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February 27, 2006

VIA ELECTRONIC MAIL (records@wutc.wa.gov)
AND OVERNIGHT DELIVERY

Ms. Carole J. Washburn
Executive Secretary
Washington Utilities & Transportation Commission
1300 S Evergreen Park Drive SW
Olympia, WA 98504-7250

Re: Docket No. UE-050684

Dear Ms. Washburn:

I enclose for filing in the above proceeding an original and 18 copies of PacifiCorp's Post-hearing Opening Brief. I also enclose with the opening brief the tables required by the February 6, 2006 Notice Concerning Format for Briefs. A copy of these filings has been served on all parties to this proceeding as indicated on the attached certificate of service.

Very truly yours,

Marcus Wood

Marcus A. Wood

MW:knp
Enclosure
cc: Service List

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)*** PACIFICORP'S POST-HEARING OPENING BRIEF

DATED: February 27, 2006

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I. PROCEDURAL HISTORY

1. This proceeding is a consolidation of PacifiCorp's (or the "Company") general rate case filing in Docket No. UE-050684 and PacifiCorp's petition for an accounting order approving deferral of costs related to declines in hydro-electric power generation in Docket No. UE-050412. The petition for an accounting order in Docket No. UE-050412 was filed on March 18, 2005. The general rate case commenced before the Washington Utilities and Transportation Commission (the "Commission") on May 5, 2005 with the Company's filing of tariff schedules proposing to increase base prices to its Washington customers by $39.2 million, a 17.9 percent increase; the tariff filing was suspended by Order No. 1 in that docket on May 24, 2005. The dockets were consolidated on June 8, 2005 by Order No. 1 in Docket No. UE-050412 and Order No. 2 in Docket No. UE-050684.

2. In response to testimony by the Commission's staff ("Staff") and by the Industrial Customers of Northwest Utilities ("ICNU"), Public Counsel, the Natural Resources Defense Council ("NRDC") and The Energy Project (collectively, "Intervenors"), the Company has accepted or partially accepted fifteen adjustments that lower PacifiCorp's revenue requirement. Exh. No. 195-T at 3-5. The Company also has quantified certain increases, particularly for hydro deferral recovery. *Id.* The Company's rebuttal testimony identified an updated revenue requirement increase request of $32,599,613, a 14.9 percent increase. *Id.* at 1; Exh. No. 198 at 2. Additional adjustments were identified after the rebuttal testimony was filed. As shown on the attached revenue requirement tables, as a result of the weather normalization adjustment, other minor agreed adjustments, and the impacts of the stipulation of the parties reached in the MEHC acquisition proceeding in Washington (Docket No. UE-051090), the requested rate increase has been further reduced to $29,840,188, a 13.5 percent increase.

3. A hearing was held on January 11, 2006 to consider delaying or dismissing the general rate case due to the concurrent proceedings in Docket No. UE-051090 regarding the acquisition of PacifiCorp by MidAmerican Energy Holdings Company ("MEHC"). The Commission determined that the general rate case should proceed and should include supplemental testimony

regarding the effect of MEHC's acquisition of PacifiCorp. Hearings in the general rate case began on January 12, 2006 and ended on February 3, 2006, with eight days of cross-examination of witnesses for PacifiCorp, Staff, Public Counsel, ICNU and NRDC.

II. OVERVIEW OF THE CASE

4. The testimony of Staff and Intervenors in this proceeding demonstrates a marked disconnect between various rate adjustment proposals and economic reality.

5. Pacific Power & Light Company ("Pacific Power") already was the low-cost investor-owned utility serving Washington at the time it completed the Pacific Power/Utah Power & Light Company ("Utah Power") merger in 1989. As a result of 16 years of efficient operation as a merged utility, PacifiCorp has widened its low-cost advantage. *See* the various Washington utility rate comparisons in Exs. Nos. 764 and 765.

6. In recent years, however, PacifiCorp has suffered significant financial deterioration with respect to its utility operations. Its equity return on Washington operations has declined to 3.5 percent. Exh. No. 1-T at 2; Exh. No. 191-T at 2. During the same period, PacifiCorp's operations have bled its parent ScottishPower, which suspended the PacifiCorp dividend for one year and then restored the dividend at a lower level than paid pre-acquisition, pumped $650 million in additional equity to support the Company, and upon reaching the end of its financial patience, sold PacifiCorp for a £927 million (more than $1.6 billion in U.S. dollars) loss. Tr. 1682:12 – 1685:8. During this period, PacifiCorp dropped from a business position 3 to a business position 5 for credit rating purposes and suffered a rating decline in November 2001. PacifiCorp avoided greater deterioration to its bond ratings because of the equity infusions by and the financial condition of its stronger, but now exhausted, parent. Exh. No. 66-T at 14; Tr. 1305:13-18; Tr. 1720:8-14.

7. The challenges currently faced by PacifiCorp require it to improve its financial condition. PacifiCorp's capital expenditure requirements are increasing and will exceed $1 billion per year by FY 2006. Exh. No. 1-T at 12. With the willingness of ScottishPower to provide credit

support for PacifiCorp's inadequate earnings now exhausted, PacifiCorp will face its new financing requirements as a ring-fenced utility that must rely on its own financial strength.

8. Staff and Intervenors respond to these facts by representing to the Commission that PacifiCorp is earning too much and should be ordered to reduce its rates. To reach conclusions so at odds with observable facts, these parties take a number of highly aggressive positions that if adopted would ensure inadequate earnings on and inadequate credit support from PacifiCorp's Washington operations. These positions include the following, each of which is discussed below:

- Staff and Intervenors, despite PacifiCorp's 17-year effort to secure agreement on a common interstate cost allocation methodology, still are not prepared to recommend an approach. Instead, both take positions that would ensure that PacifiCorp never could recover a return on and of all its investments prudently made to provide utility service.

- Two of the three opposing cost-of-capital witnesses continue to propose the double-counting of PacifiCorp's low-cost short-term debt for ratemaking purposes, even after the Staff witness has been compelled to acknowledge the double-counting.

- The cost-of-capital witnesses for Staff and Intervenors recommend that PacifiCorp's actual capital structure be ignored, as well as the capital structures of utilities those witnesses find comparable to PacifiCorp, in favor of more debt-heavy capital structures.

- The cost-of-capital witnesses for Staff and Intervenors urge the Commission to undercut its own recent findings as to equity-return levels and set PacifiCorp's equity return at national low levels.

- ICNU concurrently (i) urges various expense reductions on the grounds that PacifiCorp will be a subsidiary of MEHC, and (ii) seeks a revenue requirement reduction of $7.95 million from appropriation of tax benefits belonging to ScottishPower, based on the assumption that ScottishPower will continue to own PacifiCorp.

- Staff and Intervenors ask the Commission to disregard a number of necessary, reasonable, and prudent costs that PacifiCorp incurs and will continue to incur to provide utility service, without suggesting that the Company either can or should stop incurring such costs.

- Despite the demonstrated subsidization of retail service arising from PacifiCorp's inability to recover its net power costs, Staff and Intervenors seek to delay institution of a power cost adjustment mechanism ("PCAM").

9. In this proceeding, PacifiCorp seeks nothing more than rates that will give the Company a reasonable opportunity to earn a fair return on its Washington service, similar to the returns of companies comparable to PacifiCorp and consistent with maintaining its current credit ratings.

III. ARGUMENT

A. The Commission Should Join PacifiCorp's Other Regulatory Jurisdictions in Adopting the Revised Protocol.

10. The adoption of the Revised Protocol will resolve and eliminate a number of adjustments proposed in this proceeding. These Adjustments include Adjustment Staff 5.5—mid-Columbia contract allocation, Adjustment Staff 5.6—seasonal contract allocation, Adjustment Staff 5.7—QF contract allocation, Adjustment Staff 8.15—new eastside resource allocation, and the ICNU multi-state adjustment.

1. A Uniform System of Inter-Jurisdictional Allocations for PacifiCorp Is in the Public Interest.

11. In the years ahead, PacifiCorp will be required to invest billions of dollars in its generation system in order to continue to provide safe, adequate, and reliable service to its Washington customers. Exh. No. 5-T at 5-6. It is in the interest of PacifiCorp's customers that the Company be in a position to make required investments in a manner that will minimize its costs and risks. It is in the interest of PacifiCorp's customers that the Company be able to attract capital to make those investments at the lowest possible cost.

12. In the absence of an agreed-upon system for allocating its costs among the states where it serves, there is a risk that the Company will make suboptimal decisions so as to avoid disallowances arising from disparate state policies. To the extent it does so, the efficient operation of PacifiCorp's integrated system will suffer.[1] Further, to the extent that disagreement

[1] Consider, for example, the havoc that would result if the Commission were to adopt Staff witness Alan P. Buckley's suggestion that the Company acquire all new resources with a view of satisfying both a "Washington least-cost" plan and a system least-cost plan. Tr. 1007:21

among PacifiCorp's states regarding their responsibility for costs creates a risk of disallowances, investors and lenders will take note and make their financial decisions accordingly. Exh. No. 1-T at 13; Tr. 427:18-24, 434:17-24.

13. As this proceeding and the Company's last Washington rate case (UE-032065) demonstrate, the absence of an agreed-on allocation method distracts parties from far more important issues (such as the Company's massive future investment requirements) and makes it very difficult to make what should be fairly routine regulatory decisions. In both proceedings, the absence of an established allocation method has been claimed to be an impediment to the Commission's making a prudence determination in regard to generation resources acquired by the Company a number of years ago. Exh. No. 541-TC at 14. A more recent example of this regulatory dysfunction is Staff's and Public Counsel's position that the Company should be denied a PCAM because there is no agreed-on allocation method. This is the second consecutive PacifiCorp Washington rate case that has been nearly high-centered on allocation issues, and it is hard to believe that anyone has the appetite for a third.[2]

14. The value of achieving consensus and closure regarding interjurisdictional cost allocation methods was broadly recognized by the Company's stakeholders in Utah, Oregon, Wyoming, and Idaho. Accordingly, they committed substantial time and resources to the Multi-State Process (the "MSP"). *See, In the Matter of PacifiCorp*, Order 05-021 in Docket UM 1050 (Ore. PUC, Jan. 12, 2005). In this proceeding, Staff and Intervenors seem to acknowledge the value of consensus, but do not seem willing to concede much to achieve it. Tr. 920:10 – 921:2, 935:3-12. At other times, they are more cavalier.[3] Tr. 1012:13-23.

– 1010:21. Even Public Counsel witness Charles J. Black did not believe this would be an appropriate approach. Tr. 900:1-15.

[2] Astonishingly, however, Staff, Public Counsel and ICNU urge further study. Exh. No. 5 at 16.

[3] TR 1012. Mr. Buckley appears to start from the self-fulfilling premise that achieving consensus is impossible. Tr. 967:18-20.

2. The Revised Protocol Represents the Culmination of Years of Work and Is Broadly Supported.

15. The MSP commenced in March 2002 and ended in the summer of 2003 when broad consensus was achieved on the Revised PacifiCorp Inter-jurisdictional Cost Allocation Protocol. ("Revised Protocol"). Tr. 424:1-16, 743:6-10. Many parties participated in the process, representing a variety of interests in five states. Of these parties, only Staff and ICNU declined to support the Revised Protocol before their respective state commissions.[4]

16. MSP participants believed that the end product of their efforts should:

- promote economic efficiency,
- reflect cost-causation,
- be equitable to PacifiCorp's customers and shareholders,
- allow individual states to pursue policy initiatives without burdening customers in other states,
- permit effective regulatory oversight and
- not impede the provision of safe, adequate and reliable service by the Company.

Exh. No. 1-T at 26-27; Tr. 12:7-23.

17. In the MSP, Oregon parties expressed many of the same concerns that have been voiced by Staff and Intervenors in this case. The Oregon parties (like the Washington parties) were very much focused on the consequences of Utah load growth and on the need to preserve the value of PacifiCorp's hydroelectric system for its customers in the Pacific Northwest. Tr. 678:25 – 679:9, 1025:15 – 1026:1. At the end of the day, almost all MSP participants agreed on a single,

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[4] There were all-party stipulations in Utah, Wyoming and Idaho. Only ICNU declined to sign the Oregon stipulation. *See*, *In the Matter of PacifiCorp, Id.*; *In the Matter of the Investigation of Inter-jurisdictional Issues*, Case No. PAC-E-02-3, 2005 Ida. PUC LEXIS 38 (Ida. PUC, Feb. 28, 2005); *In the Matter of the Investigation by the Commission of Interjurisdictional Issues*, Docket No. 20000-EI-02-183, 2005 Wyo. PUC LEXIS 130 (Wyo. PSC, Mar. 2, 2005); *In the Matter of the Application of PacifiCorp*, Docket No. 02-035-04, 2004 Utah PUC LEXIS 268 (Ut. PSC, Dec. 14, 2004). Staff opposed this Commission's adoption of the Revised Protocol in UE-032065, and its position remains unchanged.

integrated-system based allocation method with credits to the former Pacific Power states that recognized the value of hydroelectric resources.

18. Where possible, the Revised Protocol assigns costs to the state that is directly responsible for them. Costs of distribution facilities and certain state-mandated programs are assigned in this way. Where costs are not directly caused by any particular state, they are allocated based on a state's share of system energy use, peak demand, and other factors. The Revised Protocol allocates the costs of Seasonal Resources to states on a weighted basis that considers monthly state loads and monthly resource operation. In this manner, the costs of summer-peaking combustion turbines are disproportionately allocated to summer-peaking states. Exh. No. 1-T at 25-26. A detailed explanation of the terms of the Revised Protocol are set forth in PacifiCorp witness David L. Taylor's testimony. Exh. No. 361-T at 7-14.

19. MSP participants agreed with Staff witness Alan P. Buckley that cost causation is an important element of an inter-jurisdictional cost allocation system. Tr. 330:1-10. However, confirming Mr. Taylor's observation that "cost causation" is in the eye of the beholder, MSP participants had widely different views on what allocation system would best reflect that standard. Tr. 742:6-22.[5] But, unlike Mr. Buckley, MSP participants recognized that considerations of cost causation needed to be balanced against other important regulatory principles such as efficiency and fairness. Exh. No. 371-T at 2. On cross-examination, even Mr. Buckley agreed that cost causation is a factor that is considered in ratemaking, but is not the sole factor. Tr. 981:4-8.

20. Mr. Buckley seems to regard a cost-causation approach more nuanced than his approach as somehow intellectually corrupt and "results-oriented." Exh. No. 541-TC at 37. This demonstrates how far out of the main stream Staff strayed in the MSP. It is extraordinarily naïve to believe that consensus on a set of issues that have been festering for 16 years could be

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[5] Only Mr. Buckley appears to believe that there is only one true way to reflect cost causation. *See,* Exh. No. 331-T at 3 (Mr. Duvall); Exh. No. 461-T at 22 (Mr. Lott); Tr. 932 (Mr. Blackmon).

achieved without compromise and without regard to the impact of the compromise on customers in various states. The notion that this Commission, or any other commission, would adopt an allocation method, no matter how ideologically pure, without regard to customer impact is misguided. Exh. No. 371-T at 5.

3. PacifiCorp Has Sought Consensus with Washington Parties Regarding Interstate Cost Allocations.

21. The Revised Protocol was finalized while the Company's last Washington case was in progress. Various parties objected to its late introduction. Ultimately, a settlement was reached with Staff providing that an earlier version of an allocation plan (the "Protocol") would be used for establishing revenue requirement for purposes of the settlement, and the Revised Protocol would be used for reporting purposes going forward. Tr. 532:8-21, 954:6-14. The Commission ordered the Company to initiate further discussions with Washington parties and to file a status report on its efforts by April 1, 2005. Notwithstanding a good faith effort, no consensus was reached among Washington parties as to how to move forward. Accordingly, the Company filed this case based upon the Revised Protocol. Exh. No. 1-T at 27-28.

4. The Revised Protocol Substantially Benefits Washington Customers.

22. The Company's testimony in this case demonstrates that: (i) the Revised Protocol produces lower costs for Washington customers than the Modified Accord method it replaced, (ii) the Revised Protocol produces lower costs for Washington customers than the Protocol method, and (iii) Washington customers benefit more from the Revised Protocol than do the Company's customers in any other state. Tr. 410:5-7, 724:12-20. Mr. Buckley dismisses any consideration of Washington impacts as "results oriented."[6] Tr. 1001:19-1002:9; Exh. No. 541-TC at 55-56.

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[6] Use of the Revised Protocol in this case reduces Washington's revenue requirement by $2.7 million, or 1 percent, as compared to the revenue requirement resulting from the allocation method that PacifiCorp has previously used in Washington. Exh. No. 1-T at 28-29.

5. Opponents of the Revised Protocol Rely on Two Superficially Appealing, but Misdirected, Arguments.

23. Washington parties who oppose the adoption of the Revised Protocol fundamentally base their opposition on two propositions: (i) the Company is adding new resources in order to satisfy Utah load growth and (ii) the Revised Protocol causes Washington customers to "subsidize" Utah load growth.

24. It is correct that several recent PacifiCorp resource additions have been located in Utah. It is also correct that Utah loads have been growing faster than those in other states. However, these observations present only a portion of a broader picture.

25. The Company operates a single, integrated generation and transmission system that benefits all of its customers. Exh. No. 5-T at 14-15. The Company makes investment decisions with the sole aim of reducing the cost and risk for its entire system. The Commission has always judged the prudence of new resources from a system-wide perspective. Exh. No. 331-T at 36; Tr. 667:2-10. Public Counsel witness Charles J. Black recognized this to be the case:

> "In Washington State, a regulated, cost-of-service utility such as PacifiCorp uses an integrated portfolio of resources to provide service to its retail electric customers. Individual resources are not planned, acquired or operated on a separate basis to serve specific retail electric customers."

Exh. No. 471-T at 4.

26. Because all customers benefit from the efficiencies and diversity of the integrated system, it is inappropriate for parties from a particular state to "cherry pick" the resources they wish to support. Mr. Buckley's concept that the Company should make system additions with an eye to how they affect Washington customers quickly breaks down when one considers how the Company might go about meeting its system needs if it were required to simultaneously consider the cost impacts of each resource addition on customers in six different states. Tr. 1009:16 – 1010:7.

27. PacifiCorp has operated a highly diverse and far-flung generation and transmission system for decades. The Commission embraced a single-system approach to cost allocation in

1986, at a time when PacifiCorp operated two control areas and owned a number of coal plants in Wyoming and Montana. *WUTC v. Pacific Power & Light Co.,* No. U-86-02, Second Supplemental Order at 3 (Oct. 31, 1986); Tr. 734:2-14. Staff supported that outcome. Tr. 834:20-23.

28. The Commission has never suggested that there was a need to trace the generation from remote plants to Washington. *WUTC v. Pacific Power & Light Co.,* Cause No. U-83-57, Second Supplemental Order at 8, 9 (Jun. 12, 1984). In approving the Pacific Power-Utah Power merger in 1989, this Commission recognized that there would be additional efficiencies gained from the integrated operation of the two companies in a much larger, diverse, and extended system. *Application of PacifiCorp*, Docket No. U-87-1338-AT, Second Supplemental Order at 13 (Jul. 15, 1988). Washington parties were more than happy to advocate for a share of the expected savings.

29. The expected benefits of the integrated system operations of the Pacific Power and Utah Power systems have been achieved. Tr. 343:6-23. Since the merger, Washington customers have enjoyed extraordinarily stable rates and have fared much better than their peers served by other Washington electric utilities. Exh. No. 1-T at 31; Tr. 358:25 – 359:3, 410:11-19; Exh. Nos. 764 and 765.

30. Staff and Public Counsel now wish to argue that the Company's system is not integrated because there is no ability to transmit "unlimited" amounts of power between its eastern control area and its western control area. Tr. 665:4-15. This is not a useful perspective, for a number of reasons. Tr. 683:4-15. Any utility system has constraints. Tr. 687:12-24, 941:25 – 942:4. It would make little sense to require that there be the capability to move the full output of each generating plant owned by a utility to every corner of its retail service territory. By this standard, the Company's Lewis River hydro-electric generation facilities would not be deemed to be providing service to the Company's Washington customers. Tr. 405:14 – 406:20. By this standard, Avista Corporation ("Avista") would not be permitted to add Coyote Springs II to its

rate base because there is no firm transmission capacity connecting it to that company's customers.[7] Tr. 687:15 – 688:3.

31. Moreover, Staff and Public Counsel's focus on transmission capacity ignores the myriad of means available to the Company to move power around its system to improve operational efficiency. Tr. 664:2 – 665:3, 692:9-16.

32. Opportunistically embracing or rejecting the costs and benefits of the Company's integrated system, as circumstances change through time, is improper and risky. The Company's Washington customers are expected to need about 300 megawatts of new resources to meet growing loads and replace expiring contracts. Exh. No. 331-T at 38. There will be dry years and wet years. Some states will lose load; others will gain it. From time to time, there will be forced outages at generating plants throughout the Company's system. Market conditions and regional market prices will change. Each of these circumstances will create opportunities for a "not my problem" response from some of PacifiCorp's jurisdictions.[8] However, in ratifying the Revised Protocol, commissions in Utah, Oregon, Wyoming, and Idaho recognize that the Company's customers are best served by a single-system perspective. Exh. No. 5-T at 13.

33. Intuition would seem to suggest that if Utah loads are growing and the Company is adding relatively more costly generation in Utah, then Washington customers must be somehow "subsidizing" Utah load growth. The testimony of Mr. Buckley, Public Counsel witness Merton R. Lott, and ICNU witness Randall J. Falkenberg seem to be driven by such intuition. However, this is one of those circumstances where intuition proves wrong. PacifiCorp witness Gregory N. Duvall's testimony describes numerous studies conducted during the MSP that demonstrate that

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[7] Staff witness Glenn Blackmon testified that customers could benefit from a resource even if it does not provide electrons to their light bulbs and heaters. Tr. 941:3-11. Mr. Buckley then agreed. Tr. 1010:22 – 1011:18.

[8] Mr. Duvall's testimony describes how a single-system allocation method reduces risks for customers arising from plant outages, market price variability, and loss of load. Exh. No. 331-T at 14-16.

faster load growth in one of PacifiCorp's jurisdictions is not materially subsidized by customers in slower-growing jurisdictions. Exh. No. 331-T at 17-23. What these studies appear to demonstrate is that, under the Revised Protocol, although the slower growing states in fact support a share of the cost of any new generating resources, they are simultaneously relieved of a share of existing plant costs and Company overheads. In combination, these phenomena result in revenue requirement increases in the faster-growing state that are sufficient to support the cost of new resource additions, with no subsidies. Exh. No. 371-T at 11.[9]

6. The Revised Protocol Is Consistent with Historic Commission Practices.

34. In the last PacifiCorp rate case in which the issue of allocations was considered, this Commission authorized an integrated system approach that included the costs of the Company's generating plants in Montana and Wyoming in PacifiCorp's eastern control area. It did so without an examination of transmission flows and without any attempt to track electrons to the Company's service territory. Exh. No. 331-T at 33. The Commission has always followed the same policy for Avista, Washington's other multi-state electric utility. Mr. Taylor undertook a national survey of utilities and could find no instance of a regulatory commission using any approach other than a system approach. Tr. 733:12-23; Exh. No. 371-T at 8. Mr. Buckley was unable to cite to any contrary examples. Tr. 970:9-14.

7. Mr. Lott's Testimony Reflects an Imperfect Memory of Commission and Staff Policies.

35. Mr. Lott states in his testimony that in approving the Pacific Power/Utah Power merger, the Commission assumed that the two operating divisions would have their own resources. Exh. No. 461-T at 8. He was unable to provide any credible support for that statement. Tr. 837:20 – 839:6. Mr. Lott also testified that the Commission expected that the integration of the two

[9] Mr. Lott agreed that under these circumstances there would be no subsidy. Tr. 860:12 – 861:1. It turns out that Mr. Buckley apparently does not care whether there is actually a subsidy or not because his opposition to the Revised Protocol is based on principle, not facts. Tr. 983:10 – 984:17.

systems would be done consistent with Pacific Power's least-cost plan. Exh. No. 461-T at 8. This testimony appears to have resulted from a misreading of the Commission's merger approval order. Tr. 841:15 – 842:8.

36. Warming to the task, Mr. Lott's testimony then went on to state that the Commission directed that PacifiCorp was not to roll in costs of the combined system except as provided for in the Pacific Power least-cost plan. Exh. No. 461-T at 19. He was not able to provide any credible support for this assertion. Tr. 844:4-21. Mr. Lott was similarly not able to support his contention that the Commission expected the two PacifiCorp divisions to remain separate on a power-supply basis. Tr. 845:2-15.

37. Mr. Lott's recollections are not borne out by the record. It is clear from the Commission's order approving the Pacific Power/Utah Power merger that the Commission had every expectation that the merged Company would operate a single integrated power system and that efficiencies would be gained from that integration. *Application of PacifiCorp, supra.*

38. Exhibit 469 demonstrates that in the year following the merger, Staff favored a total-system approach to allocations, so long as there were adequate (and growing) credits to the former Pacific Power jurisdictions. The Commission was less committal, but was most concerned, about the "San Diego Method" because of the expectation that the "entitlement" credits to Washington would decline over time. Mr. Lott conceded that the Revised Protocol represents exactly what Staff favored in 1990, a system approach with growing entitlement credits for northwest hydro-electric generation resources. Tr. 856:7 – 857:9.

8. The Competing Allocation Proposals are Half-Baked and Unworkable.

39. The debate over PacifiCorp inter-jurisdictional allocation principles has been going on for at least 20 years and preceded the Pacific Power/Utah Power merger. The issues are complex and often subjective. Anyone can describe a system that would be perfectly acceptable to one state while ignoring the need to achieve consensus of five other states. Exh. No. 5-T at 15;

Tr. 730:12-21. Anyone who proposes a solution that can be described in one-half page is wasting everyone's time. Messrs. Black, Buckley, and Falkenberg do both of the above.

40. Mr. Black has no experience working for a multi-jurisdictional utility and no experience designing or testifying to an inter-jurisdictional cost-allocation method. Tr. 893:16 – 894:17. Mr. Black has no apparent knowledge of PacifiCorp's system and its operations and no experience with the MSP. Tr. 894:5-17, 915:18 – 916:14. Yet, he was undeterred from venturing forth with a simplistic description of a two-portfolio allocation method that is the functional equivalent of a one-page plan for achieving world peace. At the heart of any separate portfolio method is a determination of what resources should be assigned to what portfolio. Tr. 677:13 – 678:7. Mr. Black was oblivious to the fact that reasonable people could very much disagree as to the proper assignment of Pacific Power pre-merger eastern resources, because he did not know where those resources were located. Tr. 921:3 – 922:4. Mr. Black was similarly casual about how transfers would be priced between the two portfolios, stating that his work was at a "policy level." Mr. Black's lack of knowledge of the issues associated with inter-portfolio transfers is amply demonstrated by his testimony criticizing the Revised Protocol for being overly complex. Exh. No. 471-T at 41. Mr. Duvall described the challenge associated with inter-regional transfer pricing and indicated that a method that assumes separate control areas is far more complex than the Revised Protocol. Tr. 674:6 – 675:7, 678:6-19.[10]

41. Mr. Buckley provides vague descriptions of not one but three possible approaches for further study. After 16 years, Staff still does not have a concrete proposal to put forward. Exh. No. 541-TC at 10; Tr. 737:6-19. Mr. Buckley has known since the Commission's Order in the Company's last rate case that allocation issues would be addressed in this case and acknowledges that Staff has done nothing to develop a working model. Exh. No. 5-T at 16.

[10] When asked if he knew how the transfer pricing would be accomplished, Mr. Black responded: "No, and I don't think anyone would." Tr. 923:4.

42. Mr. Falkenberg's approach is about as simplistic as Mr. Black's. Mr. Falkenberg is quick to acknowledge that his approach is unlikely to be acceptable to other states. Exh. No. 491-TC at 42. To that degree he is correct. Mr. Duvall explains that the ICNU proposal would give former Pacific Power jurisdictions credit for pre-merger Pacific Power resources, but not give former Utah Power jurisdictions credit for pre-merger Utah Power resources. Exh. No. 341-T at 7.

9. Staff's Proposed Amended Revised Protocol Is Patently One-Sided.

43. On an interim basis, Staff proposes its Amended Revised Protocol, which is a fairly outrageous attempt to pick and choose among PacifiCorp's resources (not surprisingly excluding the most expensive). To add insult to injury, Staff's proposal not only selectively excludes costs, but then does not exclude the generation from the plants whose costs are being excluded. Tr. 679:10 – 680:18. The Revised Protocol affords Washington customers a larger share of mid-Columbia contract benefits than the existing Modified Accord method. Staff's proposal would claim an even larger share. Tr. 682:6-22. Similarly, the Revised Protocol allocates a lower amount of qualifying facility costs to Washington than the Modified Accord. Staff is proposing to lower the allocated amount even further. Exh. No. 371-T at 19.

B. The Commission Should Approve PacifiCorp's Proposed Power Cost Adjustment Mechanism.

44. PacifiCorp is the only investor-owned electric utility in Washington that does not have a Commission-authorized power cost adjustment mechanism ("PCAM") and in this proceeding seeks to remedy this deficiency. PacifiCorp here addresses the various PCAM positions of Staff and Intervenors. PacifiCorp also addresses the related proposal by Staff to deny PacifiCorp a full hydro-electric generation deferral recovery, in Adjustment Staff 5.8.

1. The Company Proposes an Risk-Sharing PCAM.

45. PacifiCorp is proposing an incentive-based PCAM that would share variations between "baseline forecast net power costs" and "adjusted actual net power costs."[11] Variations between

[11] "Net power costs" include all fuel, wheeling, and purchase power expenses, offset by revenues from wholesale electricity and natural gas sales. "Baseline net power costs" are

actual and forecasted net power costs would be subject to a 90:10 symmetrical sharing band that straddles baseline net power costs in rates. The Company's proposal is similar to the Energy Recovery Mechanism that has been approved by the Commission for Avista. Exh. No. 1-T at 19-20.

46. Under the proposed PCAM, Washington-allocated net power costs will be calculated on a monthly basis and posted to a balancing account. An entry into the accrual account will occur every month unless actual adjusted net power costs are equal to baseline net power costs. A positive balance in the account represents money owed to the Company from customers. A negative balance represents money owed by the Company to customers. The balance will accrue interest at the Company's authorized rate of return. Exh. No. 391-T at 33-34.

47. The Company further proposes that a plus or minus $5 million accrued balance be established as a trigger point. Once the trigger point is reached, the Company will be required to return a negative balance to customers or recover a positive balance from customers. The amortization would be over a one year period. Exh. No. 391-T at 34.

48. Surcharges and surcredits arising from the PCAM will be spread to all customers on a uniform cents-per-kilowatt-hour basis. Because differences in delivery voltage result in different line losses and power requirements, the Company proposes to vary the surcharge and surcredit amounts by delivery voltage based on applicable line-loss factors.

2. The Company's PCAM Proposal Would Capture Prudently Incurred Costs, Reduce Debt-Imputation, and Provide Better Price Signals.

49. On a Company-wide basis, PacifiCorp's net power costs of $830 million are between one-third and one-quarter of its total revenue requirement. Exh. No. 1-T at 5. Since 1999, many of the components of net power costs have become highly volatile. Exh. No. 1-T at 3-4. As a

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defined as the authorized net power costs in effect during the measurement period. "Actual adjusted net power costs" are defined as actual net power costs incurred during the accrual period adjusted to remove prior-period adjustments recorded during the accrual period and to reflect Commission-adopted adjustments from the most recent rate case. Exh. No. 391-T at 33.

result of this volatility, the Company has found in recent years that the traditional ratemaking process has caused the Company to incur in excess of $1.9 billion of net power costs for which it was not compensated by customers.[12] Exh. No. 398-T at 8. These deviations from authorized net power costs were primarily related to factors beyond the Company's control. Further, the Company has observed that this greatly increased variability in net power costs from the level projected in general rate cases is not symmetrical.[13] Absent a PCAM, PacifiCorp does not have a reasonable opportunity to earn its allowed rate of return–a situation not lost on rating agencies. Exh. No. 5-T at 11. PacifiCorp is the only investor-owned utility in Washington without a PCAM. Exh. No. 381-T at 3.

50. The proposed PCAM will ensure that, in the future, PacifiCorp's prices more accurately capture the Company's actual prudently incurred costs of providing service to its customers. Exh. No. 381-T at 8.

51. Moreover, as explained by PacifiCorp witness Christy A. Omohundro, the proposed PCAM should improve the Company's credit standing and lower the level of debt imputation associated with purchased power contracts, thereby making such contracts more attractive to the Company and its customers. Exh. No. 381-T at 6-7. A PCAM would give customers better price signals to appropriately respond to higher power costs. Exh. No. 381-T at 8.

3. Cost Allocation Issues Should Not be an Impediment to the Company's Being Permitted a PCAM.

52. Notwithstanding the fact that both Avista and Puget Sound Energy ("PSE") have approved PCAMs in place, Staff opposes PacifiCorp's proposal because of the lack of an established inter-jurisdictional cost allocation method for the Company in Washington. This is

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[12] PacifiCorp witness Mark T. Widmer testified that Washington's allocated share of this amount ($158 million) is equivalent to providing the Company's Washington customers with free electricity for a seven-month period. Exh. No. 398-T at 8-9.

[13] PacifiCorp objects to a "deadband" in the PCAM because of the asymmetric nature of power costs; in PacifiCorp's case a deadband would create a permanent disallowance. Tr. 558:8-13.

but one example of how Staff's refusal to support the Revised Protocol continues to frustrate the Commission's ability to process rate applications that would be fairly routine for other Washington utilities. The Company believes that the record in these proceedings strongly supports the Commission's adoption of the Revised Protocol, so that allocation issues should not be an impediment to establishing a PCAM for PacifiCorp.

4. Staff's and Intervenors' Other Arguments Against the Company's Proposed PCAM are Not Persuasive.

53. Mr. Buckley suggests that PacifiCorp's customers should not protect the Company from volatility caused by the Company's "willing participation" in potentially volatile markets. Mr. Black also seems to believe that the Company engages in a great deal of speculative trading. Exh. No. 471-T at 47; Tr. 910:16-21. Neither of these perspectives is justified. Although at times the Company is forced to make purchases in short-term wholesale markets, the volume of these purchases is small, and they account for a small portion of the volatility in net power costs. Exh. No. 5-T at 8; Exh. No. 398-T at 10.

54. Several witnesses also suggest that the Company's unrecovered net power costs during the 2000-01 energy crises were aberrational and that the Company does not require a PCAM going forward. Exh. No. 541-TC at 187-88; Exh. No. 491-TC at 62. Mr. Widmer's rebuttal testimony demonstrates that the Company continues to be exposed to substantial risk of nonrecovery. Exh. No. 398-T at 8. As shown in PacifiCorp's 1st Supplemental Response to Bench Request 21, even if all data from the 2000-01 energy crisis is excluded, as advocated by ICNU, PacifiCorp's annual underrecovery of power costs in the post-energy crisis period still has increased by 2036 percent over pre-energy crisis levels. Exh. No. 754.

55. Mr. Buckley also contends that normalization methods used in setting net power costs in rate cases ensure that the Company will be made whole in the long run. Exh. No. 541-TC at 189-190. This perspective turns a blind eye to Company testimony that explains that because net power cost variability is asymmetric, the Company is never made whole for its losses. Exh. No. 5-T at 11; Tr. 767:1-14; Exh. No. 383-T at 3; Exh. No. 398-T at 8.

5. The Company Should Be Permitted to Recover the Full Amount of Its Hydro-Electric Generation Cost Deferral.

56. The Company seeks recovery in this case of $8.3 million of deferred hydro-electric generation costs arising from poor water conditions for the period ending December 31, 2005. Staff apparently does not oppose recovery of these deferred hydro-electric generation costs in principle, but proposes a series of adjustments that reduce the recovery to $2.1 million. Exh. No. 541-TC at 210-11. Two of these adjustments relate to the Staff's unwillingness to accept the Revised Protocol for purposes of this case. The third adjustment relates to Mr. Buckley's attempt to remove from the amount recovered the "variances in water conditions" already included in base rates through the normalization process. Exh. No. 541-TC at 210. On cross-examination, Mr. Buckley acknowledged that he had already adjusted base rates to remove normal variability and that his adjustment to the Company's hydro-electric generation deferral recovery was "doing the same thing twice." Tr. 966:1-8.

C. The Commission Should Reject Unreasonable and Unsupported Adjustments to PacifiCorp's Revenues and Expenses, Unrelated to the Revised Protocol, That Are Proposed by Staff and Intervenors.

57. In the subsections below, PacifiCorp addresses proposed Adjustment Staff 4.1—capital stock expense amortization, Adjustment Staff 4.10(a)—wages & benefits, Adjustments Staff 8.16 through 8.18—A&G allocations, Adjustment Staff 4.19—regional transmission organization ("RTO") expenses, and Adjustment Staff 7.2—property tax expense. PacifiCorp also addresses Public Counsel's proposed adjustments for capital stock expense amortization and incentive compensation, as well as ICNU's proposed adjustments for RTO expenses, imputed Western Area Power Administration ("WAPA") revenues, production factors, and ScottishPower cross charges.

1. Proposed Adjustments to PacifiCorp's Wage and Benefit Expenses Should be Rejected.

58. Employee wages and benefits are essential costs of providing utility service. Certain reductions proposed by Staff and Intervenors to the Company's pro forma adjustments to

incentive pay, medical insurance, and pension and other post-retirement expenses would prevent recovery of prudently incurred costs of serving Washington retail customers.

59. **a. <u>Incentive Compensation</u>.** ICNU witness James T. Selecky challenges the Company's entire adjusted $33,296,654 incentive compensation expense, asserting that PacifiCorp states that it offers competitive salaries, and incentive compensation thus is unnecessary. Exh. No. 301-T at 15-16; Exh. No. 193 at 4.10.5. As Company witness Erich D. Wilson explains, the Company's incentive plans are a critical part of competitive compensation packages, with incentive pay being a feature of compensation in more than 90 percent of companies. Exh. No. 271-T at 2-3. Incentive pay thus is an essential element of the Company's competitive pay package.

60. Staff witness Thomas E. Schooley and Public Counsel witness David J. Effron recognize the need for and value of incentive pay, but seek to disallow a portion of PacifiCorp's incentive package as not benefiting the Company's customers. Exh. No. 631-T at 10-23; Exh. No. 291-T at 16-17. Mr. Schooley proposes disallowance of approximately 15 percent of the Annual Incentive Plan expense, proposing a $4,162,325 reduction on a Company-wide basis. Exh. No. 631-T at 14. Mr. Schooley also recommends disallowance of the entire $2,331,516 cost of the Performance Unit Plan, arguing that because the incentive is paid in Company stock, this plan rewards maximizing the price of PacifiCorp's stock. Mr. Effron recommends that one-half of all proposed incentive compensation expenses should be disallowed, but unlike Mr. Schooley, Mr. Effron makes no effort to analyze the components of the incentive pay plan or to justify the level of disallowance he recommends. Exh. No. 291-T at 16-17.

61. PacifiCorp witness Erich D. Wilson explains that all portions of the incentive compensation plan address matters of benefit to PacifiCorp's customers. Only 10 percent of the Annual Incentive Plan is based directly on an earnings targets, which is the primary portion of the plan challenged by Mr. Schooley, and the Commission has previously allowed incentive compensation based in part on financial targets, so long as performance targets are the predominant component. Exh. No. 271-T at 4-8. Moreover, in this filing, PacifiCorp already

has reduced incentive compensation down from test-year levels by $12,890,438 on a Company-wide basis, which is substantially more than the portion Mr. Schooley recommends be disallowed. Exh. No. 193 at 4.10.5. PacifiCorp imputed for this filing only a 50 percent payout of the maximum incentive pay, even though test-year incentive compensation was 67 percent of maximum incentive pay. Exh. No. 271-T at 3-4. Thus, even if the Commission thought some small portion of the incentive pay payouts was based on criteria not of value to ratepayers, PacifiCorp already has more than adequately adjusted the amounts here requested.

62. Mr. Wilson also explains that the Performance Unit Plan, which Mr. Schooley would totally disallow, is based on the same performance-based targets as the Annual Incentive Plan, for which Mr. Schooley recommends only a 15 percent disallowance. Although the Performance Unit Plan payments are in Company stock, the stock is not restricted and may be sold at any time. This incentive reward thus is equivalent to a cash reward. Exh. No. 271-T at 8-10.

63. **b. Medical Insurance**. Messrs. Selecky and Schooley contend that PacifiCorp's 12 percent escalation rate in health care costs is too high and also assert that employees should shoulder more health care costs. Exh. No. 301-T at 5-8; Exh. No. 631-T at 34-38. These challenges are based on generalized studies rather than utility-industry-specific and PacifiCorp-specific data. Company witness Daniel J. Rosborough provides the data to support utility industry health care cost escalation rates of 11 percent, plus a 1 percent adder for PacifiCorp's slightly older work force. Exh. No. 231-T at 6. Mr. Rosborough also notes that the Company is obligated to pay 90 percent of employee health care expenses under its current plan.

64. **c. Pension and Other Post-Retirement Expenses**. Mr. Schooley recommends disallowance of an estimated $3,000,000 Company contribution to the IBEW Local 57 pension plan. Exh. No. 631-T at 33-34. The requested $3,000,000 is a reasonable approximation of actual costs that will be incurred, and the actual amount is expected to be settled through union negotiations this month. Exh. No. 231-T at 5. The amount is a necessary cost of providing service.

65. Finally, Mr. Selecky challenges the discount rate used to calculate pension and other post-retirement expenses, contending that a 6.25 percent rate should be used rather than 5.75 percent. Exh. No. 301-T at 10-11. Under financial accounting standard ("FAS") rules, the Company must use a discount rate for these purposes that is deemed reasonable by its accounting firm, and the 5.75 rate thus is dictated by PacifiCorp's accountants, PricewaterhouseCoopers. Exh. No. 239 at 1. PricewaterhouseCoopers analyzed several alternate interest rate indices in reaching its conclusions; none of these indices supported a number in excess of 5.75 percent. Exh. No. 231-T at 2; Exh. No. 239.

2. PacifiCorp Should Be Allowed to Recover 75 Percent of Its Edison Electric Institute Dues.

66. Staff witness Christian J. Ward proposes disallowance of 43.6 percent of the Company's Edison Electric Institute ("EEI") dues expenses, based on his assumption that legislative advocacy, legislative policy research, advertising, marketing, and public relations expenses all should be removed. Exh. No. 621-T at 19; *see* invoices in Exh. No. 205. Company witness Paul Wrigley explained that only the legislative advocacy portion of the EEI dues should be borne by the Company's shareholders and that legislative advocacy accounts for just under 25 percent of the EEI dues amount. Tr. 460-66. Mr. Ward proposed a Washington-jurisdiction disallowance of $30,150 based on his 43.6 percent reduction; the Company already has adopted a more appropriate adjustment of $15,719, based on a 25 percent reduction. Exh. No. 621-T at 14-17; Tr. 462:12 – 463:5.

67. Mr. Wrigley also made two important EEI-expense-related corrections to Mr. Ward's Adjustment Staff 4.18 that are not reflected in Mr. Ward's Exhibit 622 as revised on January 3, 2006. First, Mr. Ward proposes disallowance of both EEI dues on line 35 of that exhibit and the "Memberships, Civic & Political Activities" account on line 34. Mr. Wrigley points out that the latter account includes EEI dues, resulting in a double-counting of the EEI expense disallowance. Exh. No. 195-T at 7. In addition, the "Memberships" account disallowances also include Western Electric Coordination Council ("WECC") membership dues of $782,071; WECC

membership is required of PacifiCorp because it operates in two control areas. Exh. No. 195-T at 7; Tr. 452:9-10.

68. The Company has accepted several elements of Adjustment Staff 4.18, including a 25 percent disallowance of its EEI dues expense, with the accepted disallowance totaling $25,078. Exh. No. 195-T at 5. No further disallowances have been justified.

3. PacifiCorp Should Be Allowed to Recover Its Ongoing Costs of Participating in Grid West Development Activities.

69. Apart from the Bonneville Power Administration, PacifiCorp owns and operates the largest transmission system in the Pacific Northwest. Tr. 595:21-24. Use of this system in a safe and responsible manner, to carry power from PacifiCorp's generation to serve its retail loads, carries with it various obligations. These obligations include major participation in various regional transmission forums. In response to Bench Request 15, PacifiCorp provided costs of participating in such organizations as the WECC and in performing other transmission reliability, planning, and expansion functions. Exh. No. 749.

70. Both Mr. Ward and Mr. Selecky seek to defer and potentially expose the Company to never recovering the reasonable and prudent costs that it will continue to incur in connection with its participation in planning for or Grid West or a similar substitute entity. Mr. Ward seeks to exclude, on a Company-wide basis, $904,511, representing test year outside services employed and office expenses and supplies related to PacifiCorp's participation in the Grid West effort. Exh. No. 621-T at 21-22; Exh. No. 623; Adjustment Staff 4.19. Mr. Selecky takes the more extreme position of excluding, on a Company-wide basis, $2,619,000, representing not only external costs, but also the allocated time of PacifiCorp employees working on Grid West matters. Exh. No. 301-T at 22; Exh. No. 317.

71. Mr. Ward proposes his exclusion on the grounds that "[PacifiCorp] has not demonstrated that Washington retail customers have benefited from these efforts, or that these expenses are in the best interest of Washington ratepayers." Exh. No. 621-T at 22. Mr. Selecky bases his

exclusions on the argument that "this expense is not providing a current benefit to ratepayers." Exh. No. 301-T at 22.

72. The proposed Grid West cost exclusions represent examples of proposals to disallow reasonable and prudent costs of activities in which a utility such as PacifiCorp should be participating on an ongoing basis. As Mr. Wrigley explained, PacifiCorp since the early 1990s has been engaged in various forms of joint planning for restructuring of the transmission grid. These are necessary activities for a utility that is such a major owner and operator of transmission facilities. Indeed, since 1999, the Federal Energy Regulatory Commission ("FERC") has <u>required</u> participation in regional transmission organization activities by utilities such as PacifiCorp. Exh. No. 195-T at 25. The rule adopted in FERC's Order 2000, in Docket No. RM99-2-000, provided:

> "(c) <u>General rule</u>. Except for those public utilities subject to the requirements of paragraph (h) of this section [<u>i.e.</u>, companies already participating in approved transmission entities], every public utility that owns, operates or controls facilities used for the transmission of electric energy in interstate commerce as of [effective date of Final Rule] must file with the Commission, no later than October 15, 2000, one of the following:
>
> (1) A proposal to participate in a Regional Transmission Organization consisting of one of the types of submittals set forth in paragraph (d) of this section; or
>
> (2) An alternative filing consistent with paragraph (g) of this section."

Regional Transmission Organizations, 89 FERC ¶ 61,285, 1999 WL 33505505, at Order No. 2000 in Docket No RM99-2-00, issued December 20, 1999, at 702-03 (89 FERC ¶ 61,285), at 292 (Dec. 20, 1999)(final rule).

73. PacifiCorp's efforts to comply with Order 2000 and subsequent pronouncements by FERC are ongoing, have resulted in several filings testing varying Grid West designs and continue in an unabated fashion. These activities support requirements related to the transmission used to serve PacifiCorp's retail customers and also used to market surplus energy

for the benefit of retail customers, to acquire alternative supplies during outages, and to displace expensive resources when market conditions allow. Even if the current Grid West efforts fail to achieve necessary support, PacifiCorp must continue to jointly plan a transmission system to accommodate the growing importance of renewables, continued load growth (including in Washington), and increasing congestion on the grid. The people, resources and learning used in and resulting from the Grid West efforts will continue to be used in such efforts. Ongoing compliance with FERC requirements, as well as ongoing participation in key regional transmission forums, are required whether or not Grid West ever becomes operational. The related ongoing costs, as reflected in test year expenses, are ordinary, necessary and reasonable. Exh. No. 195-T at 24-25; Tr. 504:15 – 505:7; Tr. 517:17 – 518:23.

74. No party argued that PacifiCorp should not be incurring costs of transmission-related planning on an ongoing basis. Mr. Ward acknowledged that FERC was keenly interested in having utilities under its jurisdiction make reasonable efforts to pursue transmission organizations. Tr. 596:4-8. He was not willing to argue that PacifiCorp should cease its Grid West activities and defer to whatever FERC or other companies propose for regional transmission organizations. Tr. 597:2-8. He likewise did not contend that PacifiCorp's ongoing participation was imprudent or unreasonable or that PacifiCorp should stop participating in Grid West efforts. Tr. 597:9-15; Tr. 598:13-19.

75. In short, Mr. Wrigley explained why PacifiCorp has incurred and must continue to incur Grid West-related costs, or comparable planning costs, as ordinary, necessary, and reasonable expenses. These costs represent normal obligations of a major transmission owner, if it is to protect the usefulness of its system for the benefit of its customers. In other words, PacifiCorp's ongoing Grid West participation is important in order to protect the value of PacifiCorp's transmission assets to its retail customers, whether or not the participation leads to creation of a new transmission entity. Despite the calls for expense disallowance, no party disputes the ongoing need for PacifiCorp to incur Grid West and other transmission planning costs or recommends that PacifiCorp cease incurring such costs. Proposals to exclude such expenses, or

to defer such expenses for recovery only if Grid West becomes operational, thus are unreasonable.

4. Additional Revenues Should Not Be Imputed to PacifiCorp's Transmission Contract with the Western Area Power Administration.

76. Mr. Falkenberg contends that market-priced wheeling rates should be imputed to PacifiCorp's 44-year-old wheeling contract with the Western Area Power Administration ("WAPA"), rather than using the contract's fixed rate of $4.20 per kilowatt year. This proposed adjustment would impute additional nonexistent Washington pro forma revenues of $240,383. Exh. No. 491-TC at 4, table 1, II-8 and at 75. Actual revenues related to the contract exceed expenses required to perform the WAPA contract, but Mr. Falkenberg wants to adjust revenues to show what the Company might have been able to realize on the contract if it had been priced using 2006 pricing standards. Exh. No. 195-T at 26.

77. The most extreme measure the Commission should take when it perceives that revenues related to an asset are too low is to disallow all related revenues, expenses, and rate base, as it did with respect to Colstrip Unit 3 in Cause No. U-83-57. Exh. No. 195-T at 28. For the WAPA contract, with revenues in excess of expenses, such total disallowance would mean an increase in revenue requirement—the opposite of the adjustment that Mr. Falkenberg proposes. PacifiCorp is not proposing total disallowance; it is simply pointing out a rational limit to second-guessing of contracts.

78. Contrary to the implication in Mr. Falkenberg's testimony, no other jurisdiction imposes a revenue adjustment for the WAPA wheeling contract. Tr. 506:21. Although Utah and Oregon at one time made such an adjustment, they no longer do so. Tr. 506:22 – 507:8. The adjustment is not recognized anywhere with good reason: After 44 years, it is too late to second-guess the prudence of a contract, based on pricing principles in effect almost one-half century after the contract was entered, and particularly when the contract more than covers the related cost of performance.

5. PacifiCorp Has Conservatively Stated Its Property Tax Expense, and the Amount Requested by PacifiCorp Should Be Allowed.

79. PacifiCorp has included an upward adjustment to its property taxes, on a Company-wide basis, of $1,215,888. Staff has urged rejection of this adjustment, for the ironic reason that the requested increase is too small.

80. Staff witness Danny P. Kermode recommends rejection of the property tax adjustment based on his conclusion that "this adjustment is based solely on the judgment of management, and no other supporting computation has been provided . . ." Thus "the Company's adjustment fails the 'known and measurable' standard for pro forma adjustments, and it should not be allowed." Exh. No. 601-T at 7.

81. In rebuttal, Mr. Wrigley explained that the management estimate included as the appropriate increase in property tax was in fact below the reasonable range in which the actual increase could be expected to fall. The property tax increase is tied to an increase in PacifiCorp's net utility plant of $330,551,453. Based on PacifiCorp's composite property tax rate of 1.2 percent, the indicated increase in property tax associated with the increase in net plant would be $3,966,617, or more than three times the projection included in the filing. Exh. No. 195-T at 19.

82. Mr. Wrigley added, however, that state appraisers typically employ two methods when valuing utility property—a cost approach, based on original cost depreciated, and an income approach. Based on an estimate that the cost approach will receive a 50 percent weighting, and ignoring altogether any increase arising out of use of the income approach, a minimum property tax increase estimate would be $1,983,308, or well above the $1,215,888 amount requested as a Company-wide adjustment. Exh. No. 195-T at 19-20.

83. Mr. Kermode did not dispute Mr. Wrigley's reasoning and response. He did not dispute that a $330 million increase in taxable plant would lead to a property tax increase. Tr. 583:15 – 584:1. He agreed that PacifiCorp's composite property tax rate was 1.2 percent and that the property tax increase based on the composite rate would have been approximately $4 million.

Tr. 584:17 – 585:3. He described the Company as having provided proof for an increase of more than $1,983,308, and in fact having demonstrated an approximate $4 million increase. Tr. 589:14-15.

84. The sole remaining argument for rejection of the property tax adjustment is that the Company has not adequately quantified the adjustment. Tr. 588:2-6. In other words, the amount requested ($1,215,888) is far below the range of increase the Company demonstrated. PacifiCorp believes it would be arbitrary and capricious to reject a requested expense increase on the ground that the Company's evidence supported an actual increase of greater magnitude.

6. PacifiCorp Should Be Allowed to Amortize Its Capital Stock Expense.

85. PacifiCorp proposes to amortize the Company's costs related to issuance of equity capital before 1999. Exh. No. 191-T at 10; Tr. 454:11-15. This adjustment increases pro forma test-year Washington operating expenses by $171,120. Exh. No. 193 at 4.1. Mr. Wrigley notes that such amortization is comparable to the means used to recover bond issuance costs, which are regularly amortized. Exh. No. 195-T at 23.

86. The Commission previously has allowed capital stock expense to be recovered through an allowance in the authorized return on common equity ("ROE"). In Docket No. UE-991606, for example, the Commission said ". . . a 25 basis point markup for flotation costs should be made" to Avista's allowed ROE. Exh. No. 195-T at 22. Based on this precedent, Mr. Effron argues that an adjustment to ROE is the only method that may be used to recover "flotation" costs. Exh. No. 291-T at 15.

87. The Company proposes the amortization approach because this approach has a smaller effect on revenue requirement than including the issuance cost as part of the ROE in perpetuity. Exh. No. 195-T at 22. A 0.25 percent adjustment to ROE would certainly be acceptable to the Company, but the proposed adjustment is more conservative.

88. Mr. Ward objects to the proposed amortization on the basis that it constitutes retroactive ratemaking. Exh. No. 621-T at 6. Although the capital stock expense that the Company seeks to

recover was incurred before 1999, the issuance dates do not affect the rationale for recovering the expenses of issuing equity capital over time, in the same manner as bond issuance expenses are recovered. The amortization of bond issuance expenses is routinely included as part of the utility revenue requirement, without raising similar claims of retroactive ratemaking. Exh. No. 195-T at 23.

89. Little, if any, of this capital stock expense has yet been recovered. None of this expense was recovered through ROE during the period prior to 1982 or in the period after 1986, and only one decision was cited as possibly allowing such recovery. The Commission's order in Docket Nos. U-82-12 and U-82-35 (consolidated) states that the allowed ROE includes an adjustment to "prevent the dilution from cost of financing." Tr. 456:12-19. This reference is so cryptic that it is impossible to discern the extent of the adjustment, if the decision had any impact at all. In any event, this decision would only affect allowed ROE from 1982 to 1986, if it had any effect at all. This minor uncertainty should not be the basis for disallowance of all of PacifiCorp's capital stock expenses.

90. Finally, Mr. Ward argues that capital stock expense is handled through capital accounts and therefore should not be included as a utility operating cost. Exh. No. 621-T at 5. The requested recovery relates to a capital stock <u>expense</u>; capital <u>expenses</u> traditionally are amortized. Mr. Ward does not explain why capital stock issuance expenses should be handled differently from bond issuance expenses.

7. The System Overhead A&G Allocation Factor Should Not Be Changed.

91. The s system overhead ("SO") allocation factor is used to allocate Company system overheads. For the last 17 years, the factor has been derived from relative plant in service among the states and has not been controversial. Exh. No. 371-T at 20-21. Staff has proposed to change the factor so that it is the average of three other allocation factors. This change was based on a mistaken analysis of historical data that suggested to Staff that the SO factor was not properly tracking Washington's relative share of the system. Exh. No. 371-T at 21-22. Because

PacifiCorp's testimony just cited demonstrated that Staff was mistaken, there is no basis for departing from long-standing practice.

8. Production Factor Adjustments by ICNU and Public Counsel Should Be Rejected in Favor of Staff's Corresponding Adjustment That PacifiCorp Has Accepted.

92. PacifiCorp projects power costs for the rate year, rather than use test-year power costs. These rate-year power costs must be adjusted downward to correspond to test-year loads, because test-year loads are only 92.8 percent of projected rate-year loads. Therefore the projected power costs are scaled back by this 92.8 percent "production factor." As Mr. Widmer points out, this approach is consistent with the production factor methodology used by PSE. Exh. No. 391-T at 5.

93. Mr. Schooley voices no objection in theory to scaling back projected power costs using the production factor, but proposes an adjustment regarding application of the production factor. Exh. No. 631-T at 52. PacifiCorp has accepted Mr. Schooley's Adjustment Staff 8.10 and a corresponding reduction of $3,413,288 in its Washington revenue requirement. Exh. No. 631-T at 52-53; Exh. No. 195-T at 3. With this adjustment by Staff, PacifiCorp urges the Commission to accept PacifiCorp's use of projected power costs, scaled back to the test year using the production factor.

94. Mr. Falkenberg argues that the Company should not be allowed to make pro forma adjustments to power costs to reflect utility plant additions that are used and useful as of the start of the rate period. Exh. No. 491-TC at 7-18. He acknowledges that this is the methodology that Puget Sound Energy uses to calculate its power costs, but claims that PacifiCorp should not be afforded the same methodology because PacifiCorp is experiencing faster growth than PSE and because PacifiCorp operates in multiple jurisdictions. Exh. No. 491-TC at 10. His first objection is baffling; PacifiCorp's faster growth means that its production factor is lower, so its test year power costs are adjusted downward by a greater percentage. Mr. Falkenberg's second objection denies PacifiCorp comparable treatment to that afforded to a Washington-only utility.

Given acceptance of the Revised Protocol, this objection would be moot. Mr. Falkenberg's recommendation, which would ignore recent power cost increases, is virtually certain to lead to cost under-recovery, and is therefore unfair and unreasonable.

95. In the context of the production factor adjustment, Mr. Falkenberg also recommends that the Currant Creek plant should be removed from rate base because it was not used and useful during the test period. Exh. No. 491-TC at 744-45. This adjustment ignores Commission precedent that allows pro forma adjustments to include utility plant that is used and useful at the start of the rate effective year. A recent example of application of such precedent is the Commission's allowance of Coyote Springs II into rate base in Avista's most recent rate case. Exh. No. 195-T at 29; *WUTC v. Avista Corp.*, Docket Nos. UE-050482, UG-050483, Order No. 05 at 113 (Dec. 21, 2005).

96. Finally, Mr. Effron contends that the production factor adjustment should not be used because of a purported mismatch between pro forma adjustments to utility plant and depreciation and growth in accumulated deferred income taxes on embedded plant. Exh. No. 291-T at 9-12. With the Company's acceptance of Mr. Schooley's adjustment to the production factor calculation, changes to production costs after the test year have been properly modeled. Mr. Effron's adjustment runs counter to the precedent in the Avista docket noted above; a pro forma adjustment to account for known and measurable additions to utility plant does not imply that existing utility plant must be depreciated at the rate year level or that accumulated deferred taxes following the test year must be included.

9. ICNU's Adjustment for ScottishPower Cross-Charges Should Be Rejected in Favor of Staff's Corresponding Adjustment That PacifiCorp Has Accepted.

97. Based on actual cross-charges between ScottishPower and PacifiCorp between April 2004 and December 2004, PacifiCorp proposes to include cross-charges as a known and measurable expense under Adjustment 4.13. Exh. No. 191-T at 13. Mr. Schooley proposes that these cross charges be reduced to remove charges related to certain strategic planning and

executive incentive functions. Exh. No. 631-T at 41-43. PacifiCorp has accepted the Staff-proposed changes. Exh. No. 197 at 1; Exh. No. 195-T at 3.

98. Mr. Selecky proposes a more generalized adjustment to the same cross-charges that was somewhat smaller than Staff's corresponding adjustment. Exh. No. 301-T at 14; Exh. No. 305 at 1. Because PacifiCorp has accepted the larger of the two proposed cross-charge adjustments, the second and smaller adjustment to the same item is moot.

D. The Commission Should Reject Unreasonable and Unsupported Adjustments to PacifiCorp's Rate Base, Unrelated to the Revised Protocol, That Are Proposed by Staff and Intervenors.

99. In the subsections below, PacifiCorp addresses four related Staff adjustments to the Company's cash working capital: Adjustment Staff 8.1—update cash working capital, Adjustment Staff 8.1a.—remove current assets, Adjustment Staff 8.2—Trapper mine rate base, and Adjustment Staff 8.3—Jim Bridger mine rate base. PacifiCorp also addresses a portion of Public Counsel's proposed adjustment for miscellaneous deferred debits and Public Counsel's proposed removal of certain acquisition premium adjustments.

1. The Cash Working Capital Requirement That PacifiCorp Included in Its Rate Base, Based on a Lead-Lag Study, Is the Appropriate Amount and Should Be Allowed.

100. PacifiCorp, like other businesses, has a cash working capital requirement. Cash working capital is the capital needed during the time between the payment of services and the receipt of revenue. As an investor-supplied capital requirement necessary to provide electric service, cash working capital is treated as a capital component of, and thus an addition to, utility rate base.[14] PacifiCorp conforms with the state-of-the-art and generally applicable requirements of rate

[14] Staff labels its approach to calculating cash working capital the "Investor Supplied Working Capital" approach. PacifiCorp hopes it is self-evident, however, that all funds needed to make payments for services before receipt of revenues from its customers must come from investors; there is no other source of funds needed to pay costs incurred in advance of cash receipts from customers. Thus, lead-lag studies, which take account of the timing of all payments and of all receipts of funds from customers, also calculate the amount of cash working capital required from investors.

regulators by using a lead-lag study to calculate its cash working capital requirements. Exh. No. 195-T at 11. Neither Staff nor any Intervenor has noted any deficiency in PacifiCorp's lead-lag study or any nonconformance of that study with accepted methods for determining cash working capital.

101. In lieu of a lead-lag study, Mr. Schooley has continued in this proceeding his use of a balance sheet approach to calculate cash working capital. By this balance sheet method, Mr. Schooley concludes that PacifiCorp actually has a negative cash working capital need—in other words, Mr. Schooley has concluded that the Company must on average receive payments for service before it is required to pay its related bills. As a result of this conclusion, Staff removes the following cash-working-capital-related components from companywide rate base: (i) Prepayments, fuel stock, materials and supplies and working capital of $17,956,094, (ii) Trapper mine rate base amount of $47,494, (iii) Bridger mine rate base materials and supplies, inventory, and prepayments of $534,735, and (iv) Dave Johnson mine closure other working capital of $270,089. Exh. No. 631-T at 43-51.

102. In this proceeding, the Commission has the choice between the state-of-the-art means of computing an accurate cash working capital allowance that is nearly universally accepted by utility regulators—the lead-lag approach of PacifiCorp, or an outmoded, less accurate, and unreliable method that to the best of PacifiCorp's knowledge is accepted by no other utility regulators—the balance sheet approach of Staff. The Commission has not had the opportunity to revisit the issue of the proper approach to calculation of cash working capital for many years, and PacifiCorp urges a close look at developments in this area over the past two decades. PacifiCorp merely seeks the right to use an accurate means of establishing the level of cash working capital actually required from its investors.

103. The FERC has succinctly summarized the conclusions of regulators nationwide:

> "The determinations by regulators that have reviewed the proper methods of calculating cash working capital are clear. As the FERC has concluded as a result of rulemaking review: "[w]here a fully developed and reliable lead-lag study is available in the

record, we will utilize that study to determine the working capital allowance."

Carolina Power & Light Co., 6 FERC ¶ 61,154 at p. 61,296 (1979).

104. FERC also has determined that "a fully-developed and reliable lead lag study is the most accurate method of determining the working cash needs of a particular utility." *Kansas Gas & Elec. Co.*, 28 FERC ¶ 63,004 at p. 65,038 (1984).

105. State regulators agree. PacifiCorp's lead-lag study approach to the calculation of cash working capital is accepted in all five of the other states in which it provides service. Tr. 509:20 – 510:2. A survey of the states in the WECC area in which PacifiCorp does not provide service reveals that each of these states also uses the lead-lag study approach.[15]

106. Staff simply has not followed regulatory developments in the calculation of cash working capital. Mr. Schooley could not identify any other jurisdiction in the United States that uses a balance sheet approach to the calculation of cash working capital. Tr. 612:1-8; Tr. 619: 6-12. In response to a question from the bench, Mr. Schooley also acknowledged that since his initial his employment in 1991, he has not stayed current with the development of lead-lag and other methodologies for computing cash working capital. Tr. 629:3-25.

107. Why is the balance sheet approach so universally ignored in the setting of cash working capital requirements? One reason may be that the balance sheet approach fails to measure what a cash working capital study needs to measure. For example, Mr. Schooley acknowledged that his balance sheet approach included amounts billed but not paid, as well as amounts booked as revenue for services rendered, but not yet even billed. Tr. 614:22 – 615:8. When asked if revenues not available to the Company until a future date could be used to pay current bills of PacifiCorp, Mr. Schooley responded "yes." Tr. 618:22 – 619:1.[16] Thus, Mr. Schooley has

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[15] N.M. Admin. Code § 17.9.530.14(E)(1); *In re Ariz. Pub. Serv. Co.* Comm'n Docket No. E-10345A-03-0437; *Colo. Mun. League v. Pub. Utils. Comm'n*, 687 P.2d 416, 420 (Colo. 1984); *In re Nevada Power Co.*, Docket No. 03-10002, Nev. PUC LEXIS 103 (Nev. Pub. Serv. Comm'n, Mar. 26, 2004).

[16] Mr. Schooley casually observed that one could pay current bills with something that will be available in the future because "[y]ou use your credit card every day." Tr. 619:1. This

concluded that PacifiCorp has no cash working capital needs by assuming away the very reason the Company needs cash working capital—the fact that one <u>cannot</u> pay current bills with balance sheet revenues that it has not received, or for that matter even billed.

108. Finally, Mr. Wrigley pointed out how sensitive the balance sheet results are to judgments made by the user of this approach. He noted that if Staff had treated various accounts the same way as it did in PacifiCorp's last rate proceeding, the computed cash working capital requirements would have been a <u>positive</u> $84.9 million, rather than the <u>negative</u> $16.1 million advanced in this proceeding. Exh. No. 195-T at 13-14. Mr. Wrigley was cross-examined at length as to whether Staff's treatment of the various accounts in this proceeding could be justified. However, this cross-examination missed the point of Mr. Wrigley's testimony: that the balance sheet approach easily can be, and has been, used to get a broad array of inconsistent results.

109. PacifiCorp has employed the appropriate lead-lag study method for calculating cash working capital. No party has pointed out any defect in PacifiCorp's use of this accepted methodology. PacifiCorp should be allowed to include in its rate base the cash working capital it has demonstrated it needs.

2. Proposed Reductions in Miscellaneous Deferred Debits, Beyond the Levels Accepted by PacifiCorp in Its Rebuttal Testimony, Have Not Been Justified and Should Be Rejected.

110. PacifiCorp has accepted substantial adjustments to the miscellaneous deferred debits ("MDD") rate base account, as proposed by Mssrs. Schooley and Effron. The Commission should reject Mr. Effron's unsupported proposal to remove the remaining balance.

111. Of the initial $7,596,981 in the MDD account, PacifiCorp has agreed to remove deferred costs of $1,538,585 related to the Trail Mountain Mine and the $2,390,210 related to the

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observation might have been more helpful if PacifiCorp possessed a zero-interest credit card on which lenders were willing to advance cash working capital without charge. The fact that PacifiCorp must, in fact, obtain investor funds to pay obligations due before its own bills are paid is the precise fact that Staff continues to ignore in its cash working capital analysis.

Transition Plan regulatory asset. Exh. No. 193 at 2.2; Exh. No. 197 at 3. In Mr. Wrigley's rebuttal testimony, these are referenced as Adjustments Staff 8.12 and 8.14, with a net effect on revenue requirement of $195,814 and $1,805,004, respectively. Exh. No. 195-T at 3. Both Mr. Effron and Mr. Schooley proposed these removals. Exh. No. 291-T at 4; Exh. No. 631-T at 54-56. Additionally, both of these witnesses recommended removal of the $1,586,540 of amortization costs for the Transition Plan regulatory asset, and this has been included in Adjustment Staff 8.14 as accepted by the Company. Exh. No. 197 at 3.

112. In addition, Mr. Schooley recommended Adjustment Staff 8.13 to remove deferred environmental remediation from the MDD account. Exh. No. 631-T at 55. Although PacifiCorp did accept this adjustment, the effect is substantially offset by adjustment 8.5a, which reverses PacifiCorp's proposed Adjustment 8.5. Exh. No. 195-T at 4; Exh. No. 197 at 2-3.

113. Beyond these accepted changes, Mr. Effron proposes without substantiation that all remaining assets in the MDD account be removed from rate base. Exh. No. 296-T at 5. Mr. Effron simply states that the Commission has not authorized the inclusion of these assets in rate base and that acceptance of such treatment in the settlement in Docket No. UE-032065 does not constitute precedent. Exh. No. 296-T at 5. As Mr. Wrigley points out in rebuttal, authorization is not required to include these items in rate base. Exh. No. 195-T at 17. With the contested elements of the MDD account removed, the remainder of the account thus should be accepted.

3. The Acquisition Premium Adjustments Included by PacifiCorp in This Proceeding Have Been Justified and Should Be Allowed.

114. PacifiCorp has included in rate base $7,969,300 of undepreciated costs constituting the premium over book value it paid for three acquisitions of utility assets. Exh. No. 195-T at 17-18; *see* Exh. No. 193 at 2.2 "Elec Plant Acq Adj" & 2.32 for rate base amounts. Mr. Wrigley points out that 92 percent of this amount is related to the "Yampa Acquisition" of the Craig and Hayden power plants, which the Company was authorized to record on its books in Docket No. UE-

911186, and which Staff deemed a prudent acquisition in the Joint Report filed in compliance with an order in Docket No. UE-991832. Exh. No. 195-T at 17.

115. Mr. Schooley acknowledges the prior treatment of the Yampa Acquisition and does not propose any disallowance for the acquisition premium, but notes that there has been no explicit Commission approval. Exh. No. 631-T at 60-62. Commission approval of an acquisition premium is required before the premium may be included in rate base. Exh. No. 631-T at 60. Therefore the Company seeks recognition of the prudence of the premium paid in the Yampa Acquisition, based on the prior review and the favorable and undisputed conclusion noted above. Exh. No. 195-T at 18.

116. The remaining two acquisition premiums in the rate base account are relatively minor: $530,000 related to the Wyodak steam plant and $101,000 for a transmission line. Exh. No. 195-T at 18. The Company seeks Commission approval of these premiums on the basis that it was prudent to acquire the assets at a small premium over cost less depreciation, rather than construct duplicate facilities.

E. The Commission Should Recognize in This Proceeding the Actual and Reasonable Capital Structure That Supports PacifiCorp's Utility Rate Base.

117. In the subsections below, PacifiCorp addresses proposals by Staff and Intervenors to restate the Company's capital structure supporting its plant in service, by including short-term debt and by removing a portion of the Company's equity capital.

1. Inclusion of Short-Term Debt in PacifiCorp's Capital Structure Would Result in a Double-Counting of Short-Term Debt in PacifiCorp's Rates.

118. Staff witness James A. Rothschild has proposed including in PacifiCorp's capital structure supporting its plant in service a 4 percent short-term debt component. Exh. No. 153 at 1. He argues for this inclusion because the Commission has in the past included short-term debt in utility capital structures and because PacifiCorp carries short-term debt balances. Exh. No. 151-T at 13-15. Public Counsel witness Stephen G. Hill also includes a short-term debt component as supporting PacifiCorp's plant in service. Based on his finding that the actual

amount of such debt had averaged 2.67 percent over the last 10 quarters, Mr. Hill uses a 3 percent short-term debt component. Exh. No. 91-T at 35; Exh. No. 107 at 1. Mr. Rothschild assumes a short-term debt cost of 3.32 percent, while Mr. Hill assumes a short-term debt cost of 3 percent. Exh. No. 107 at 1; Exh. No. 153 at 1. Because of increases in recent months in the cost of short-term debt, the current cost of such debt to PacifiCorp is 4.50 percent, and the forward short-term rate as of March 31, 2006 is 4.71 percent. Tr. 1309:24 – 1310:5; Exh. No. 66-T at 4.

119. ICNU witness Michael P. Gorman does not include short-term debt as a component of the capital structure supporting PacifiCorp's plant in service. Exh. No. 121-T at 16. When asked in a data request why he had excluded this capital component, he accurately replied that PacifiCorp's short-term debt is accounted for as supporting the Company's construction work in progress, and thus is not properly included in the capital supporting its plant in service:

> "Based on the Company's responses to data requests, the amount of short-term debt projected to be used by PacifiCorp in the test year was not significant. Hence, Mr. Gorman assumed that short-term debt was being used to support construction work in progress ("CWIP"). It is Mr. Gorman's understanding that CWIP is not included in rate base. Hence, short-term debt was not included in his proposed capital structure."

Exh. No. 141 at 2 (Response to Staff's Data Request No. 4).

120. PacifiCorp's witness Bruce Williams explained what Mr. Gorman recognized—that inclusion of short-term debt as supporting PacifiCorp's plant in service constitutes an improper double-counting of the same low-cost capital already used to determine the financing costs of CWIP. PacifiCorp recovers the carrying cost of CWIP incurred before such plant is included in rate base through the capitalization of an allowance for funds used during construction ("AFUDC") and the subsequent addition of such amounts to rate base when the plant associated with the applicable AFUDC enters rate base. The FERC Uniform System of Accounts treats short-term debt as the first source of capital available to PacifiCorp in calculating its allowable AFUDC. Exh. No. 66-T at 1-2.

121. PacifiCorp's average short-term debt balances are lower than the Company's average CWIP balances. Exh. No. 67 at 1; *see also* Exh. No. 72. Over the last 18 months, for example, CWIP balances have exceeded the Company's short-term debt by over $116 million on average. Exh. No. 66-T at 1. Accordingly, the attribution of PacifiCorp's short-term debt by Mr. Rothschild and Mr. Hill as part of the capital supporting plant in service cannot be correct. If short-term debt balances are less than CWIP, as they are for PacifiCorp, then short-term debt is attributed entirely to funding plant not yet in the rate base and cannot concurrently also be counted as funding plant in service; *e.g.*, rate base. To include short-term debt in the capital structure in this case would effectively count the same capital as available to lower Washington rates twice—once to reduce the amount of AFUDC added to rate base at the time plant is deemed used and useful and a second time to lower the rate of return on the same rate base.

122. On the stand, Mr. Rothschild had no choice but to recognize his double-counting of short-term debt. He was presented with the FERC formula for calculating AFUDC. Exh. No. 165. Acknowledging the simple mathematics of the AFUDC formula, he agreed that if the CWIP balance is equal to or greater than the short-term debt balance (as for PacifiCorp), all of the utility's short-term debt is assumed in the AFUDC formula to be applied to CWIP. Tr. 1333:17-24. He also acknowledged that the Commission would double-count short-term debt by including such debt in calculating PacifiCorp's rate of return, unless the Commission also modified the calculations in the FERC Uniform System of Accounts to establish a Washington-only AFUDC rate based on PacifiCorp's weighted average cost of capital. Tr. 1375:17 – 1376:7. As Mr. Williams pointed out, such a Washington-only approach would require PacifiCorp not to follow the FERC Uniform System of Accounts, both for Washington situs assets and for non-Washington situs rate base assets. Such an approach also would require different Company-wide AFUDC calculations for Washington than for all other states in which PacifiCorp operates. Tr. 1307:16 – 1308:15.

123. Faced with an undeniable and indefensible double-counting error, Mr. Rothschild attempted to introduce a red herring. He stated, without any attempt at analysis, that if all of

PacifiCorp's short-term debt was allocated to CWIP, that perhaps the Commission should impute additional short-term debt that the Company should issue to cover seasonal variations in revenues. Tr. 1334:10 – 1335:6. Of course, the uses of short-term debt and the amount of short-term debt needed by PacifiCorp is not changed by whether such debt is counted as supporting CWIP or as supporting working capital requirements for day-to-day operations. The issue is not how PacifiCorp uses short-term debt, which is fungible with all other capital of the Company. Rather, the issue is how many times ratepayers may be allocated credit for the same capital. If the capital is allocated to AFUDC to lower the cost of plant entering service, it cannot also be allocated to the ongoing financing of plant in service to lower the Company's rate of return.

124. Other state regulators have recognized that if CWIP is excluded in rate base, short-term debt also must be excluded. For example, none of the other five states in which PacifiCorp operates includes short-term debt in computing the Company's rate of return on its plant in service.[17]

125. PacifiCorp understands that exclusion of short-term debt from its capital structure would require a break with past Commission practice; however, based on the evidence presented, and the admissions of Staff's rate-of-return witness, a contrary result would constitute double-counting and would be arbitrary and capricious. One reason rate hearings are held is to demonstrate when changes in ratemaking approaches are called for; this is one such situation.

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[17] *See, In the Matter of the Application of PacifiCorp*, Docket No. U-901-E, Decision 03-11-019 (Cal. PUC Nov. 13, 2003); *In the Matter of Pacific Power and Light (dba PacifiCorp),* Docket No. UE 170, Order No. 05-1050 (Or. PUC Sep. 28, 2005); *In the Matter of the Application of PacifiCorp*, Docket No. 20000-230-ER-05, Bench Order (Wyo. PSC, Feb. 10, 2006); *In the Matter of the Application of PacifiCorp dba Utah Power & Light Company*, Case No. PAC-E-05-1, Order No. 29833, (Ida. PUC, Jul. 22, 2005); *In the Matter of the Application of PacifiCorp*, Docket No. 04-035-42, Order (Ut. PSC, Feb. 25, 2005).

2. PacifiCorp's Proposed 49.5 Percent Common Equity Ratio Is Consistent Both with the Company's Actual Common Equity Ratio and with the Common Equity Ratios of Electric Utility Companies Comparable to PacifiCorp.

126. PacifiCorp's cost of capital in this case is based on what its actual capital structure will be as of March 31, 2006. That capital structure will be 49.40 percent long-term debt, 1.10 percent preferred equity, and 49.50 percent common equity. Exh. No. 61-T at 2-3. The 49.50 percent common equity component will be the result of four quarterly cash contributions by PacifiCorp Holdings, Inc. ("PHI"), PacifiCorp's parent company, totaling $500 million, and also takes into account planned debt financing through March 31, 2006. Exh. No. 61-T at 5.

127. The Company's actual March 31, 2006 common equity ratio is consistent with the ratios of utilities comparable to PacifiCorp. Value Line estimates the common equity ratio of the companies used to evaluate PacifiCorp's equity return requirements to be 53.2 percent. This actual equity ratio also is designed to enable PacifiCorp to finance its required capital expenditures while maintaining credit metrics that support the continuance of its current "A-" credit rating. Exh. No. 61-T at 6.

128. Witnesses for Staff and Intervenors have proposed capital structures with varying lower common equity ratios. Each of these recommendations has the following in common: (i) they ignore PacifiCorp's actual common equity ratio; (ii) they ignore one or more of the actual equity infusions being made into PacifiCorp by March 31, 2006; and (iii) they ignore the higher common equity ratios of the comparable companies used in both their and PacifiCorp's analyses of equity return requirements. As discussed below, these recommendations are based on neither PacifiCorp's actual nor comparable company comparative capital structure requirements and are therefore unreasonable.

129. Mr. Rothschild anchors the low end of the recommendations, with a proposed 43.5 percent common equity component in PacifiCorp's capital structure. Exh. No. 151-T at 10. If he had properly excluded short-term debt from the capital structure, for the reasons provided in

the preceding section of this brief, his common equity ratio would have been 45.3 percent. Tr. 1336:8 – 1337:4.

130. The 45.3 percent common equity ratio, excluding short-term debt, still falls short. For example, Mr. Rothschild acknowledges that Value Line projects that the comparable companies to PacifiCorp will have equity ratios ranging from 48.6 percent to 51.8 percent. Tr. 1350:18 – 1351:7. To get a lower ratio, he advised taking the numbers for his "FPL" company only, as the median company in his sample; however, when short-term debt is removed, FPL itself has an equity ratio of 48.5 percent. Tr. 1339:12-19.

131. Mr. Rothschild also cited PacifiCorp's historical equity ratios to support his lower numbers. Exh. No. 151-T at 16-17. This comparison also could not withstand close scrutiny. Over the past 10 years, PacifiCorp's common equity ratio, excluding short-term debt, has ranged from 44.3 percent to 51.1 percent. Tr. 1340:14-22. Looking more closely, in the years through 2000, the common equity ratio ranged from 48.6 percent to 51.1 percent. Tr. 1341:20 – 1342:3. The common equity ratio dropped after 2001 as a result of the write-offs to earnings PacifiCorp absorbed because of the energy crisis. The earnings hits meant that unless PHI provided new equity capital, the common equity ratio of the Company would (and it did) decline. During this period of temporary financial decline, PacifiCorp's business risk position declined from position 3 to position 5. Tr. 1345:12-25. In response, PHI committed to infuse $500 million in equity in 2005 and the first quarter of 2006, to restore the historical equity support for PacifiCorp's capital structure and credit. Tr. 1342:4 – 1343:4. The infusion of new equity capital, however, merely restored the Company's pre-energy crisis financial ratios. Tr. 1344:20 – 1345:8.

132. Mr. Hill similarly recommends a 44 percent common equity ratio. His recommendation is based on reasoning comparable to Mr. Rothschild's. As with Mr. Rothschild, he (i) improperly double-counts short-term debt, (ii) ignores the common equity ratios of the comparable companies that he used in his equity return analysis, (iii) relies on the temporary decline in PacifiCorp's common equity ratios during the troubled period following the energy

crisis and as a result of PacifiCorp's attendant losses, and (iv) ignores the equity infusions into the Company that has restored its pre-energy crisis ratios. Exh. No. 91-T at 33-40.

133. Mr. Gorman recommends the less extreme, but still unjustified, reduction of PacifiCorp's actual March 31, 2006 common equity ratio to 47.1 percent. Exh. No. 121-T at 16. This recommendation is made in the face of Mr. Gorman's acknowledgment that his own group of utilities comparable to PacifiCorp currently maintains an average 49 percent common equity ratio. Tr. 1678:3-11.

134. The reasons initially given by Mr. Gorman for his proposed reduction to the actual equity ratio were (i) he did not know if PHI would make the full $500 million equity infusion projected by PacifiCorp (Exh. No. 121-T at 8), (ii) his recommended capital structure was adequate to support PacifiCorp's current "A-" bond rating (Exh. No. 121-T at 9), and (iii) it had not been shown that ScottishPower would fund the equity infusions into PacifiCorp with equity infusions at ScottishPower (Exh. No. 121-T at 9).

135. Mr. Gorman's reasoning for replacing PacifiCorp's actual amount of common equity with a lower level cannot withstand scrutiny. First, the $500 million in equity infusions is required by an agreement with MEHC. Exh. No. 66-T at 5-6. During the hearing, Mr. Gorman acknowledged that by then the infusions were known and measurable.[18] Tr. 1670:23 – 1671:6. Second, Mr. Williams pointed out that, contrary to Mr. Gorman's assurances, when properly calculated including debt equivalents in the manner of Standard & Poor's, Mr. Gorman's recommended equity percentage fell well below the bottom of the "A" utility range. Exh. No. 66-T at 8-9. Finally, as Mr. Hill pointed out, ScottishPower itself has a 54 percent consolidated common equity ratio, thus making clear that the ScottishPower consolidated equity ratio for purposes of establishing rating metrics is even stronger than the requested PacifiCorp equity ratio. Exh. No. 114-T at 5.

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[18] Mr. Gorman's qualification that he did not know if offsetting dividend distributions had been made is not germane. Dividends are returns of earnings, which if not distributed would cause equity of the Company to be even higher. The PacifiCorp numbers will be the actual common equity numbers as of March 31, 2006. Exh. No. 66-T at 7.

136. With Staff's and Intervenors' common equity ratios unsupported by PacifiCorp's actual equity ratio, by the equity ratio of companies found to be comparable to PacifiCorp, or by the ratings metrics for PacifiCorp's current credit rating, PacifiCorp expects that parties may fall back on the argument that "the Commission set lower common equity ratios for Avista and for PSE in recent rate decisions." However, a review of the applicable recent decisions reveals that for each utility, the Commission set the equity return based on its estimate of the actual equity ratio that the utility could achieve during the rate period. As the Commission stated in its PSE Order, despite a then current equity ratio of 40 percent, the rate period equity ratio should be set at 43 percent, because:

> "Our goal in this proceeding should be to set the Company's equity ratio at the level that the evidence shows is most likely to prevail, on average, over the course of the rate year."

WUTC v. Puget Sound Energy, Inc., Order No. 06 in Docket Nos. UG-040640 *et al.*, Order No. 06 at 17 (Feb. 18, 2005). Avista also was allowed a settlement equity ratio of 40 percent, despite an actual equity ratio of 27 percent, to support the company's equity-building efforts. *WUTC v. Avista Corp.*, *supra*. at 25-26.

137. PacifiCorp has demonstrated the reasonableness of its actual 49.5 percent common equity ratio, and that ratio thus should be adopted.

F. The Commission Should Reject the Abnormally-Low Common Equity Return Allowances Proposed by Staff and Intervenors.

138. PacifiCorp witness Dr. Samuel C. Hadaway testified that an 11.125 percent ROE would be a reasonable return on PacifiCorp's common equity capital. Exh. No. 21-T at 28. The Staff and Intervenor witnesses make recommendations that range from an 8.95 percent to a 9.80 percent ROE. Exh. No. 26-T at 1. As discussed below, PacifiCorp has demonstrated that these lower ROE recommendations are below the levels allowed comparable utilities and are incompatible with metrics established for PacifiCorp's current bond rating.

1. The Common Equity Returns Recommended by Staff and Intervenors are Out of Line with Returns Being Allowed Throughout the Nation.

139. As this Commission has recognized in its prior rate orders, the determination of the cost of common equity capital is an imprecise art, requiring the exercise of informed judgment. Tr. 1362:3-11. Although each equity return decision rests on the facts of a particular case, other decisions in this jurisdiction and decisions in other jurisdictions are useful indicators. Indeed, the Commission does look at and give weight to the average of returns authorized in other jurisdictions as corroborative evidence and as a useful reality check on the reasonableness of common equity return proposals. *WUTC v. Avista Corp., supra.* at 23 (fn 45).

140. The returns currently being allowed in other jurisdictions are in the record. The average ROE allowed nationally was 10.84 percent in the third quarter of 2005 and 10.75 percent in the fourth quarter of 2005. Tr. 1235:8-14. To maintain its financial strength and support its large capital program, PacifiCorp seeks an equity return slightly above the average of allowed returns nationally; Staff and Intervenors seek equity returns far below the average in other jurisdictions.

141. Closer to home, this Commission approved in December 2005 a contested 10.4 percent ROE recommended by Staff in a stipulation with Avista, rejecting the testimony of the witness for Public Counsel that the ROE should have been only 9.25 percent. Tr. 1359:17 – 1360:10; *WUTC v. Avista Corp., supra.* at 22-23. Earlier in 2005, this Commission, rejected a Staff ROE recommendation of 9 percent and a Public Counsel ROE recommendation of 9.75 percent, and found the appropriate ROE for Puget Sound Energy to be 10.3 percent. *WUTC v. Puget Sound Energy, Inc., supra.* at 11-12, 32. With respect to PacifiCorp rate orders during the past year, the Utah Public Service Commission most recently allowed a 10.5 percent equity return and the Wyoming Public Service Commission most recently allowed a 10.75 percent equity return.[19] The lowest return for PacifiCorp in any jurisdiction in recent years has been 10 percent from a

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[19] *In the Matter of the Application of PacifiCorp*, Docket No. 04-035-42, Order (UPSC Feb. 25, 2005); *In the Matter of the Application of PacifiCorp*, Docket No. 20000-230-ER-05, Bench Order (Wyo. PSC Feb. 10, 2006).

stipulation presented to the Oregon Public Utilities Commission. That Stipulation, however, disclaimed any agreement as to the cost of capital and also included favorable provisions not requested from or currently provided by this Commission, such as a fully forward test year. Tr. 397:1-21; Tr. 412:23 – 413:16.

2. The Common Equity Returns Recommended by Staff and Intervenors Are Insufficient to Maintain PacifiCorp's Credit Rating.

142. In addition to being out of line with average returns nationally, returns allowed by PacifiCorp's other jurisdictions and returns allowed by this Commission for the other Washington utilities, Staff's and Intervenors' proposed ROEs are most striking by the degree they are inconsistent with maintenance of PacifiCorp's current "A-" bond rating. Mr. Williams provided the applicable comparisons to the three main ratings metrics—funds from operations ("FFO") interest coverage, total debt ratio and FFO to total debt. Each of the recommendations by Mr. Hill and Mr. Gorman, if applied Company-wide, would fail both the total debt ratio and FFO to total debt metrics for PacifiCorp's current bond rating. Exh. No. 26-T at 7-8. With PacifiCorp's attempting to maintain its credit ratings going forward, such low metrics represent a serious financial threat.

3. PacifiCorp's Requested Common Equity Return of 11.125 Percent Is Well-Supported.

143. The need to maintain PacifiCorp's credit rating alone justifies the Company's requested ROE. However, Dr. Samuel C. Hadaway also presented a series of analyses supporting an 11.125 percent return.

144. Dr. Hadaway first reviewed various versions of discounted cash flow ("DCF") models. DCF models are based on the concept that a stock's price represents the present value of all future cash flows expected from the stock. The formula capturing this concept can be simplified to show that the required equity return is equal to a stock's dividend yield plus its expected long-

term dividend growth.[20] Exh. No. 21-T at 12-13. Dr. Hadaway rejected the "constant growth" form of the DCF model, which equates analysts' three- to five-year growth projections with long-term growth. Dr. Hadaway pointed out that the analysts' current near-term growth projections represent a 2 percentage point drop (from 5.3 percent to 3.3 percent) since 2001, and in his professional opinion, similar investor perceptions of such dramatic drops in long-term utility dividend growth are unlikely. Exh. No. 26-T at 11. He also noted that the constant growth form of the DCF model is not consistent with risk-premium checks of reasonableness or with consensus economic forecasts for higher interest rates. Exh. No. 21-T at 22.

145. To correct for the above problems, Dr. Hadaway adapted an approach also employed by the FERC, which uses nominal growth in gross domestic product ("GDP") as a surrogate for long-term utility dividend growth. Exh. No. 21-T at 23-25; Exh. No. 26-T at 24.[21] To reflect current lower inflation rates in his calculation of long-term GDP growth, he gave greater weight to years since 1980, which produced a lower GDP growth number. Exh. No. 26-T at 12. The resulting DCF projections ranged from 10.7 percent to 11.2 percent. Exh. No. 21-T at 22.

146. Dr. Hadaway also presented a risk-premium analysis, which compares electric utility allowed ROEs with contemporaneous long-term interest rates on utility bonds. The data shows that risk premiums are lower when interest rates are high and larger when interest rates are low. The risk-premium approach produces an ROE range of 11 percent to 11.8 percent. Exh. No. 21-T at 25-28. In rebuttal testimony, Dr. Hadaway updated his preferred form of risk-premium analysis for then current interest rate projections and obtained a revised indicated ROE of 10.9 percent. Exh. No. 36.

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[20] Under the standard DCF model, growth rate projections need to represent growth rates to infinity, and not growth rates for shorter periods, such as the expected length of time that rates will be in effect. Tr. 1248:22 – 1252:2.

[21] *See, e.g., Williston Basin Interstate Pipeline Company*, 91 FERC ¶ 63,005 (Apr. 27, 2000).

147. Dr. Hadaway was asked on cross-examination what the result of his risk-premium analysis would be if he replaced projected utility bond interest rates of 6.6 percent used in the model with the actual bond rates of 5.6 percent over the last three months. He responded that the revised ROE would be approximately 10.4 percent. Tr. 1229:7 – 1231:16. Of course, this approach would require Dr. Hadaway to ignore current forecasts of utility bond interest rates for the period the new rates will be in effect.

148. In the final analysis, the Commission's determination of the proper common equity return within a "zone of reasonableness" becomes a matter of reasoned judgment. The guiding requirement is the Hope standard, which states:

> "From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital."[22]

In weighing ROE recommendations against the Hope standard, PacifiCorp urges the Commission to include among its considerations (i) whether it wants a result that jeopardizes PacifiCorp's current good, but imperiled, credit rating; (ii) whether it wants to send the kind of signal to the investment community that the single-digit ROEs requested by Staff and Intervenors will send; and (iii) whether it reasonably can justify the radical break, as urged by Staff and Intervenors, with its recent ROE allowances. PacifiCorp seeks an ROE result more consistent with the national mainstream of regulatory decisions.

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[22] *Fed Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603, 64 S.Ct. 281, 88 L.Ed. 333 (1944).

G. The Commission Should Reject Unsupported Adjustments to PacifiCorp's Washington-Allocated Income Tax Expense Proposed by Staff and Intervenors.

149. In the subsections below, PacifiCorp addresses proposed Adjustment Staff 7.4—IRS settlement and Adjustment Staff 7.5—Malin-Midpoint tax adjustment. PacifiCorp also addresses Public Counsel's proposed reductions to the Company's state income tax and ICNU's proposed consolidated tax adjustment.

1. The Proposal to Allocate PHI's Interest Tax Deductions to PacifiCorp is Unreasonable and Is Unsupported in the Record.

150. Mr. Selecky proposes to impute to PacifiCorp the benefits of tax deductions related to interest payments made by PacifiCorp's parent, PHI, on an inter-company loan with ScottishPower. Exh. No. 301-T at 17-22. Mr. Selecky claims in his prefiled testimony that "permitting PHI to retain income tax expense that is not ultimately paid to taxing authorities provides PHI an excessive return on its investment in PacifiCorp." Exh. No. 301-T at 20. This imputation would reduce PacifiCorp's Washington revenue requirement by $7.97 million. Exh. No. 766.

151. This proposed adjustment should be moot if the Commission assumes acquisition of PacifiCorp by MEHC and adopts cost reductions that reflect the stipulations made in the MEHC acquisition proceeding. After the MEHC acquisition, the ScottishPower and PHI structures and the related tax deductions will disappear. The argument for the tax benefit imputation will vanish with the PHI tax deductions themselves.

152. However, PacifiCorp witness Larry O. Martin also explained why this proposed adjustment to PacifiCorp's revenue requirement would be unreasonable in any event. The adjustment ignores the long-standing regulatory principle of matching "benefits and burdens" in utility ratemaking and breaks down the ring-fencing around the utility. Mr. Selecky has looked only to the tax effect of PHI's interest payments and has ignored the actual interest payments themselves. He seeks to appropriate for ratepayers a PHI tax benefit of $60.8 million, while disclaiming ratepayer responsibility for the interest expense of $160.31 million incurred by PHI to generate the tax benefit. Exh. No. 181-T at 3, 7. As the Commission affirmed in its order

regarding the sale of the Centralia generating station, "[i]n general, the Commission relies on the broad principle that reward should follow risk and benefit should follow burden." *Avista Corp. et al.,* Docket Nos. UE-991255, et al., Second Supplemental Order at 53 (Mar. 6, 2000).

153. This same principle was noted in a white paper prepared by the staff of the Oregon Public Utilities Commission. The staff quoted Accounting for Public Utilities for the widely accepted ratemaking proposition that such matching of benefits and burdens is:

> "[C]onsistent with a fundamental principle of the cost of service approach to ratemaking; the principle that consumers should bear only costs for which they are responsible. Under this principle, there is a well-reasoned, and widely recognized, postulate that taxes follow the events they give rise to. Thus, if ratepayers are held responsible for costs, they are entitled to the tax benefits associated with the costs. If ratepayers do not bear the costs, they are not entitled to the tax benefits associated with the costs."

Exh. No. 823 at 7.

154. In a data response, Mr. Selecky acknowledged that the loan between PHI and ScottishPower that was reflected in his tax adjustment was in the amount of $2.375 billion, or less than the ScottishPower acquisition premium on its purchase of PacifiCorp of $2.571 billion. Exh. No. 328. Given that ratepayers have been insulated from paying any portion of the acquisition premium, it is particularly unreasonable to impute tax deductions on a portion of the acquisition-related capital of PHI that would not even be sufficient to pay such acquisition premium.

155. The proposed adjustment also ignores PacifiCorp's ring-fencing. According to paragraph 27 of the ScottishPower merger stipulation adopted by the Commission in 1999 in Docket No. UE-981627,

> "Any diversified holding and investments (e.g., non-utility business or foreign utilities) of ScottishPower and PacifiCorp following approval of the merger shall be held in separate company(ies) other than PacifiCorp, the entity for utility operations. Ring fence provisions (i.e., measures providing for separate financial and accounting treatment) shall be provided for each of these diversified activities, including but not limited to

> provisions protecting the regulated utility from the liabilities or financial distress of ScottishPower."

Not only is the appropriation of a PHI tax deduction contrary to this ring-fencing principle, but by breaching the ring fence, such appropriation would increase the risk that a bankruptcy court would disregard PacifiCorp's and its affiliates' corporate separateness and make PacifiCorp liable for its affiliates' debts. Exh. No. 181-T at 12-14.[23]

156. Cross-examination of Mr. Selecky demonstrated the emptiness of his claim that "permitting PHI to retain income tax expense that is not ultimately paid to taxing authorities provides PHI an excessive return on its investment in PacifiCorp." Exh. No. 301-T at 20. In addition to the fact that ScottishPower had to bear without ratepayer assistance the acquisition premium that it incurred to purchase PacifiCorp, it has done poorly on its PacifiCorp investment. During the energy crisis, ScottishPower wholly suspended PacifiCorp's dividend payment for a year and then restored the dividend at a level below the pre-acquisition level. In 2002, ScottishPower infused $150 million in equity into the Company. In 2005 through early 2006, ScottishPower has infused an additional $500 million in equity into PacifiCorp to restore the Company's pre-power-crisis capital structure. Finally, in selling PacifiCorp to MEHC, ScottishPower took a disposition write-off of £927 million (which is over $1.6 <u>billion</u> in U.S. dollars). Tr. 1682:12 – 1685:8. PacifiCorp's ratepayers properly have been insulated from all these losses, as ratepayers pay only PacifiCorp's costs, not the costs of PacifiCorp's owners. Given the insulation of Washington ratepayers from ScottishPower losses, a proposal that PacifiCorp's ratepayers appropriate the tax deductions of the Company's owners is particularly egregious.

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[23] Mr. Martin explains that Mr. Selecky also miscalculates and overstates his proposed adjustment. Exh. No. 181-T at 16-17. However, because the adjustment should be rejected on its face, PacifiCorp only notes the reference in Mr. Martin's testimony to the correct calculation.

2. The Proposal to Deny Tax Normalization with Respect to the Proceeds of the Malin-Midpoint Sale and Leaseback Transaction Is Contrary to the Tax Normalization Requirements of the Internal Revenue Code.

157. In 1981, the Company completed the 446 mile Malin-Midpoint transmission line (the "Malin Line") and thereby became entitled to take accelerated tax depreciation, as well as investment tax credits, related to its investment. Because the Company projected that it would not have sufficient net income to take full advantage of the Malin Line tax benefits, it sold the tax benefits to Amoco. As Mr. Kermode acknowledges, PacifiCorp did not transfer any ownership interest to Amoco. Exh. No. 601-T at 26. PacifiCorp merely sold the rights to tax benefits for $44 million.

158. At issue in this proceeding is whether the proceeds from the sale of the Malin Line tax benefits are subject to the normalization requirements of the Internal Revenue Code ("IRC"). PacifiCorp believes the Malin Line tax benefits are subject to such normalization requirements, and accordingly has treated the sale proceeds in the same manner as the underlying deferred taxes must be treated under the IRC. For ratemaking purposes, PacifiCorp treats the Malin Line safe harbor lease as if it received the tax benefits from the Federal Government in the form of a $44 million loan from Amoco. Therefore, for ratemaking purposes, the full value of Malin Line is in rate base. The logical rate treatment is that customers actually receive the tax benefits over time as a reduced cost of money through a rate base reduction as normally occurs for deferred timing differences.

159. In two rate orders in the early 1980s, the Commission rejected the interpretation of the Malin Line transaction as just described, and decided that for ratemaking purposes, the $44 million in proceeds should be amortized over Malin Line's useful life, with the annual amortization reducing expenses and the unamortized balance deducted from rate base. This is the approach that Mr. Kermode recommends be continued. As PacifiCorp witness Harold D. Elliott explained, this approach constitutes double counting; it gives ratepayers both the tax benefits available had the transaction not taken place and a rate base reduction as if the

transaction actually reduced PacifiCorp's equity interest in the Malin Line. Exh. No. 281-T at 3-4.

160. The Commission noted in both rate orders that it would consider altering its position if the IRS clarified that the safe harbor provisions of the sale and leaseback would be violated by the Commission's treatment of the transaction. Exh. No. 608. Subsequently, an IRS private letter ruling (for another utility) confirmed that the Commission's treatment would violate the safe harbor provisions, and a leading accounting firm interpreted that ruling as a clear signal of how the Internal Revenue Service (the "IRS") would treat similar cases. Exh. No. 282; Exh. No. 283. In other words, the Commission's treatment could unravel the tax treatment of the Amoco-PacifiCorp transaction, turning it into an actual sale and leaseback.

161. Mr. Kermode has attempted to distinguish the IRS private letter ruling by arguing that Amoco did not purchase tax benefits with its $44 million. Exh. No. 601-T at 43. This argument conflicts with Mr. Kermode's conclusion in his prefiled testimony, cited above. Moreover, in his Exhibit 606, Mr. Kermode provides the Congressional Record supporting the interpretation that the $44 million purchased tax benefits, not an ownership interest. Exh. No. 606 at 4 ("[The utility] is still in actuality the owner and user of the property . . ."). For tax purposes only, the transaction is a "sale and leaseback," with PacifiCorp's rent payments to Amoco exactly offset by interest and principal payments to PacifiCorp. For all other purposes, including ratemaking, PacifiCorp is the sole owner of the Malin Line. Mr. Kermode has failed to identify anything that Amoco received for its $44 million payment, other than tax benefits.

162. Facing a clearly articulated IRS position, the Company must treat the Malin Line transaction in the manner it proposes in this proceeding. The Company urges the Commission to accept the adjustment, in accord with IRS requirements.

3. PacifiCorp's Current Amortization of Tax Audit Settlement Amounts Is Appropriate and Should Continue.

163. The Company is subject to an intensive audit of every tax year and tax payment adjustments are a virtual certainty. Exh. No. 181-T at 24. Equity dictates that ratepayers should

compensate the full cost of tax settlement payments, but the Company is only requesting that ratepayers bear one-half of these costs. Specifically, the Company is requesting that Washington's share of one half of $64,217,849 in tax settlement payments be placed in rate base and amortized over five years. Exh. No. 191-T at 20-21. This approach continues the treatment set forth in the settlement agreement in the Company's last rate case, Docket No. UE-032065, and the Company urges the Commission to adopt this same approach in the present case. Exh. No. 181-T at 17.

164. Mr. Kermode objects to the Company's proposal, based on the mistaken belief that recovery of actual tax settlement payments would constitute retroactive ratemaking. Exh. No. 601-T at 13. To the contrary, the payments are not owed until the deficiency is assessed, which happens in the test period, not in the audited tax years. As Mr. Martin makes clear, tax settlement payments are not known and measurable until they are ultimately assessed by the taxing authority. Exh. No. 181-T at 23.

165. Mr. Martin proposes that an alternative solution in the future would be ratepayer funding of a tax contingency account for future tax adjustments. Exh. No. 181-T at 29. This would be equivalent to the payment of known and measurable insurance premiums in a test period to cover unknown expenses in future years. Establishment of such a contingency account would be an acceptable solution. However, prohibiting the Company from either ensuring against future tax adjustments or otherwise recovering these costs is not a solution at all. Mr. Kermode's approach of denying all recovery inequitably shifts legitimate expenses from ratepayers to shareholders.

4. Proposed Reductions to PacifiCorp's State Income Tax Have Been Shown to Be Mistaken and Should Be Rejected.

166. In a misunderstanding of the Company's accounting practices, Mr. Effron has proposed two adjustments to PacifiCorp's state income taxes. Exh. No. 291-T at 20-21. These adjustments should be rejected based on the clear explanation provided by Mr. Wrigley in rebuttal. Exh. No. 195-T at 20-21.

167. Mr. Effron's first proposal calls for the company to eliminate the Washington-jurisdictional $611,699 operating deduction for "Interests and Dividends (AFUDC-Equity)" shown in Mr. Wrigley's Exhibit 193 at 2.22, line 1375. Exh. No. 291-T at 20. Mr. Effron opined that this item "has the effect of increasing taxable income by reducing available income tax deductions." Exh. No. 291-T at 20. As Mr. Wrigley explained, the item has no effect on state and federal taxable income because it is completely offset by a Schedule M deduction of $679,000. Exh. No. 195-T at 20 (citing Exh. No. 193, tab B6 at 3, 7th line from bottom, Washington column).

168. Mr. Effron's second proposal is to apply a state income tax rate of 4.54 percent to the Company's taxable state income. Exh. No. 291-T at 20. Mr. Wrigley explains that state income taxes are a total Company cost; all state taxes are summed, then the total Company number is allocated to the states based on each state's respective "Income before Taxes." Exh. No. 195-T at 21.

169. Both of Mr. Effron's proposed adjustments arise from misunderstandings of PacifiCorp's filing and should be rejected.

H. PacifiCorp's Supplemental Testimony Has Properly Stated the Impacts on Revenue Requirement of Any Acquisition of PacifiCorp by MidAmerican Energy Holdings Company.

170. In the subsections below, PacifiCorp describes the post-MEHC-acquisition revenue requirement reductions that would result from the Commission-approved stipulation among Washington parties in Docket UE-051090. PacifiCorp also addresses the various proposals by Staff and Intervenors to adopt post-acquisition "double-leverage" adjustments to PacifiCorp's cost of capital.

1. Implementation of the Washington Stipulation in the MEHC Acquisition Docket Would Reduce PacifiCorp's Washington-Allocated Adjusted Test-Year Revenue Requirement by Approximately $940,000, with the Exact Impact Dependent on the Commission's Resolution of other Rate Case Issues.

171. Three MEHC commitments in the Washington Stipulation in Docket No. 051090 have the potential to lower the revenue requirement in the present rate case by $941,590. Exh. No. 226 at 1. As Mr. Wrigley explained, this amount is dependent on Commission acceptance of the Washington Stipulation, Commission acceptance of the Revised Protocol allocation methodology, and on the Commission-approved level of A&G costs. Exh. No. 225-T at 1-3; Exh. No. 228 (Washington Stipulation).

172. The first MEHC commitment that would affect the revenue requirement relates to limitations on non-fuel costs associated with the West Valley lease and is listed as Adjustment 4.21. Under Washington-Specific Commitment 3a in the Washington Stipulation, MEHC and PacifiCorp agree to reduce these non-fuel costs on a system basis by $5,000,000 annually following the close of the transaction through the lease termination date of May 31, 2008. Using Revised Protocol allocation, this equates to a Washington jurisdictional revenue requirement reduction of $413,163. Exh. No. 226 at 1. As Mr. Wrigley explained, this adjustment is inapplicable if an allocation methodology is adopted in which Washington ratepayers do not pay for the West Valley plant. Exh. No. 225-T at 2; Tr. 1452:6-21.

173. The second MEHC commitment reducing the revenue requirement is Washington-Specific Commitment 4a, regarding affiliate management fees. Implementation of this commitment will reduce the revenue requirement by $28,733. Exh. No. 225-T at 2; Exh. No. 226 at 1. This reduction is shown as Adjustment 4.22.

174. Finally, MEHC Washington-Specific Commitment 7a adjusts Company-wide administrative and general costs downward by $6 million annually on certain conditions, equating to a Washington revenue requirement reduction of $499,694. Principally, this adjustment is required only if total Company-allowed A&G expenses are at least $228.8 million. The Company has proposed a figure in excess of this amount; therefore, if the proposed amount

is approved, the entire adjustment would apply. This revenue requirement reduction is listed as Adjustment Staff 4.23. Exh. No. 225-T at 3; Exh. No. 226 at 1.

2. The Proposed MEHC-Related "Double-Leverage" Adjustments to PacifiCorp's Stand-Alone Cost of Common Equity Are Financially Unsound and Are Unsupported by the Facts in this Proceeding.

175. Staff witness Kenneth L. Elgin and Mr. Hill each recommends that a mix of debt and equity capital of MEHC be substituted for the equity capital of PacifiCorp, in what is referred to as a "double-leverage" adjustment. However, the proposed adjustments of Mr. Elgin and of Mr. Hill are quite different. Mr. Elgin bases his adjustment on the consolidated capital of MEHC, including debt held by operating subsidiaries of MEHC. Exh. No. 798; Tr. 1540:3-10. Mr. Hill bases his adjustment on the capital structure of the MEHC parent company. Exh. No. 114-T at 16-17.

176. Both of these double leverage adjustments defy generally accepted principles of business finance. In addition, both of the adjustments are based on incorrect factual assumptions. As Dr. Roger A. Morin concluded in a publication relied on by Mr. Hill for his double leveraging formula:

> "In summary, the double leverage adjustment has serious conceptual and practical limitations and violates basic notions of finance, economics and fairness. The assumptions which underlie its use are questionable, if not unrealistic. The approach should not be used in regulatory proceedings."

Tr. 1723:2-25.

177. PacifiCorp's witness Dr. James H. Vander Weide has explained that the proposed double-leverage adjustments violate three fundamental principles of financial economics. First, the proposals violate the "law of one price," which provides that the required return on any investment is equal to the expected or required rate of return on investments of the same risk. The means by which a purchaser of a company's stock chooses to finance the stock does not change the underlying risk or the expected or required rate of return. In other words, if an investor purchases General Electric Company common stock, the required return on that stock is

independent of whether the investor purchases the stock with available cash or with borrowed funds. Exh. No. 811-T at 7-12; Tr. 1642:25 – 643:25. Dr. Vander Weide has provided the standard formula that describes this principle of leverage, and has demonstrated mathematically why the return requirement of purchased stock does not change based on how its purchase is financed. Exh. No. 811-T at 10-12.

178. Mr. Elgin attempted to address questions from the bench concerning this fundamental principle of finance. He could not provide a cogent explanation as to why, if double-leveraging were a valid approach, and the law of one price were invalid, the Commission should not be required to analyze who owned the stock of other Washington utilities and inquire into how each investor financed its stock purchase. Tr. 1583:17 – 1588:3.

179. Second, the double-leverage approach violates the principle that the required rate of return on an investment should depend only on the specific risks of that business. The double leverage calculation incorrectly ascribes to a utility subsidiary the business and financial risks of the parent's other business operations. This double-leverage assumption is particularly inappropriate given the careful ring-fencing that will be in place to separate the risks of PacifiCorp from the risks of MEHC. Exh. No. 181-T at 12-15; Tr. 1644:1 – 1645:16.

180. Third, the double-leverage approach violates the principle that the required rate of return on an investment depends only on the business and financial risk of that investment, not on the cost of the funds used to make the investment. Were this principle not correct, any utility could reduce its cost of capital, or in effect obtain "free" capital cost reductions, simply by setting up a leveraged parent to hold its stock. Exh. No. 181-T at 15; Tr. 1645:17 – 1646:14. In response to questions both by PacifiCorp's attorney and from the bench, Mr. Elgin struggled to explain why, if double-leverage provided a means to lower the required rate of return for a utility, both Avista and PSE should not be required to set up debt-leveraged holding companies, in order to lower their respective costs of service while still paying their investors a fair return. Tr. 1500:16 – 1508:8; Tr. 1579:3 – 1583:16.

181. The proposed double-leverage adjustments also rest on factual quicksand. For example:

(a) Mr. Elgin asserted that without his adjustment, MEHC as owner of PacifiCorp would realize a substantially higher ROE than PacifiCorp is allowed. He stated his analysis indicated a 14 percent MEHC equity return. Exh. No. 791-T at 18; Exh. No. 797; Tr. 1509:17 – 1510:9.

Contrary to such conclusion, however, and as Mr. Elgin's Exhibit 797 actually showed, the acquisition of PacifiCorp lowered the <u>average</u> return of the entire MEHC enterprise from 17 percent to 13.93 percent. Mr. Elgin acknowledged that if the <u>average</u> return of MEHC were lowered by the PacifiCorp acquisition to approximately 14 percent, then the actual return on the PacifiCorp investment itself had to be <u>less</u> than 14 percent. Tr. 1511:2-6. The actual impacts of leverage on the return of MEHC then were quantified. As shown in Exhibit 810(a), Mr. Elgin's example assumed that PacifiCorp itself earned an 11 percent ROE. At that level of return, MEHC's leveraged return would be either 11.10 percent, if MEHC could obtain debt at an annual interest rate of only 5.25 percent as assumed by Mr. Elgin, or would be 10.88 percent, if MEHC could obtain debt at an annual interest rate of 5.95 percent, as assumed by Mr. Hill. If PacifiCorp earned Staff's recommended 8.95 percent equity return on Staff's PacifiCorp stand-alone capital structure, MEHC's equity return would be only 7.07 percent. Exh. No. 810(a); Tr. 1513:5 – 1523:13.

(b) Both Mr. Elgin and Mr. Hill treated capital of MEHC as if it were the source of PacifiCorp's equity. Exh. No. 116; Exh. No. 798. As the hypothetical examples in Exhibit 810(b) demonstrated for "AcquireCo," the capital of MEHC actually has financed stock purchases, and MEHC has provided none of PacifiCorp's capital. Tr. 1528:13-18.[24]

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[24] On cross-examination of Dr. Vander Weide, the Staff attorney asked about decisions in the only state in which Staff could find a double-leverage treatment for an electric utility. Dr. Vander Weide pointed out that even in this one state, the regulatory commission declared double leverage not applicable unless the parent actually had invested equity capital in the utility.

(c) Mr. Elgin argued that MEHC was highly leveraged, depicting the company as having 79 percent debt and 21 percent equity. Exh. No. 796. However, despite the repeated references to such consolidated capital ratios, MEHC's stand alone capital structure actually is funded with over 57 percent equity or equity equivalents. Mr. Elgin produced his lower number by (i) overlooking Berkshire Hathaway's subordinated debt in MEHC (carrying an 11 percent interest rate), which is treated by rating agencies as equivalent to equity capital, and (ii) by including over $6 billion in debt issued by MEHC's subsidiaries, none of which is available to MEHC to buy stock of other utilities. Tr. 1547:17 – 1549:21.

(d) Mr. Elgin used the phrase "lacks merit" to describe the argument of Dr. Vander Weide that a double-leverage adjustment is unnecessary due to ring-fencing provisions applicable to PacifiCorp after the MEHC merger. Exh. No. 791-T at 38. This conclusion is contradicted by Mr. Elgin's own testimony in the MEHC merger proceeding, in which he explains why ring-fencing can indeed serve as a substitute for a double-leverage adjustment. Tr. 1551:8 – 1553:16. Mr. Elgin also describes PacifiCorp's proposed ring-fencing as "state of the art." Tr. 1576:10-13.

(e) Both Mr. Elgin and Mr. Hill purport to offer calculations to counter Dr. Vander Weide's double leverage formula that demonstrate that double-leveraging by a utility's parent does not change the equity cost of a utility subsidiary. Exh. No. 811-T at 10-12. Mr. Elgin claims to get a different result based on "a study of Mr. Rothschild that supported his recommended return on equity for PacifiCorp." Exh. No. 791-T at 28. A review of the citation given, however, reveals that Mr. Rothschild did not perform any study, but simply made a subjective 0.20 percent adder to his recommended ROE to partially account for his abnormally low proposed equity ratio for PacifiCorp.

Thus, even the decisions in that one state do not support a double-leverage adjustment in this proceeding, because MEHC has not injected any equity into PacifiCorp. Tr. 1624:18 – 1625:4; Tr. 1636:9 – 1638:2.

Mr. Rothschild provided no empirical basis for the adjustment to common equity costs relied on by Mr. Elgin.

Mr. Hill offered two alternative calculations of parent equity cost increases as a result of double-leverage risk. Neither could withstand scrutiny. He described a capital-asset-pricing–model ("CAPM")-based adjustment, relying on "beta" risk estimates, as his "primary methodology." Exh. No. 114-T at 10-13; Tr. 1695:13-19. He failed, however, to justify how he could disprove the "single price" principle of finance using a beta risk measure concerning which he made the following observation in his direct testimony: "Also, there are problems with the key CAPM risk measure [beta] that indicate that the CAPM analysis is not a reliable primary indicator of equity capital costs." Exh. No. 95 at 2; Tr. 1620:10-17.

Mr. Hill's other calculation was, by his own admission, derived from a misstated formula. As Dr. Vander Weide explained, if the correct formula were used, Mr. Hill would have found that when the subsidiary's cost of equity was 9.125 percent, as Mr. Hill recommends in this case, the parent's required leveraged cost of equity would be 14.02 percent. Tr. 1619:5 – 1620:9; Tr. 1694:8-18.

182. Finally, Mr. Williams has explained the adverse impacts of the proposed double-leverage adjustments on PacifiCorp's post-MEHC acquisition ring-fenced credit rating metrics. PacifiCorp's credit ratings would be in the "BBB" range, and in some cases would be weak even for preserving a "BBB" rating. In addition, if the credit agencies actually applied a debt-ratio equivalent to that produced by the proposed double-leveraged ratemaking, the credit ratios would be even worse. And even these weakened ratios assume that PacifiCorp otherwise is allowed to recover all of its costs and thus earn the inadequate returns produced by application of double leveraging.[25] Tr. 1478:14 – 1480:24.

[25] Mr. Hill offered no alternative credit ratios, but challenged on oral testimony some of Mr. Williams' calculation assumptions. Tr. 1698:20 – 1702:10. However, on cross-examination of his two major challenges (and the only ones that could be addressed immediately on cross-examination), Mr. Hill was shown to be mistaken. He had misread a credit report as to the

183. In short, PacifiCorp's risks and equity costs do not change as a result of how any stock purchaser elects to finance its purchase of the Company's stock, and double-leveraging cannot rationally be applied in this proceeding.

I. The Commission Should Approve PacifiCorp's Proposal to Increase Funding of PacifiCorp's Low-Income Energy Assistance to 0.34 Percent of Gross Operating Revenues.

184. PacifiCorp witness Andrew N. MacRitchie has proposed to increase the Company's low-income energy assistance funding by 30 percent. Exh. No. 5-T at 19. This will raise the Company's current collection rate from 0.26 percent of gross operating revenues to 0.34 percent and allow the Company to serve approximately 900 additional low-income customers. Exh. No. 5 at 19.

185. On cross-examination, Mr. MacRitchie explained why a 0.34 percent of gross operating revenues level is appropriate, even though it is lower than PSE's 0.41 percent funding level and Avista's 0.64 percent level. PacifiCorp has lower residential rates than PSE and Avista by a wide margin, so PacifiCorp's low-income customers face less of a utility bill burden than their counterparts in those other service areas. Tr. 289:8 – 290:5.

186. PacifiCorp has a strong working relationship with the Energy Project and has committed to pursue two of its proposals, in addition to supporting the funding increase just noted. The Company has agreed to work with Staff to track low-income issues in more depth and to analyze programs to identify and manage arrearages for households that are unlikely to be able to pay their bills. The Company looks forward to working cooperatively with the Energy Project in the future, and appreciates the Energy Project's recognition of PacifiCorp's existing programs. Exh. No. 651-T at 8.

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amount of PacifiCorp's imputed debt. Tr. 1716:25 – 1718:13. He also did not understand that by applying PacifiCorp's allocation approach to the Company-wide calculation of the ratios, PacifiCorp actually assumed that the recommended returns would apply to 100 percent of rate base and thus made the metrics as favorable as possible. Tr. 1718:14 – 1719:7.

J. The Commission Should Approve the Joint Rate Decoupling Proposal of the Natural Resources Defense Counsel and PacifiCorp for a Three-Year Test Period.

187. PacifiCorp and the NRDC filed joint testimony in support of a true-up mechanism to decouple revenues from energy sales. Exh. No. 681-T. Together, PacifiCorp and the NRDC encourage the Commission to allow the Company to adopt this mechanism.

188. The testimony of Ralph C. Cavanagh substantiates the need for decoupling; without decoupling, many energy efficiency and demand-side management programs that are cost-effective from the customer's vantage will result in lost profits for PacifiCorp. Exh. No. 671-T at 2. Under normal conditions in which wholesale pricing roughly equates to the variable cost of the marginal energy generator, not selling a kilowatt-hour to a customer means selling that power for less in the wholesale market. Although wholesale market pricing recently has exceeded PacifiCorp's retail rates, this aberration is unlikely to continue, and the Company has agreed to an independent assessment of the impact of its wholesale market activities in its joint statement with the NRDC. Exh. No. 681-T at 1.

189. The Company agrees with several of the recommendations of Staff witness Joelle Steward regarding decoupling. The Company agrees that a three-year trial period and an independent assessment of the program are appropriate. Exh. No. 701-T at 12. The Company also is prepared to work with all parties to establish details of the mechanism. As well, the Company expressed a willingness to implement decoupling through a tariff filing as Ms. Steward suggests, though the Company still considers a compliance filing to be sufficient. Exh. No. 701-T at 11-12.

190. Finally, the Company notes that while decoupling encourages increased conservation investment, by removing a penalty for such investment, it does not measurably reduce overall revenue risk, and should not be used as an excuse to reduce ROE. The maximum decoupling rate adjustment would be a modest 2 percent. Tr. 1103:16-20. In return, the Company would surrender all opportunities to gain from sales increases. Tr. 1113:15-19. The key revenue risk,

the weather risk, would be retained by the Company, unaffected by any decoupling adjustment. Tr. 1113:8-14.

K. The Commission Should Adopt PacifiCorp's Proposed Rate Spread and Rate Design.

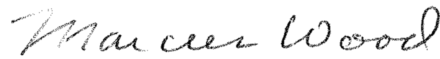
191. The Company has accepted the rate spread and rate design proposals in Exhibit 711-T, the joint testimony of Ms. Steward, Kathryn Iverson, and Jim Lazar. Exh. No. 257-T at 3. The joint testimony revised the Company's original rate spread and rate design in only one respect—to provide that Schedule 36 receive the overall average percentage rate increase rather than 75 percent of the average. The rate spread and rate design found in Company witness William R. Griffith's Exhibit 258 incorporates this change. The Company encourages the Commission to adopt this rate spread and rate design, which all of the parties have accepted.

IV. CONCLUSION

192. For the reasons stated in PacifiCorp's testimony, at the hearings and in the foregoing Opening Brief, the Company requests that the Commission grant PacifiCorp's rate increase as requested.

DATED: February 27, 2006.

STOEL RIVES LLP



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CERTIFICATE OF SERVICE

I hereby certify that I served a copy of the foregoing document upon the parties of record in this proceeding by first-class mail and electronic mail, addressed to said parties/attorneys' addresses as shown below:

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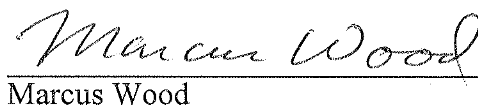
DATED: February 27, 2006.



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