recently paid quarterly dividend.[135/] Mr. Gorman relied upon consensus, or mean, of professional security analysts' growth estimates as a proxy for the investor consensus dividend growth rate expectations.[136/]

72 The overall results of Mr. Gorman's constant growth DCF model is an 8.9% ROE. This result is reasonable in today's low cost of equity marketplace because: 1) the consensus growth rates are consistent with the five-year projected Gross Domestic Product ("GDP") growth and are higher than the projected rate of inflation; 2) the group yield reflects both current and projected interest rates; and 3) the dividend fundamentals show strong and consistent earnings strength in relation to the lower cost dividends in the current marketplace.[137/]

73 PacifiCorp witness Dr. Hadaway recommends an 11.125% ROE based, in part, on his inflated DCF analysis. Specifically, Dr. Hadaway estimated a range of DCF model results of 10.7% to 11.2%.[138/] The Commission should reject Dr. Hadaway's analysis because he arbitrarily excludes his traditional constant growth DCF analysis, and

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134/ Exh. No. 121T at 19 (Gorman Direct).
135/ Id. at 19-20
136/ Id. at 20.
137/ Id. at 21-22.
138/ Exh. No. 21T at 28 (Hadaway Direct); Exh. No. 24 at 2-5 (DCF Analysis).

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he includes unrealistic estimates of GDP growth in his other DCF models. The DCF model results Dr. Hadaway excluded and the use of current market information in his remaining DCF model results support an ROE of less than 9.8%.[139/]

74 Dr. Hadaway rejects "out of hand" the results of his own constant growth DCF analysis and those of Staff, Public Counsel, and ICNU simply because he believes the results are too low.[140/] Contrary to his assertions, the constant growth DCF results are "viable and legitimate cost of equity estimates" which should not be rejected simply because they indicate an ROE below 10%.[141/] Excluding these results has the practical effect of refusing "to recognize the dramatic decline in capital costs in today's marketplace" and failing to arrive at a fair adjusted return for PacifiCorp.[142/]

75 Dr. Hadaway's remaining DCF model results have been overstated by projecting unrealistically high GDP growth rates.[143/] Specifically, Dr. Hadaway relies upon an unreasonable 6.6% GDP growth rate, which is based on the average GDP over the last 20- and 40-year periods.[144/] However, the consensus economists' projected GDP over the next five and ten years is 5.5%.[145/] Dr. Hadaway rejects these consensus economists' projections because, in his view, they are "extremely pessimistic."[146/] These consensus projections are not pessimistic, but merely reflect the most accurate growth

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139/ Exh. No. 121T at 32-36 (Gorman Direct).
140/ Exh. No. 21T at 23: 14 – 24: 10 (Hadaway Direct); Exh. No. 26T at 26: 10-12 (Hadaway Rebuttal).
141/ Exh. No. 121T at 32-33 (Gorman Direct); Exh. No. 91T at 4-5 (Hill Direct).
142/ Exh. No. 121T at 33: 10-12 (Gorman Direct).
143/ Id. at 34: 8 – 36: 11.
144/ Id. at 34: 8 – 39: 3
145/ Id. at 35: 10-12.
146/ Exh. No. 26T at 27: 2 (Hadaway Rebuttal).

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estimates based on expected forward-looking inflation and growth.[147] Correcting PacifiCorp's DCF analyses to include the published consensus economists' five to ten year projected GDP growth rates results in an average ROE of 9.6%.[148]

b. The Risk Premium Analyses Support ICNU's ROE Recommendation

76 A risk premium model calculates a utility's ROE by estimating the "risk premium" that investors require to invest in a utility. The risk premium model "is based on the principle that investors require a higher [rate of return] to assume greater risk."[149] The model estimates this risk premium by estimating the difference between returns on common equity and bonds.

77 Mr. Gorman estimated PacifiCorp's risk premium ROE with two methods. First, Mr. Gorman compared the difference between the required return on utility common equity and Treasury bonds. Second, Mr. Gorman compared the difference between regulatory commission authorized returns on common equity and contemporary "A" rated utility bond yields. Mr. Gorman's estimated risk premiums are based on the time period of 1986 through June 2005, and produce a return estimate in the range of 9.4% to 10.3%, with a mid-point estimate of 9.9%.[150]

78 Dr. Hadaway's risk premium model produces a much higher ROE of 11%.[151] This analysis inappropriately relies only upon projected interests rates and

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[147] Exh. No. 121T at 35-36 (Gorman Direct).
[148] Exh. No. 136 (DCF Summary).
[149] Exh. No. 121T at 22: 19-20 (Gorman Direct).
[150] Id. at 22-25.
[151] Exh. No. 21T at 26: 15-17 (Hadaway Direct); Exhibit No. 25 (Risk Premium Analysis).

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ignores current real and observable interest rates.[152/] In contrast, Mr. Gorman appropriately relied upon a mixture of real and forecast interest rates in his risk premium analysis.[153/] Dr. Hadaway's forecasts are not transparent, have questionable accuracy, are projecting dramatic increases in interest rates that are "not consistent with consensus economists' projected increases to interest rates, and likely [do] not reflect overall market expectations."[154/]

79 Dr. Hadaway's risk premium model also is flawed in that Dr. Hadaway estimates that "A" rated utility bonds will increase before rates go into effect. Rates on these bonds have actually decreased.[155/] Dr. Hadaway also failed to consider whether commission decisions were based on historic or forecast interest rates or if the decisions produced results consistent with investor demands.[156/] Finally, Dr. Hadaway attempts to support his analysis with studies based on overall market risk, which fail to recognize that electric utility risk is considerably lower than overall market risk.[157/] Correcting some of these errors produces a risk premium result of 9.0% to 9.85%.[158/]

c. The Capital Asset Pricing Model Results Support the Overall Reasonableness of ICNU's Recommendation

80 The CAPM is a version of the risk premium method that calculates the market risk premium based on the difference between the expected rate of return on the

152/ Exh. No. 121T at 37: 1 – 38: 4 (Gorman Direct).
153/ Id. at 4: 1 – 6: 16, 37: 13 – 38: 4.
154/ Id. at 38: 2-4.
155/ Id. at 38: 5-17.
156/ Exh. No. 151T at 6 (Rothschild Direct).
157/ Exh. No. 121T at 38: 18 – 40: 14 (Gorman Direct).
158/ Id. at 38: 8-10, 40: 12-14.

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market as a whole and the risk-free rate of return.[159] While the Commission has typically relied on the DCF model over the CAPM,[160] the CAPM can be used to set rates or as a useful tool to evaluate the reasonableness the cost of equity proposals.[161]

81 Mr. Gorman's CAPM analysis included an estimate of the market risk-free rate, the Company's beta, and the market risk premium. The beta "is a measure of the risk in a single stock as compared to the risk in broader market."[162] Mr. Gorman utilized the projected 20-year Treasury bond yield as the market risk free rate, a group average beta estimate for the comparable utility group, and a market premium estimate based on a forward looking estimate and a long-term historical average.[163] The results of Mr. Gorman's CAPM produces an estimated ROE of 10.3%.[164]

d. ICNU's 9.8% ROE Proposal Maintains PacifiCorp's Financial Integrity

82 The Commission should approve a 9.8% ROE for PacifiCorp based on the midpoint of Mr. Gorman's DCF model, risk premium model, and CAPM. Establishing the Company's ROE on a midpoint range of three credible model runs results in a more reliable cost of equity estimate[165] that is approximately equivalent to the 10% ROE authorized for PacifiCorp by the OPUC in September 2005.[166] ICNU's recommendation

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[159] Leonard Saul Goodman, The Process of Ratemaking 631.

[160] Re the Review of Unbundled Loop and Switching Rates, the Deaverage Zone Rate Structure, and Unbundled Network Elements, Transp., and Termination, Docket No. UT-023003, Twenty-fourth Suppl. Order at ¶¶ 66-70 (Feb. 9, 2005).

[161] See Leonard Saul Goodman, The Process of Ratemaking 632-33.

[162] WUTC v. PSE, Docket Nos. UG-040640, UE-040641, UE-031471 and UE-032043, Order No. 06 at ¶ 52.

[163] Exh. No. 121T at 25-28 (Gorman Direct).

[164] Id. at 28: 16-17.

[165] See WUTC v. Avista, Docket Nos. UE-050482 and UG-050483, Order No. 05 at ¶ 46.

[166] Exh. No. 12 at 3 (Re PacifiCorp, OPUC Docket No. UE 170, Order No. 05-1050 at Appendix H).

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will also provide PacifiCorp an opportunity to earn a fair risk-adjusted return, and "compensate PacifiCorp for incremental utility plant investments needed to maintain a reliable utility infrastructure."[167/]

83 ICNU's recommended ROE is adequate to maintain PacifiCorp's financial integrity. Although the Commission should not be beholden to the ratings agencies, the evidence demonstrates that a 9.8% ROE should support PacifiCorp's current bond ratings. Mr. Gorman compared the key credit rating financial ratios for PacifiCorp at his proposed capital structure and return on equity with Standard and Poor's ("S&P") benchmark financial ratios and determined that his recommendation is reasonable.[168/] S&P evaluates a utility's credit rating based on an overall assessment of its total credit risk exposure.[169/] Mr. Gorman calculated each of S&P's financial ratios based on PacifiCorp's cost of service for Washington, and determined that his proposed rate of return and cash flow would support the Company's current bond rating and financial integrity.[170/]

G. PacifiCorp's Production Factor is a Self-Serving Adjustment Designed to Increase Power Costs by Shifting the Costs of Utah Load Growth to Washington Customers

84 PacifiCorp has proposed a new production factor adjustment to its power costs that represents nearly one-third of its proposed rate increase and would increase its revenue requirement by approximately $9.8 million. The Commission should reject the production factor adjustment because it transfers the cost of Utah load growth to

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167/ Exh. No. 121T at 2: 1-4 (Gorman Direct).
168/ Id. at 29: 5 – 32: 5.
169/ Id. at 29: 12 – 30: 9.
170/ Id. at 29: 5 – 32: 5.

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Washington, is unsound, and creates a mismatch between loads to compute power costs and loads for all other costs. The production factor adjustment is harmful because it charges Washington a larger percentage of the total system costs (because Utah has grown significantly since 2004) and the higher 2007 power costs incurred due to Utah load growth. PacifiCorp has never utilized the production factor adjustment in any other jurisdiction and has proposed the methodology in this proceeding only to artificially increase its revenue requirement.

85 PacifiCorp has proposed a fully projected March 31, 2007 test year for the loads in its net variable power cost study, while utilizing a historic September 30, 2004 test year for most other rate base, revenue, expense, billing unit and allocation factor items.[171/] The Company originally proposed a projected 2007 test year for power costs in order to include in rates the higher costs of new resources needed for Utah load growth. The Company has proposed different test periods for other costs in this proceeding in an effort to ensure that it obtains the highest overall rate increase.

86 PacifiCorp's production factor adjustment attempts to reconcile the discrepancy between the 2007 test year power cost loads and the 2004 historic test period for most other items. Since system loads are expected to grow by 2007, the production factor adjustment allegedly conforms the Company's 2007 test year power cost loads to its 2004 historic test year. In the past, PacifiCorp has not utilized different test years and has not needed to reconcile the difference with a production factor adjustment.[172/]

171/ Exh. No. 491TC at 7: 17-20 (Falkenberg Direct); Exh. No. 191T at 3: 8-13 (Wrigley Direct).
172/ Exh. No. 491TC at 8: 3-19 (Falkenberg Direct).

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87 Washington's share of systemwide costs is based on its larger 2004 historic share of system loads. If PacifiCorp had utilized a full forecasted 2007 test year for all of its loads and allocation factors, then Washington would be allocated a smaller portion of system-wide costs because Washington's loads are not growing nearly as rapidly as Utah's. Under PacifiCorp's proposal, Washington has the worst of both worlds: Washington must pay higher power costs based on the 2007 test year loads, and Washington is allocated a higher portion of those costs based on the 2004 test year allocation factors.

88 PacifiCorp has argued that the Revised Protocol protects Washington ratepayers from the costs of Utah load growth because the Utah growth results in a higher allocation factor for Utah and charges the faster growing states a larger percentage of the Company's overall costs.[173/] While ICNU does not agree that the increased allocation factors adequately protect slower growing states from cost shifts due to higher load growth,[174/] the production factor adjustment breaks this linkage so that the Revised Protocol does not even provide theoretical protection against cost shifting.[175/]

89 PacifiCorp should be required to use either a fully projected or historic test year, but not "mix and match" test years to manufacture the highest possible revenue requirement.[176/] Specifically, the Commission should reject the Company's proposed production factor adjustment and require PacifiCorp to use loads for its power cost study

173/ Exh. No. 331T at 18: 9-16 (Duvall Direct); Exh. No. 371T at 10: 10 – 11: 15 (Taylor Rebuttal).
174/ Exh. No. 491TC at 17: 13-22, 22: 1-4, 23: 8-11, 28: 1 – 30: 23 (Falkenberg Direct).
175/ Id. at 2: 29 – 3: 2, 11: 18 – 12 : 17.
176/ Id. at 16: 3-12.

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based on the 2004 historic test year.[177] The production factor problem cannot be equitably solved by updating the allocation factors to reflect the 2007 projected test year loads because there would be significant changes to the test year, including increases to test year revenues and billing units.[178] This would essentially require PacifiCorp to present a new test year, which would not provide Staff and intervenors an opportunity to review the new rate filing.[179]

90 PacifiCorp's production factor adjustment suffers from additional problems. For example, the adjustment is technically unsound because PacifiCorp computed the impact of reconciling the historic loads with projected loads by using average net power costs. This inappropriately understates the impact of conforming loads to test year levels because changes in loads result in incremental, not average, power costs.[180] The production factor also reduces the benefits Washington would receive under the Revised Protocol.[181] Reduction of these credits is important because they are the critical grounds upon which PacifiCorp alleges that the Revised Protocol will result in lower costs to Washington than the Rolled-in method.[182]

H. PacifiCorp Should Not Be Permitted to Include Phantom Income Taxes in Rates

91 PacifiCorp's rates should only include income taxes that PacifiCorp or its parent companies actually pay to the taxing authorities. ScottishPower has established a

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177/ Id. at 18: 13-16.
178/ Id. at 16: 3-9.
179/ Id. at 16: 9-12.
180/ Id. at 9: 5-11.
181/ Id. at 17: 3-12.
182/ Exh. No. 361T at 39 (Taylor Direct); Exh. No. 491TC at 17: 9-12 (Falkenberg Direct).

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unique corporate structure for PacifiCorp that is designed to minimize the Company's taxable income and allow shareholders to retain a portion of the money that ratepayers pay for taxes. Ignoring this tax benefit violates cost of service principles and will allow PacifiCorp's shareholders to earn excessive returns and retain income taxes that are never paid. The Commission should reduce PacifiCorp's revenue requirement by approximately $7.9 million to recognize only legitimate and known tax costs that are actually paid.

1. PacifiCorp's Rates Should Not Be Artificially Increased to Include Income Taxes that Will Never Be Paid to the Taxing Authorities

92 The evidence demonstrates that PacifiCorp's corporate structure allows PacifiCorp and its parent companies "to retain income tax expense that is not ultimately paid to taxing authorities" and provides shareholders with "an excessive return on [their] investment in PacifiCorp."[183/]

93 Utilities can generally recover from ratepayers the amount of the taxes that are actually paid.[184/] In contrast, "if the utility can avoid or reduce tax expenses though legal means, then the actual tax expense, not a hypothetical inflated tax expense, should be included in the development of revenue requirements."[185/] When a utility is part of a consolidated group, and the members of the group file a consolidated return, if "the out-of-pocket tax cost of the regulated affiliate is reduced, there is an immediate

183/ Exh. No. 301T at 20: 16-18 (Selecky Direct).

184/ Exh. No. 142T at 8 (Gorman Suppl.); see BP W. Coast Prods. v. FERC, 374 F.3d 1263, 1286 (D.C. Cir. 2004).

185/ Exh. No. 142T at 8: 7-9 (Gorman Suppl.).

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confrontation with the ratemaking principle that limits cost of service to expenses actually incurred."[186/]

94 ScottishPower created PHI as a non-operating, direct, wholly owned subsidiary of ScottishPower. PHI was created and financed, "in part, in order to minimize the income tax expense that ScottishPower would have to pay on PacifiCorp's taxable income."[187/] ScottishPower accomplished this by capitalizing PHI through an intercompany acquisition-related loan, and PHI used that loan to acquire ScottishPower's shares of PacifiCorp. The significance of the loan between ScottishPower and PHI is that the interest that PHI pays to ScottishPower on the loan is deductible on the consolidated income tax returns that PHI files on behalf of PacifiCorp and other PHI affiliates. These interest deductions significantly reduce the consolidated group's taxable income, with the result being that the group effectively avoids paying a certain amount of taxes on PacifiCorp's income.[188/]

95 The Commission should adopt Mr. Selecky's proposed income tax adjustment because it "is purely based on cost of service principles" and is designed to ensure that PacifiCorp's rates only collect "legitimate and known costs of providing service."[189/] Specifically, Mr. Selecky calculated his adjustment based on PHI's annual tax deductible interest expense of $160.31 million.[190/] Because 94.72% of PHI's assets are related to PacifiCorp's jurisdictional activities, this percentage of the deductible

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186/ Fed. Power Comm'n v. United Gas Pipeline Co., 386 U.S. 237, 244 (1967).
187/ Exh. No. 301T at 20: 27 – 21: 2 (Selecky Direct).
188/ Id. at 17-21.
189/ Id. at 21: 4-7.
190/ Id. at 18: 17-18.

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interest expense should be reflected in PacifiCorp's rates.[191] For the proposed test period, the Washington jurisdictional rate base is 8.2% of the total Company rate base, so the rates of Washington jurisdictional customers should reflect 8.2% of the deductible interest expense. This equals approximately $12.45 million, which, using a Washington composite tax rate of 37.95%, reduces Washington's tax by $4.726 million and reduces the Company's Washington revenue requirement by $7.967 million.[192]

96 Under ICNU's proposal, PHI will retain the tax benefit that flows from its corporate structure and little or no taxes will be paid on PacifiCorp's income. The Commission should simply recognize this interest deduction in setting PacifiCorp's rates and prevent ratepayers from bestowing an additional benefit by including in rates taxes that are never paid because of PHI's interest deductions.[193] Because these amounts are not owed to any taxing authority, they do not constitute a legitimate and known cost of providing utility service, and they should not be included in rates.

2. There Is No Legitimate Rationale to Charge Ratepayers Taxes that Are Not Paid to Taxing Authorities

97 PacifiCorp raises a number of confusing and distorted arguments in an effort to obfuscate and distract the Commission from the fact that the Company is seeking to charge ratepayers costs that it does not actually incur. The Commission should not be distracted from the fact that ICNU's tax adjustment simply recognizes the manner in

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[191] Id. at 18: 19-22; Exh. No. 308 at 2 (PacifiCorp response to ICNU DR No. 3.39).
[192] Exh. No. 301T at 18: 22 – 19: 9 (Selecky Direct).
[193] Id. at 19: 17-19.

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which PacifiCorp was acquired and financed, and that PacifiCorp is seeking to collect "from its Washington ratepayers income taxes that will never be paid."[194/]

98 PacifiCorp asserts that adoption of the tax adjustment is improper because all of its affects have "not been developed on this record . . . ."[195/] PacifiCorp was well aware that ICNU was sponsoring an income tax adjustment and has been provided a full and fair opportunity to submit testimony on this issue. The Commission cannot be prevented from adopting ICNU's proposed tax adjustment because PacifiCorp has allegedly elected not to raise additional arguments.

99 PacifiCorp argues that ICNU's tax adjustment violates regulatory cost of service principles, including stand alone tax computation, the separation of PacifiCorp from its non-regulated operations, and the ScottishPower merger ring fencing provisions.[196/] PacifiCorp attempts to create confusion and distort ICNU's actual proposal. As clarified by Mr. Selecky, ICNU's tax proposal "does not take into account the profits, losses or credits that result from [PacifiCorp's] operations of its unregulated subsidiaries."[197/]

100 PacifiCorp also asserts that the tax savings identified by Mr. Selecky represent only a timing benefit.[198/] Contrary to PacifiCorp's assertions, ICNU's tax adjustment is not based on timing differences, losses carried forward, or any type of special deductions, and does not create net operating losses or deferred taxes that reverse

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194/ Id.
195/ Exh. No. 5T at 18: 15-17 (MacRitchie Rebuttal).
196/ Exh. No. 5T at 17-18 (MacRitchie Rebuttal); Exh. No. 181T at 8-13 (Martin Rebuttal).
197/ Exh. No. 301T at 19: 25-26 (Selecky Direct).
198/ Exh. No. 181T at 6: 15-21 (Martin Rebuttal).

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in the future. Instead, ICNU's tax adjustment is based on an interest deduction by PHI that is permanent and does not give rise to deferred taxes that must be paid in the future.[199/]

101 Finally, PacifiCorp asserts that ICNU's tax adjustment should be rejected because it allegedly violates the "benefits/burdens" test.[200/] The Commission has never applied the benefits/burdens test to income tax issues, nor has the Commission affirmatively allowed PacifiCorp to calculate its income tax expense without regard to the interest deductions that permanently reduce or eliminate PacifiCorp's taxable income. Extending the benefits/burden test as proposed by the Company would grant its shareholders a windfall, and would be contrary to the principles that ratepayers should only be charged for reasonable and prudent costs incurred in providing service.

3. The Commission Should Not Reduce ICNU's Tax Adjustment

102 PacifiCorp has proposed an alternative tax adjustment in the event that the Commission agrees with ICNU that the Company's rates should be based on sound cost of service principles and exclude tax expenses that are never paid to the taxing authorities. PacifiCorp's adjusted tax proposal would result in a $3.145 million revenue requirement reduction, instead of ICNU's proposed $7.967 million reduction.[201/]

103 PacifiCorp first argues that, if a tax adjustment is made, then the tax adjustment should be based on taxable income rather than relative assets.[202/] PacifiCorp's only support for this downward adjustment to ICNU's tax proposal is that taxes are

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199/ Exh. No. 301T at 20: 3-7 (Selecky Direct).
200/ Exh. No. 5T at 17-18 (MacRitchie Rebuttal); Exh. No. 181T at 9-12 (Martin Rebuttal).
201/ Exh. No. 181T at 16: 1 – 17: 1 (Martin Rebuttal).
202/ Id. at 16: 4-7.

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computed based on income rather than assets.[203] The decision to calculate the tax adjustment based on taxable income or assets is a policy decision. ICNU believes that it is more appropriate to base the tax adjustment on assets because, in cost of service studies, interest expenses are allocated based on investments or assets.

104 PacifiCorp also suggests that Mr. Selecky based his tax adjustment on an outdated interest amount and provides a "corrected" interest amount with which to calculate the tax adjustment.[204] PacifiCorp's testimony does not dispute that ICNU's interest amount of 6.75% is supported by the information PacifiCorp provided to ICNU in discovery as "the most recent bond rating agency . . . report for PacifiCorp."[205] PacifiCorp did not update its data response, provide any documents with its testimony that supported its new interest amount, or even specify what its alleged new interest rate is. Therefore, the Commission should reject PacifiCorp's proposed adjustment because the Company has failed to provide any evidence to demonstrate that ICNU's interest amount is not accurate.

I. PacifiCorp Has Inflated Its Expected Medical Costs

105 PacifiCorp alleges increases in medical costs that do not reflect prevailing market conditions, past health care cost increases, or known and measurable cost reductions. ICNU and Staff have recognized that PacifiCorp's proposed medical costs "will likely overstate its projected medical costs for the period covered by this rate case"

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[203] Id.
[204] Id. at 16: 13-16.
[205] Exh. No. 316 at 1, 13 (PacifiCorp response to Public Counsel DR No. 6).

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and "are not appropriate."[206] ICNU's proposal recognizes health care costs will increase, but under a more realistic and reasonable assessment that results in a $435,000 revenue requirement reduction from the Company's filed case.[207]

106 PacifiCorp claims that its health care costs will increase 12%, which is "a substantial increase in annual health care costs from historic costs to projected test year costs."[208] ICNU recommends that the Commission reject PacifiCorp's medical cost escalation rate, and recognize that its medical costs are likely to increase by only 8%.[209]

107 ICNU's more modest escalation rate is reasonable because health care costs are increasing at lower rates than in previous years, and national surveys recognize that health care costs are expected to increase only 8%.[210] In rebuttal testimony, PacifiCorp claims that its proposed 12% increase is sound because of an email that allegedly shows that medical costs for gas and electric utilities tend to be higher than the national trend.[211] However, even the alleged 3% difference between national and utility health care cost increases results in an overall increase of less than the 12% PacifiCorp is requesting in this case.[212]

108 PacifiCorp also fails to refute evidence that its own health care costs have increased at rates lower than the national average,[213] and it is unreasonable to expect that

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[206] Exh. No. 631T at 35: 3-4, 37: 17-18 (Schooley Direct); Exh. No. 301T at 5: 2 – 6: 22 (Selecky Direct).
[207] Exh. No. 301T at 8: 17-22 (Selecky Direct).
[208] Id. at 5: 6-11.
[209] Id. at 7: 5-6.
[210] Exh. No. 631T at 37: 5-14 (Schooley Direct); Exh. No. 301T at 6: 6-18 (Selecky Direct).
[211] Exh. No. 237T at 6: 8-17 (Rosborough Rebuttal).
[212] Id.; Exh. No. 240 (Email regarding utility industry trend vs. national trend).
[213] Exh. No. 301T at 6: 22 – 7: 4 (Selecky Direct); Exh. No. 631T at 35: 17-19 (Schooley Direct).

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PacifiCorp's health care costs will "increase at a rate in excess of the forecasted rate."[214/] PacifiCorp has also made several changes in its medical plans and practices to mitigate its cost increases that "could result in significant additional savings to PacifiCorp."[215/] Overall, a fair review of the medical trend information and changes PacifiCorp has made to its medical plans indicates that the annual increases will be less than 12%.[216/]

109 PacifiCorp also proposes that the Company pay for 90% of total medical costs and employees pay 10% of these costs.[217/] Staff and ICNU oppose PacifiCorp's proposal.[218/] The evidence demonstrates that PacifiCorp's proposed 90/10 split between the Company and employees is "significantly below industry average."[219/] Although the Company continues to support its proposed 90/10 split, PacifiCorp admits that its proposal exceeds both the national sharing average and the electric utility industry sharing average.[220/] Surveys conducted by Hewitt & Associates LLC and Towers Perrin demonstrate that an 80/20 split is appropriate because "employees are picking up approximately 20% of health care costs."[221/] ICNU recommends that medical costs should reflect a 20% employee contribution that is consistent with the national average for employee contribution.[222/]

214/ Exh. No. 301T at 7: 3-5 (Selecky Direct).
215/ Exh. No. 631T at 36: 8 – 37: 4 (Schooley Direct).
216/ Id. at 36: 1-4; Exh. No. 301T at 5: 2 – 6: 24 (Selecky Direct).
217/ Exh. No. 231T at 10: 4-6 (Rosborough Direct).
218/ Exh. No. 301T at 7: 7 – 8: 8 (Selecky Direct); Exh. No. 631T at 35: 7-10 (Schooley Direct).
219/ Exh. No. 301T at 7: 13-14 (Selecky Direct).
220/ Exh. No. 237T at 7: 4-14 (Rosborough Rebuttal); Exh. No. 241 (Hewitt Associates Survey Data Information from 2004).
221/ Exh. No. 301T at 7: 7 – 8: 8 (Selecky Direct).
222/ Id.

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110 PacifiCorp critiques ICNU's proposal based on the nonsensical argument that the Company had a 90/10 cost sharing through the end of 2005.[223/] However, PacifiCorp admits that, as of January 2006, the Company has already reduced its share of medical cost contributions to 85%.[224/] At a minimum, this known and measurable change in coverage should be reflected in rates.[225/] However, a further reduction of the Company's contribution to 80% is warranted to reflect national trends. PacifiCorp should not be allowed to charge ratepayers for medical costs higher than the national average simply because the Company is a regulated utility.

J. PacifiCorp Has Overstated Its Pension and Other Retirement Benefits

111 PacifiCorp has proposed pension expense and other post retirement benefit costs that exceed the amount the Company is likely to incur during the time rates are in effect. PacifiCorp has projected pension expense of nearly $50 million and other post-retirement benefits of $24 million.[226/] These costs represent significant cost increases. PacifiCorp's pension expense was $0.5 million in 2002, $14.8 million in 2003, and $31.5 million in 2004.[227/] ICNU recognizes that PacifiCorp's pension and other retirement benefits will increase, but proposes that the Commission adjust PacifiCorp's costs to recognize known and measurable changes. ICNU's proposed adjustment results in

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223/ Exh. No. 237T at 7: 12-15 (Rosborough Rebuttal).
224/ Id. at 7: 10-13.
225/ Exh. No. 631T at 35: 7-10 (Schooley Direct).
226/ Exh. No. 231T at 3: 14-15 (Rosborough Direct); Exh. No. 301T at 12: 13-16, 13: 3-5 (Selecky Direct).
227/ Exh. No. 309 (PacifiCorp Response to ICNU DR No. 3.8).

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electric pension expense of $41.1 million, and other post retirement benefit expense of $20.4 million.[228/]

112 The key assumptions in determining electric pension expense are test period expenses, the appropriate discount rate, and the expected return on pension fund assets.[229/] ICNU and PacifiCorp both start with fiscal year 2006 expense and propose the same expected return, but ICNU proposes a discount rate that more accurately reflects the time value of money.[230/] A different discount rate also is the basis for the difference between ICNU and PacifiCorp's proposals regarding post retirement other than pension expenses.[231/]

113 The discount rate is an interest rate that is used to calculate the time value of money. Increasing the discount rate reduces the overall amount of pension expense and other post retirement expense.[232/] PacifiCorp proposes a 5.75% discount rate based on the discount rate in effect in 2004.[233/] However, PacifiCorp's own testimony asserts that there will be significant increases in interest rates, including a 0.9% increase in the corporate bond rate.[234/] If the Commission accepts PacifiCorp's argument that interest rates will increase in the test period, then it is reasonable to increase the discount rate to 6.25% (a 50 basis point increase) for pensions and other post retirement benefits.[235/]

228/ Exh. No. 301T at 12: 13-16, 13: 3-5 (Selecky Direct).
229/ Id. at 10: 1-9.
230/ Id. at 10: 10 – 12: 12.
231/ Id. at 12: 17 – 13: 8.
232/ Id. at 10: 14-17.
233/ Exh. No. 231T at 3: 23 – 4: 1 (Rosborough Direct).
234/ Exh. No. 21T at 19: 1-7 (Hadaway Direct).
235/ Exh. No. 301T at 10: 14 – 11: 8, 12: 17 – 13: 8 (Selecky Direct).

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K. Ratepayers Should Not Be Required to Pay for Incentive and Bonus Costs

114 The Commission should exclude from rates all of PacifiCorp's incentive and bonus costs because the Company provides competitive base salaries and a portion of the incentive costs only benefit shareholders. ICNU's proposal would reduce PacifiCorp's Washington revenue requirement by approximately $2.151 million.[236/] ICNU, Staff and Public Counsel all support removing all or part of the Company's incentive and bonus expenses.[237/]

115 PacifiCorp's bonus/incentive program, long-term incentive program plan and incentive performance share plan should be removed from rates because "PacifiCorp currently provides competitive base salaries."[238/] PacifiCorp has claimed that its incentive compensation package is appropriate because its base salary is not sufficient to provide competitive compensation.[239/] However, the information the Company has prepared for the rate case is contradicted by PacifiCorp's claims outside of this proceeding that it provides "competitive base pay."[240/]

116 The Commission should, at a minimum, exclude the portion of the Company's incentive expense that is directly related to financial performance. Evidence demonstrates that at least a portion of the incentive plans is based on financial goals that "are separate from incentive payments based on service quality, safety and reliability

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236/ Id. at 16: 21-24.

237/ Id. at 14: 17 – 16: 24; Exh. No. 291T at 16: 11 – 17: 21 (Effron Direct); Exh. No. 631T at 15: 1 – 17: 5 (Schooley Direct).

238/ Exh. No. 301T at 15: 3-6 (Selecky Direct).

239/ Exh. No. 318 at 2 (PacifiCorp Response to Public Counsel DR No. 121).

240/ Exh. No. 301T at 16: 13-20 (Selecky Direct); Exhibit No. 306 at 1 ("Compensation and Benefits" Information from PacifiCorp's Web Site).

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considerations."[241/] The Commission has a long history of requiring shareholders to bear the costs of incentive programs that are related to financial goals, even if the total compensation level does not exceed market levels.[242/] Incentive "compensation based on financial goals such as maximizing profitability and growth, increasing earnings per share, or increasing return on equity" only benefits shareholders.[243/] Because shareholders benefit from increases to earnings and return on equity, shareholders should "bear the cost of the incentive compensation related to such financial goals."[244/]

L. RTO Costs Should Continue to Be Removed from Rates Until an RTO Is Operating and Benefits Washington Ratepayers

117 PacifiCorp's RTO costs are not currently benefiting Washington ratepayers, and the Company should not recover these costs until an RTO is operating and providing actual benefits. ICNU's proposal to remove the Company's RTO costs and include them in a deferred account is consistent with the current ratemaking treatment for these costs and provides a future opportunity to recover these costs.[245/] Removing these costs from rates reduces the Company's Washington revenue requirement by approximately $226,000.[246/]

118 PacifiCorp asserts that it will spend approximately $2.6 million on RTO costs during the test period, despite the fact that an RTO will not and is not expected to

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241/ Exh. No. 631T at 17: 3-5 (Schooley Direct); Exh. No. 291T at 16: 11-15, 17: 9-21 (Effron Direct).
242/ WUTC v. Avista Corp., Docket Nos. UE-991606 and UG-991607, Third Suppl. Order at ¶¶ 268-73; WUTC v. PSP&L, Docket Nos. UE-920433, UE-920499 and UE-921262, Eleventh Suppl. Order at 61-62.
243/ Exh. No. 291T at 16: 20 – 17: 8 (Effron Direct).
244/ Id. at 17: 6-9; Exh. No. 631T at 15: 16-18 (Schooley Direct).
245/ Exh. No. 301T at 22: 13 – 23: 2 (Selecky Direct).
246/ Id. at 4: 15-19.

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operate in the near future.[247] Ratepayers should not bear these costs because the Company has not demonstrated that Washington ratepayers benefit from these costs or that the expenses are in ratepayers' best interest.[248]

119 PacifiCorp claims that its RTO efforts are required to comply with Federal Energy Regulatory Commission ("FERC") requirements.[249] This claim ignores that FERC is no longer actively promoting a Northwest RTO or its RTO-related standard market design.[250] PacifiCorp also claims that the Commission should approve the RTO costs because the Company must engage in normal transmission planning.[251] However, PacifiCorp did not submit any evidence that it needs to spend significant amounts of money, or take a leading role, in the development of an RTO in order to conduct its ordinary transmission planning.

120 PacifiCorp also fails to recognize that the future of a Northwest RTO is more uncertain than ever. BPA, which owns and operates more than three-fourths of the transmission grid in the Pacific Northwest, has stopped participating in the formation of Grid West.[252] Grid West is the third name and version of the ill-fated efforts to create a Northwest RTO. In this proceeding PacifiCorp claims that "the participation of BPA in Grid West is irrelevant."[253] Outside of this case, PacifiCorp has recognized the

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247/ Id. at 4: 15-19, 22: 3-12.
248/ Id. at 4: 15-19, 22: 19 – 23: 2; Exh. No. 621T at 21: 19 – 22: 7 (Ward Direct).
249/ Exh. No. 195T at 25: 11-13 (Wrigley Rebuttal).
250/ See, e.g., Bonneville Power Admin. et al., 112 F.E.R.C. ¶ 61,012 (July 1, 2005).
251/ Exh. No. 195T at 24: 4-20 (Wrigley Rebuttal).
252/ Exh. No. 223 (BPA Fast Facts); Exh. No. 215 (PacifiCorp Response to ICNU DR No. 13.2); Exh. No. 219 (PacifiCorp Response to ICNU DR No. 14.33).
253/ Exh. No. 215 (PacifiCorp Response to ICNU DR No. 13.2).

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importance of BPA's decision and has described the loss of BPA as "unfortunate."[254/] BPA's "participation was a linchpin" in Grid West and could end the Grid West efforts.[255/] BPA's role is necessary for any West-wide RTO, and the loss of BPA implies that, if Grid West becomes operational, it will focus on transmission issues in the Company's eastern control area. Thus, far from being irrelevant, the loss of BPA and the long, troubled history of the proposed Northwest RTO demonstrate that ratepayers should not be charged for PacifiCorp's RTO costs.

M. The Commission Should Exclude the Imprudent WAPA Transmission Costs from Rates

121 The Commission should reduce PacifiCorp's revenue requirement by imputing revenue from the Company's non-compensatory transmission contracts with WAPA.[256/] PacifiCorp was imprudent in entering into the WAPA transmission contracts because the contracts do not compensate the Company for cost increases.

122 In 1962, UP&L entered into a fixed-rate, 80-year contract to wheel power for what became WAPA.[257/] Later, UP&L bought the transmission system of CP National Corporation, acquiring another wheeling contract with WAPA.[258/] The wheeling rates for these contracts were set and did not include any significant escalation methodology to compensate for increasing costs.[259/]

254/ See Exh. No. 222 (Oregonian article: Compromise on united power grid is blocked; The Grid West project appears dead, Nov. 2, 2005).

255/ Id.

256/ Exh. No. 491T at 74: 19 – 76: 20 (Falkenberg Direct).

257/ Re PacifiCorp, UPSC Docket No. 99-035-10, Report and Order at 23 (May 24, 2000); Exh. No. 491T at 75: 1-23 (Falkenberg Direct).

258/ Re PacifiCorp, UPSC Docket No. 99-035-10, Report and Order at 23.

259/ Exh. No. 491T at 75: 1-23 (Falkenberg Direct).

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123 PacifiCorp previously acknowledged that the WAPA transmission contracts are not compensatory and that FERC authorized the Company to increase a portion of those rates.[260/] PacifiCorp's wheeling costs are much higher now, as are the wheeling rates of most utilities. It is a basic premise of utility service that the costs associated with service may increase over time. It was imprudent for PacifiCorp not to anticipate that prices could increase and to fail to incorporate a price adjustment.

124 Other commissions have required PacifiCorp to impute the revenue for the WAPA transmission contracts.[261/] For over two decades, the UPSC has found the wheeling contracts to be non-compensatory and ordered that revenues be imputed based on the then-current FERC wheeling rate.[262/] In 2001, the OPUC reduced PacifiCorp's revenue requirement to offset the WAPA contract due to concern about Oregon "retail customers subsidizing contracts" like the WAPA contract.[263/]

125 PacifiCorp has asserted that Utah and Oregon have abandoned their WAPA adjustments and no longer impute revenue based on the Company's current FERC wheeling rate. In its recent Utah and Oregon rate cases, PacifiCorp merely filed its case without making any WAPA contract adjustment. However, both the Oregon and Utah rate proceedings settled and neither commission abandoned its treatment for the WAPA transmission contracts. ICNU recommends that, if the Commission adopts the

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260/ PacifiCorp, 99 FERC ¶ 61,026 (Apr. 10, 2002); PacifiCorp Revision to PacifiCorp's Rate Schedule FERC No. 262, FERC Docket No. ER01-1152-000 (Jan. 30, 2001).

261/ Re PacifiCorp, UPSC Docket No. 99-035-10, Report and Order at 23; Re PacifiCorp, OPUC Docket No. UE 116, Order No. 01-787 at 36-38 (Sept. 7, 2001).

262/ Re PacifiCorp, UPSC Docket No. 99-035-10, Report and Order at 23-24.

263/ Re PacifiCorp, OPUC Docket No. UE 116, Order No. 01-787 at 36-38.

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Revised Protocol, then it should impute WAPA contract revenues based on PacifiCorp's current FERC wheeling rate.[264/]

IV. CONCLUSION

126 ICNU urges the Commission to adopt the following adjustments to PacifiCorp's proposed revenue requirement increase that would result in an approximately $13.7 million rate reduction:

- Incorporate all applicable MEHC acquisition rate credits;
- Adopt Mr. Falkenberg's modification to the Revised Protocol to ensure that Washington customers receive the value and pay the costs of the resources that are used to serve them;
- Reject PacifiCorp's PCAM, the proposed deferral account, and any amortization of deferred amounts;
- Reduce PacifiCorp's ROE to reflect more realistic economic forecasts and expected investor earnings;
- Remove from PacifiCorp's cost of capital all unnecessary equity infusions;
- Reverse PacifiCorp's production factor adjustment that is designed to shift costs of Utah load growth to Washington customers;
- Remove tax expenses that will not be paid to the taxing authorities;
- Reduce the Company's overstated medical costs to reflect prevailing market conditions, and known and measurable changes;
- If the Commission accepts PacifiCorp's arguments regarding future interest rates, then the Company's pension and other retirement benefits should be reduced to reflect the expected interest rates;

264/ Exh. No. 491TC at 76: 16-20 (Falkenberg Direct).

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- Reduce the Company's incentive and bonus expenses because PacifiCorp's salaries are competitive and a portion of the costs are directly related to PacifiCorp's financial condition;

- Remove all RTO costs because an RTO is not operational and is not currently benefiting Washington ratepayers;

- Impute additional revenues due to the imprudent WAPA transmission contacts; and

- Adopt the non-duplicative Public Counsel and Staff revenue requirement adjustments.

Dated this 27th day of February, 2006.

Respectfully submitted,

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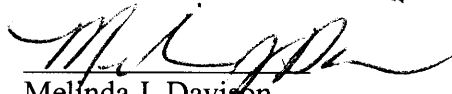

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Attachment A

Tables

PacifiCorp General Rate Case
UE-050684

Table 1 **Net Operating Income Impacts**

	Results based on Revised Protocol	Adj. No.	ICNU with Staff, OPC and MEHC	Contested/Uncontested
1	**Net Operating Income "Unadjusted"**		33,209,409	
2				
3	Pre Merger ECD	1.1	5,339,122	Contested
4	Stipulated NPC	1.2	1,667,324	Contested
5	Reverse Production Factor	1.3	6,095,125	Contested
6	WAPA Transmission	1.4	149,155	Contested
7	Health Care	1.5	259,986	Contested
8	Pension & OPEB	1.6	418,483	Contested
9	Incentive/Bonus Expense	1.7	1,284,297	Contested
10	Consolidated Tax Adjustment	1.8	7,967,000	Contested
11	RTO Expense	1.9	140,231	Contested
12	Interest Synch	1.10	(50,531)	Contested
13	Defferred Debits	1.11	(38,473)	Contested
14	Electric Plant Acq. Adjustment	1.12	197,472	Contested
15	Major Plant Additions	1.13	(94,396)	Contested
16	Amort. Of Capial Stock Expense	1.14	106,104	Contested
17	Weather Normalization	1.15	(681,088)	Uncontested
18	DSM Amortization Removal	1.16	1,352,847	Contested
19	Property Insurance	1.17	(95,136)	Contested
20	Misc. A&G	1.18	(85,242)	Contested
21	MEHC Rate Credits Excluding West Valley	1.20	642,958	Uncontested
23	Total Net Operating Income Adjustment		24,575,235	
24	**Sum of Unadjusted NOI plus Adjustments**		**57,784,644**	

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Table 2 **Net Rate Base Impacts**

	Results based on Revised Protocol	Adj. No.	Staff with MEHC	Contested/Uncontested
1	**Net Rate Base "Unadjusted"**		600,197,129	
2				
3	Pre Merger ECD	1.1	-	Contested
4	Stipulated NPC	1.2	-	Contested
5	Reverse Production Factor	1.3	-	Contested
6	WAPA Transmission	1.4	-	Contested
7	Health Care	1.5	(146,000)	Contested
8	Pension & OPEB	1.6	(235,000)	Contested
9	Incentive/Bonus Expense	1.7	(723,000)	Contested
10	Consolidated Tax Adjustment	1.8	-	Contested
11	RTO Expense	1.9	-	Contested
12	Interest Synch	1.10		Contested
13	Defferred Debits	1.11	(3,192,969)	Contested
14	Electric Plant Acq. Adjustment	1.12	(7,969,000)	Contested
15	Major Plant Additions	1.13	(31,162,634)	Contested
16	Amort. Of Capial Stock Expense	1.14	-	Contested
17	Weather Normalization	1.15	-	Uncontested
18	DSM Amortization Removal	1.16	-	Contested
19	Property Insurance	1.17	-	Contested
20	Misc. A&G	1.18	(57,761)	Contested
22	Affiliate Management Fee	1.20	-	Contested
23	Total Net Rate Base Adjustments		(43,486,364)	
24	**Sum of Unadjusted Net Rate Base plus Adjustn**		556,710,765	

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Table 3
Rate of Return

Weighted Average Cost of Capital

		Staff Proposal		
1	Type of Capital	Capital Structure	Rate	Weighted Cost
2	Debt	51.80%	6.4270%	3.32919%
3	Preferred Stock	1.10%	6.5900%	0.07249%
4	Common Stock	47.10%	9.8000%	4.61580%
5	Weighted Average Cost of Capital	100.00%		**8.0175%**
6	Return On Equity			**9.8000%**

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Table 4

Conversion Factor

1	Operating Revenue	100.0000%	
2	Operating Revenue Deductions:		
3	Uncollectible Accounts	0.3570%	
4	Franchise Tax	0.0000%	
5	WA Revenue Tax	3.8730%	
6	WUTC Fee	0.1900%	
7	Sub-Total	95.5800%	
8	State Income Tax	4.3393%	4.540%
9	Sub-Total	91.2407%	
10	Federal Income Tax @ 35%	31.9342%	
11	Net Operating Income Conversion Factor	**59.30643%**	
12	Company uses inverse known as "Net to Gross Bump-up".	168.61578%	
13			
14	Revenue Sensitive Tax Rates		
15	FIT	35%	
16	customer accounting	0.3570%	
17	other taxes	4.0630%	

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Table 5
Calculation of Net Operating Income Deficiency or (Excess):

			Cite Source
1	Net Rate Base - Washington Jurisdiction	556,710,765	Table 2
2	Proposed Rate of Return	8.0175%	Table 3
3	Net Operating Income Requirement	44,634,286	
4	Proforma Net Operating Income	57,784,644	Table 1
5	Recommended Increase (Decrease) in Net Operating Inco	(13,150,359)	

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Table 6
Revenue Requirement Calculation

1	Net Operating Income Excess	(13,150,359)
2	NOI > Revenue Conversion Factor	59.30643%
3	Revenue Requirement Increase (Decrease) (line e/line f)	(22,173,580)